I assembled the following outline to assist you if you are considering going out on your own, whether solo or with other lawyers. The outline touches upon a myriad of issues, many of which are of a practical nature. Most issues are not unlike issues that any person might encounter when forming a new business – who much will it cost, where shall I locate, what support will I need, and how do I manage my risks?

This outline is unlike the content of other continuing legal education seminar papers. It has relatively little legal content. Which is not to say it lacks value. Should you venture out on your own, your success will not likely depend on how much law you know. What law you need you can research or ask other lawyers, and hopefully be paid for doing so. Your success will likely come from your business decisions. I hope this outline will assist you in those decisions.

I Funding the new practice

No practice can exist without capital. Fortunately, the practice of law is not capital intensive. With a bit of office space, a PC and some chutzpah, a lawyer can make a go of it. Only the office space and the PC will cost!

Actually, it is not quite that simple. While a practice is not capital intensive, it will require some capital. If you lack the necessary capital, you won’t practice long. It is imperative to develop a realistic budget and secure the necessary capital.

A Preparing the budget

No two lawyers or practices are alike, and it is not surprising that budgets may vary considerably. Your budget will be affected by your type of practice, your location, the number of employees and your standard of living. A plaintiff personal injury practice, which may go months without significant revenues and incur substantial litigation costs, will require much higher capital reserves than a practice with regular monthly billings and few client expenses. Starting a brand new practice will require more than a relocation of an existing practice.

Perhaps the most important budgeting factor is your standard of living. Most new practices will face a period of little or no revenue – from the time they start until services can be invoiced and invoices collected. This is sometimes called “filling the pipeline”. A lawyer saddled with high fixed monthly payments obviously has less financial flexibility than a lawyer who can live on
next to nothing. Differences in standards of living may cause other
differences in costs to pale in comparison. In planning your budget, you must
be realistic about your standard of living costs and plan accordingly.

The ABA Law Practice Management Section has developed a number of
books and other materials about developing your budget. I especially
recommend Jay Foonberg’s *How to Start and Build a Law Practice*, now in its
fifth edition. It has an entire chapter on the budgeting process, including a
sample budget. Don’t go solo without buying a copy. It’s that good.

**B Sources of capital**

Your budget will tell you how much you need. Where do you find it?
Obviously, some lawyers have the necessary capital in the bank. Others
might be a little short. If you are a bit short, you will need to convert non-cash
assets to cash or borrow or both. For example, you could sell your expensive
sports car, downsize to a less expensive model (perhaps purchased with zero
down and zero percent financing), and invest the sales proceeds in the
practice. If you own your own home, you may be able to borrow against your
equity with a second mortgage. Jay Foonberg has other ideas in his book.

**II Structuring**

Oklahoma lawyers today have a wide range of entities through which they may
practice. In addition to the historical choices of sole proprietorships and
partnerships, you may practice through corporations (either C or S corporations),
limited liability companies (PLLC’s) and limited liability partnerships (LLP’s). Each
entity has unique characteristics, which pose numerous advantages and
disadvantages. I discuss these advantages and disadvantages below.

By choosing an entity (other than a sole proprietorship), your entity will be
regulated by the entity’s constituent act. Corporations fall under the General
Corporation Act; PLLC’s under the Limited Liability Company Act, and
partnerships, including LLP’s, under the Revised Uniform Partnership Act.¹ In
addition, corporations and PLLC’s are subject to the Professional Entity Act.² All
entities and sole proprietorships are further regulated by our Rules of Professional
Conduct, which may affect the structure of your practice. For example, the Rules
regulate practice with non-licensed individuals, the responsibilities of a partner or
supervisory lawyer, the sale of a practice, advertising and the use of non-compete
agreements.³

**A Sole proprietorship** – the most common form of business, the advantages
of a sole proprietorship are the ease of formation and operation and the
taxation of income at the “owner” level. Here the advantages cease. The

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¹ The General Corporation Act is at Okla.Stat. tit. 18, §1001 et seq.; the Limited Liability
Company Act is at Okla.Stat. tit. 18, §2000 et seq.; and the Revised Uniform Partnership Act is at Okla.Stat. tit. 54, §1-100 et seq. LLP’s are regulated under the
Revised Uniform Partnership Act. See Article 10, Okla.Stat. tit. 54, §1-1001 et seq.

