

# Partnership Disputes

Following interesting feedback from the article entitled Partnership: The Third Way, which appeared in an earlier issue of The Dentist, it may be time to dust down your old Partnership or Expense Sharing Agreement and see whether it covers all relevant issues.

As a solicitor specialising in dental matters, I am from time to time supplied with an Expense Sharing Agreement, after a dispute has arisen. I am regularly surprised when, on closer inspection, I find out that it is not an Expense Sharing Agreement at all, but a Partnership Agreement, under the terms of which profits are shared, rather than expenses.

It is intended that this article examine more closely the commercial difficulties arising within a conventional Expense Sharing arrangement.

First and foremost, let us debunk the great myth. Contrary to popular belief, expense sharing, even though it is expenses that are shared and not gross fees, is, in pure legal terms, a form of Partnership.

This, in turn, presents two problems. Firstly, when solicitors not experienced in the concept of expense sharing are asked to produce an Expense Sharing Agreement for their dental clients, they often produce a conventional Partnership Agreement, that is to say one in which gross fees are pooled and profits are shared. This fairly fundamental distinction is often not spotted amongst the legal mumbo jumbo and the results, if the Agreement ever requires to be "dusted down" and litigated over, can be fairly serious.

Secondly, even if it is clear that the document is indeed an Expense Sharing Agreement, the parties themselves, let alone their lawyers, need to be clear in their own minds that the legal nature of the relationship is in fact a Partnership.

But is it enough to say, "we are expense sharers" and leave it at that? As has been pointed out by one of the correspondents following on from the previous article appearing in The Dentist, it is not enough.

What happens when one or other of the expense sharers wish to leave the Practice? For the purposes of this article, I will assume that Andrew and Bob are the expense sharers, sharing expenses as to one half each. Each of Andrew and Bob retain 100% of their gross fees and there are no complicating factors such as associates or hygienists. Andrew grosses £500,000.00 per annum and Bob grosses £250,000.00 per annum. The expenses of the partnership of the Practice of £200,000.00 per annum are met as to £100,000.00 by each of Andrew and Bob.

Andrew and Bob do not have a written Expense Sharing Agreement and Andrew wishes to sell his share of the Practice to Charlie.

In most cases, Andrew and Bob will have rubbed along fairly well for twenty or thirty years and Bob will simply sign such papers as may be necessary for Andrew to leave and be replaced by Charlie. Bob will do his best to get along with Charlie for the remainder of Bob's dental career.

But there will be occasions where Bob does not want to work with Charlie, or where Bob thinks that if it weren't for him, Andrew would not be where he finds himself today. In other words, to be blunt, Bob would like a part of the money that is being paid by Charlie for Andrew's Practice.

So what can Andrew do to encourage Bob to co-operate on the transfer? The simple fact is that unless a clearly thought through Expense Sharing Agreement is in place, there is not a lot that Andrew can do to force Bob's hand. In the absence of specific agreed terms, partnership law will apply.

Partnership law is derived from the Partnership Act 1890, a time when there were probably very few dentists, let alone Expense Sharing Agreements! The law provides for the introduction of a new Principal, but only with the unanimous agreement of the other Principals. Thus, Bob would be required to agree to the introduction of Charlie.

The law does permit Andrew to resign from the partnership, following which there will be dissolution and a sale of the assets of the partnership. The staff, Associates and hygienists may be scattered to the four winds. Admittedly, this is better than staying in a partnership, which you want to leave, but only just!

There are numerous reasons why it is crucial not just to have an Expense Sharing Agreement, but also one, which caters for key eventualities.

For example, I was recently instructed to act on the sale of a three Principal Expense Sharing Practice of significant value and long standing, located in the centre of a large city.

The Practice had originally been a profit sharing partnership and a long and tortuous Partnership Agreement had been entered into. The Agreement made the usual arrangements for Partnership, which was for the profits to be shared as to one third each. On the (eventual) sale of the Practice, the assets were to be distributed as to one third each.

At a point in the last 10 years, it was recognised that David was specialising in implantology and grossing extremely high fees, that Eric was rubbing along, in the middle of the road, as it were, but that Freddie wished to spend more time improving his golf handicap than doing dentistry. This had the effect of their gross fees becoming approximately £500,000.00 per year £400,000.00 per year and £300,000.00 per year respectively. The total gross of the Practice was £1,200,000.00.

The great and the good valued the goodwill (including third party goodwill residing at the Practice) at £900,000.00. The question to be debated was whether the partners should split the purchase price of the goodwill in accordance with their Partnership Agreement (£300,000.00 each) or whether it should be valued in accordance with the principles that would have applied, had they entered into a properly drawn Expense Sharing Agreement?

The figures in question would have split the value as to £375,000.00, £300,000.00 and £225,000.00 respectively. The inescapable fact of human nature, when it comes to tens of thousands of pounds, is greed, disharmony and bad blood. That said, had the solicitors to the Partnership been asked to prepare a straightforward Expense Sharing Agreement at the time when the change from profit sharing to expense sharing was effected, about 10 years ago, there would be no disharmony at the point of sale.

So what are the crucial ingredients in an Expense Sharing Agreement? Well, for the purposes of this article, the most crucial provision is the ability of each Expense Sharer to transfer his business to a third party and the requirement of the remaining Expense Sharer(s) having the ability to object to the introduction of the third party, except on extremely narrow grounds. This provision needs, for various reasons, to be dealt with fairly sensitively, but it is the absolute basic and most fundamental provision to be inserted in any Expense Sharing Agreement.

The other obvious point, flowing from the David, Eric and Freddie crisis, is to make sure that if you change the nature of your relationship, you must change the Agreement governing the relationship.

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