² The Professional Entity Act is at Okla.Stat. tit. 18, §801 et seq.

³ See gen., Okla.Stat., tit. 5, Ch. 1, App. 3-A. While certain rules apply only to sole
proprietorships or partnerships, most of the rules apply equally to professional
corporations and LLC’s.
most significant disadvantage is the absence of limited liability. First, the liability shield will protect against contractual liabilities. Second, while a liability shield will not protect against an owner’s own acts or omissions, the shield will guard against liabilities created by other agents (assuming the owner was not negligent in hiring or supervising the agent) or independent contractors and against liabilities imposed on the entity by statute. These possibilities, in my mind, far outweigh the relatively nominal cost of forming and maintaining a limited liability entity. Because the sole proprietor has self-employment income, he or she is subject to SE tax on all earnings.

B **Partnerships** - the advantages and disadvantages of the partnership are similar to those of the sole proprietorship, with one important exception. The partnership suffers from the additional disadvantage of making the individual partners responsible for the acts and omissions of every other partner, regardless of whether the partner was responsible for supervising or controlling the negligent partner. Under Oklahoma’s RUPA, a partner is required to contribute amounts sufficient to satisfy partnership obligations and the partnership is required to indemnify a partner for personal liabilities incurred in the partnership’s business. In the typical partnership, when a partner is found negligent, the partnership would indemnify him or her against losses and, if the partnership lacked sufficient assets to pay the claim, all partners would contribute amounts sufficient to satisfy the claim.

C **PLLC’s and LLP’s** – Although PLLC’s and LLP’s are regulated under different constituent acts, they both taxed as partnerships and operate in a similar fashion. PLLC’s resemble a hybrid cross between a corporation and a partnership. Like a corporation, they afford limited liability to all owners (called members instead of shareholders). They are like partnerships for income tax purposes. All income, gain, loss, deduction, and credit “pass through” the entity to its members. There is no entity-level taxation as in corporations. LLP’s are general partnerships with limited liability, and thus resemble PLLC’s by combining limited liability with partnership taxation.

*The PLLC and LLP advantages are as follows:*

“Pass through” Partnership Taxation — in General. PLLC’s and LLP’s are taxed as partnerships, which means that all income and loss flows through the entity to be taxed to the owners. Unlike a corporation, there is no entity-level taxation. As a general rule, this means that the PLLC or LLP and its owners will tend to pay less income tax than a corporation and its owners, since the PLLC’s and LLP’s income is not taxed once at the entity level and again at the owner level.

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4 See Ditty v. Checkrite, Ltd., Inc., 973 F Supp 1320, 1336 (D Utah 1997), in which the court refused to pierce the veil of a law firm LLC to impose liability on an attorney in the firm even though the attorney was the sole shareholder and director as well as the president of the firm and took an active role in it.

5 Okla.Stat. tit. 54, §1-401(c). The indemnification obligation requires the partnership to indemnify a partner for losses incurred in the ordinary course of the partnership’s business, even if the losses arise from the partner’s negligence.
— Special Allocations. Frequently in the PLLC and LLP, the owners will specially allocate income and costs. For example, two lawyers practicing together do not always split everything equally. Fees paid by a particular client or on a particular matter may be allocated to one lawyer, but not the other. A portion of the fee may be paid to the lawyer originating the client or matter. Costs may be charged to the lawyer who incurred the cost or allocated to the lawyers based on their ratable share of income. The ability to make these special allocations of income and cost is a significant advantage in PLLC’s and LLP’s.

Corporations cannot make special allocations. In the C corp, income and costs are absorbed at the entity level. The shareholders can create compensation formulas that approximate the results of special allocations in PLLC’s or LLP’s, but these formulas (embedded in employment or shareholder agreements) can become exceptional complex and difficult to administer. S corps can do this too, but if they split income between salary and dividends, the latter must be distributed solely on the basis of stock ownership.

— Formation. Formation of the PLLC or LLP will not create a taxable event. If an owner contributes appreciated property, the appreciation is allocated to his or her account and will be recognized only when the property is sold. In either a C or S corp, formation will be tax-free if the shareholders retain 80% or more of the stock after formation. The 80% control test can pose problems when a second shareholder or group of shareholders wish to join the corporation, but will own less than 80% of the stock.

— Basis Step Up for Borrowings. PLLC and LLP owners and S corp shareholders may deduct company losses on their individual tax returns to the extent of basis. PLLC and LLP owners may increase the basis of their ownership interest when the PLLC or LLP borrows money. S corp shareholders may not increase the basis of their stock when the corporation borrows money, even if the shareholders have guaranteed the borrowings. An S corp shareholder may only increase the basis of stock by the direct loans made by that shareholder to the corporation. The basis increase may be significant. A higher basis allows greater use of deductions, which reduces taxable income (an advantage). In addition, the entity can distribute cash without taxation if the distributions do not exceed an owner’s basis.

— Adding New Owners. The PLLC and LLP has several advantages when adding new owners. First, the new owner is not required to buy a capital interest to get a certain income interest. In an S corp, a new shareholder joining an existing shareholder must buy one-half of the stock to get one-half of the income, since distributable income is based on stock ownership. If the stock purchase price does not equal one-half of the net fair market value of the underlying assets, the new owner will incur income to the extent of the deficiency. In the PLLC or LLP, a similarly situated, new owner can receive a 50% income interest, need not pay anything, and will not be taxed on receipt of the interest.

Second, if a new owner buys an interest (including a partial interest) from an existing owner, the PLLC or LLP may elect to increase the basis of its assets. As noted above, a basis increase allows greater use of deductions (such as
from equipment depreciation), which decreases taxable income, and can shelter cash distributions if the distributions do not exceed the tax basis.

— **Departing Owners.** A PLLC or LLP can redeem a retiring or withdrawing owner’s interest and deduct the amount of the liquidation payment to the withdrawing owner in exchange for that owner’s interest in the PLLC’s or LLP’s goodwill and unrealized receivables. To the extent that a withdrawing owner realizes gain in the redemption, the PLLC or LLP can increase its basis in its property, further increasing deductions and reducing taxable income. These advantages, which may be substantial, are not available to C or S corps.

— **Ownership of Appreciable Property.** It is not uncommon for a professional entity to own real estate, which is appreciated property. In this situation, a PLLC or LLP offers an advantage of being able to distribute the appreciated property to its owners without recognition of gain. Neither a C nor an S corp can do this. When a corporation makes an in-kind distribution, gain is recognized at the corporate level.

**Limited Liability.** The PLLC and LLP owners are protected from personal liability for the acts or omissions of the PLLC and its agents. All that the owners risk is their invested capital. This is the same liability shield that protects corporate shareholders.

**Simplicity of Operation.** Neither the LLC Act nor RUPA requires annual meetings of the owners. Neither are the owners required to record minutes (although minute-taking is a good practice). The only records that the PLLC must keep are copies of its articles of organization, its operating agreement, its tax returns and any financial statements, a document reflecting the owners’ voting rights, and the names and addresses of its owners and managers. The only records that the LLP must keep are copies of its statement of qualification and books and records sufficient to permit a partner to determine his or her interest and the allocation among the owners of the LLP’s income and losses. The operating procedures and record-keeping for PLLC’s and LLP’s are much simpler than those required of corporations.

**The PLLC and LLP disadvantages are as follows:**

**Self-Employment Income.** In a PLLC or LLP, all income allocated to the owners is subject to self-employment tax. For 2002, the first $84,900 is subject to the social security portion (12.4%) and the Medicare portion (2.9%) of the FICA (self-employment) tax. PLLC and LLP owners do not have the option that S corp shareholders have of dividing the income between salary and dividends, the latter of which is not subject to SE tax.

This disadvantage may be less significant than it appears. The S corp must allot a reasonable salary to the shareholder/employee, which is subject to SE tax.

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tax. Only that portion of income that can be reasonably allocated to dividends avoids SE tax. In an effort to limit the SE tax disparity between partnerships (PLLC’s and LLP’s) and S corps, partnerships can now deduct one-half of their SE taxes and the deduction increases to 80% by the year 2006.

Medical Expense Deductions. Because PLLC and LLP owners are not "employees", they are not entitled to deduct 100% of payments made for health insurance and other medical expenses. C corp shareholder/employees (but not S corp shareholder/employees) can take such deductions. Under recent changes, however, PLLC owners are now able to deduct 30% of amounts paid for health insurance.

Potential Loss of Limited Liability. The LLP has another unique disadvantage. As a condition to obtaining limited liability, the LLP must provide $500,000 of security against claims, either through insurance, escrowed deposits, letters of credit or surety bonds. Corporations and PLLC's have no such requirement. Other questions about liability protection may arise in the LLP — such as the relationship of the protection to contribution and indemnity obligations or the priority of partnership obligations the responsibility for which differs among the partners — which are not present in corporations or PLLC's.

D PC's – A professional corporation is available in two different forms for tax purposes: C corps and S corps. The differences are substantial and I shall distinguish between the two when discussing the advantages and disadvantages.

The C Corp. The C corp is a separate legal entity both for state law and Federal tax law purposes. Incorporation will be tax-free if the control tests are met under the Internal Revenue Code. The income and gain that it subsequently generates will be taxed at the corporate level. If distributions are subsequently made to the shareholders, the shareholders will be taxed on the value of the distributions. It may merge with other corporations on a tax-free basis. When it winds up its affairs, any gain will also be taxed at the corporate level and again at the shareholder level when distributed.

C Corp Advantages - Limited Liability. The C corp limits the liability of its shareholders to the amount of capital they have at risk in the business. The shareholders are not liable for the obligations of the corporation.

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8 See Radtke v. U.S., 712 F.Supp. 143 (E.D.Wisc., 1989) in which the court denied an attorney/shareholder's attempt to claim all S corp income ($18,000) as dividends and recharacterized the income as salary.

9 I.R.C. §164(f). The Service has proposed new SE tax regulations that would allow some active LLC owners to separate compensation and profits if the LLC had passive owners. These regulations would essentially allow LLC owners to do what S corp shareholders do. The regulations are, however, not expected to include professional service providers. Proposed Treas. Reg. §1.1402(a)-2.

10 I.R.C. §351 (requiring that the shareholders forming the corporation retain at least 80% control after formation).
- **Familiarity.** Corporations have a long history and people are familiar with the operating characteristics of corporations. In addition, corporations are supported by a body of well-established law to guide their operations.

- **Medical Expense Deductions.** When a C corp provides its employees with fringe benefits, such as health insurance, it receives a deduction for the benefit, yet the value of the benefit is not taxed to the employees. This effectively allows the benefit to go untaxed. This arrangement applies regardless of whether the employee is also a shareholder in the C corp. Because partners, PLLC members and S corp shareholders are not “employees”, the same rules do not apply to LLP’s, PLLC’s and S corps. Under recent changes, however, LLP’s, PLLC’s and S corps are now able to deduct 30% of amounts paid for health insurance.

**C Corp Disadvantages - Double Taxation.** The corporation is recognized as a separate entity for Federal and state income tax purposes. This means that income and gain is taxed both at the corporate level and when distributed to the shareholders as dividends. For personal service corporations, the Federal tax rate is 34% and the rate is not graduated.\(^\text{11}\) Individuals are taxed at graduated rates up to 39.6%.\(^\text{12}\) Thus, the cumulative tax on income from C corps may be as much as 60% before imposition of state taxes.\(^\text{13}\)

While double taxation is certainly a disadvantage (and “pass through” taxation is certainly an advantage), it must be placed in the context of actual practice. Business owners everywhere tend to maximize their tax position (that is, they minimize their tax payable). In the C corp, owners do this by incurring additional corporate expense, which reduces taxable income. The most common example is the paying out as compensation to owner/employees those amounts that would otherwise be taxed as income. If the corporation pays out all such income, it achieves a partnership-type result — no income at the entity level; all income taxed to the owner.

This practice has its price. If the C corp pays out all its income, it may deplete its capital reserves for operations. It is not unusual for shareholder/employees to go several months without compensation while the PC replenishes its capital reserves. It can borrow cash to avoid this problem, but borrowings incur interest expense and smaller PC’s may incur relatively high interest expense without a substantial operating history, substantial capital or shareholder guarantees. In addition, the Internal Revenue Service can recharacterize the distributions as excessive compensation and thus tax the distributions as dividends.\(^\text{14}\)

\(^{11}\) I.R.C. §1366(a).

\(^{12}\) I.R.C. §1.

\(^{13}\) An example of the tax calculation would be: $100 times 34% leaving a balance after payment of $64, which is then taxed at 39.6%. The remaining balance is slightly less than $40. This calculation doesn’t consider personal deductions and exemptions, the effect of graduated individual rates and the burden of state taxes.

- **Self-Employment Taxes.** To avoid double taxation, the C corp must distribute all of its income as compensation to its shareholder/employees. Thus, it cannot avoid SE taxes as an S corp does by dividing compensation and dividends.

- **Franchise Taxes.** The State of Oklahoma assesses franchise taxes against corporations, which are not assessed against LLC’s or LLP’s. The rate is $1.25 for each $1,000 of capital. While the amount of the tax is likely insignificant for most professional corporations, the failure to pay the tax can result in a suspension of the corporation’s charter. During the suspension, the directors and officers will be personally liable for all corporate obligations incurred during the suspension. Reinstatement of the charter by paying the delinquent tax will not retroactively eliminate the personal liability.\(^{15}\)

- **Complexity.** Corporate governance assumes that directors will meet regularly (at least annually to elect officers), that the shareholders will meet annually (to elect directors), and that minutes will be kept reflecting the action taken at the meetings. The corporate statutes specify in detail the procedures for the call and conduct of such meetings.\(^{16}\) These requirements do not apply to LLC’s or LLP’s.

- **Hierarchical Structure.** The distinct roles of shareholders, directors and officers can also create problems for professional corporations. The directors must authorize material corporate acts, which forces a subjective determination whether an act is material. Among the officers, levels of authority vary so that the president has greater authority than a vice president.\(^{17}\) These distinctions also force determinations whether a certain person is the appropriate officer to act for the corporation. Further, the distinctions in authority create a hierarchical structure in which the various officers are not equal participants in management. The lack of equality may be acceptable in larger PC’s, in which the need for centralized management is well-recognized. But in smaller PC’s, the lack of equal participation may chafe. Unless established by contract, PLLC’s and LLP’s would not use the hierarchical structure used by corporations. The members and partners would participate equally in the management of the firm.

**The S Corp.** The S corp is identical to the C corp for state law purposes. Its distinction arises from the “pass through” tax treatment it receives under Subchapter S of the Internal Revenue Code.\(^{18}\) Under Subchapter S, taxation at the corporate level is generally omitted and the corporation’s income and loss will pass through to be taxed at the shareholder level. Thus, the S corp avoids the double taxation of the C corp.

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\(^{16}\) At least 19 sections of the Oklahoma General Corporation Act deal in some manner with the conduct of, notice for, or voting at meetings.

\(^{17}\) There can be only one president. There may be several vice presidents, although they must be ranked to establish succession.

\(^{18}\) *Id.*, §1361 *et seq.*
In exchange for its tax treatment, S corps bear a number of restrictions. The restrictions limit the number of shareholders to 75, and the authorized stock to one class (although voting rights may differ within the class), which prevents the disproportionate allocation of income and loss. Most shareholders must be U.S. citizens, resident aliens, estates, or certain trusts. While restrictions on the number and identity of shareholders will not affect most PC’s, the inability to allocate disproportionate shares of income and loss is significant for many professionals.

_S Corp Advantages - Still a Corporation._ The S corp is a state law corporation and brings with it the familiarity (and the complexities) of corporate operation.

- **Limited Liability.** Like C corps, PLLC’s and LLP’s, the S corp protects its shareholders from personal liability for the acts and omissions of the corporation and its agents.

- **Self-Employment Taxes.** A particular advantage of S corps is in the area of self-employment taxes or FICA. SE tax is paid on all wages or compensation income. For 2002, the first $84,900 in wages and self-employment income is subject to the social security portion (12.4%) and the Medicare portion (2.9%) of the FICA (self-employment) tax. The Medicare portion also applies to amounts over $84,900.

In a professional LLC or partnership, each member or partner will pay SE tax on all of his or her income. In a corporation, a shareholder/employee can divide the income between salary and dividend income. SE taxes are not payable on dividend income. In the C corp, such division would not be wise since the double taxation penalty is much greater than the savings from avoided SE taxes. But in the S corp, there is no double taxation penalty. The dividend income is taxed only at the shareholder level and escapes SE taxes.

This division should be used cautiously, especially if the shareholder is attempting to avoid SE taxes on amounts under the $84,900 cap. The Service may attempt to recharacterize the dividends as compensation, especially in a professional service business in which invested capital does not contribute materially to income. In addition, one must also consider that reducing compensation income also reduces the level of contributions that can be made to qualified retirement plans. Such contributions are deductible (thus reducing taxable income) and create further tax savings through the deferral of tax on investment income and gain.

_S Corp Disadvantages - S Corp Restrictions._ In exchange for pass through tax treatment, S corps bear a number of restrictions. The restrictions limit the S corp to a single class of authorized stock (although voting rights may differ within the class), which prevents the disproportionate allocation of income

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20 *Spicer Accounting, Inc. v. Comm’r.*, 918 F.2d 80 (9th Cir. 1990); *Radke V. Comm’r.*, 895 F.2d 1196 (7th Cir. 1990); and Rev.Rul. 74-44, 1974-1 CB 287.
and costs. For professionals, the inability to specially allocate income and costs can be a significant disadvantage.

-Lack of Partnership Taxation. The specifics of the pass-through treatment differ between S corps and partnerships (and by extension, PLLC’s and LLP’s). The tax treatment of S corps blends corporate and partnership treatments. For example, the formation and dissolution of S corps may be taxable events, which are not recognized in the formation or dissolution of partnerships. This creates the possibility that a contribution or distribution of appreciated property by or to a partner will not be taxable in a partnership, although it would be taxable in an S corp. 21

A partnership permits certain basis adjustments that are not allowed in an S corp. 22 In a partnership, its liabilities will proportionately increase each partner’s basis if no partner is personally liable for the liabilities. 23 If a partner’s interest is transferred, the new partner may increase his or her basis by the amount of the appreciated assets in the partnership. 24 The S corp offers neither of these possible advantages. In a partnership, a professional may receive a profits interest in exchange for future services without the immediate recognition of income, while the similarly situated professional in the S corp would immediately recognize income.

Unlike an S corp, the partnership need not make an affirmative election to obtain pass-through treatment. 25 In the partnership (and in a PLLC or LLP), such treatment is assured and may not be terminated by a majority in interest as in an S corp. In general, these tax differences strongly favor partnerships, PLLC’s and LLP’s.

-Franchise Taxes. S corps are subject to Oklahoma franchise taxes. While the amount is not significant, the failure to pay the tax can result in a

21 The distinction is particularly important when the entity repurchases a departing professional’s interest. In both LLC’s and S corps, professionals may provide contractual buyout rights. In an LLC, the payments made to purchase the member’s interest may be treated as liquidating payments, which may be made with pre-tax dollars. See I.R.C. §736.


The partnership tax rules also insure that built-in gain or loss attributable to contributed property will be allocated to the contributing partner. In an S corp, the gain or loss will be spread among all the shareholders. See Vitek, supra at 211-12 (using examples to show the different results).

23 I.R.C. §752(a).

24 I.R.C. §743(b).

25 S corps must file with the Service an election to be taxed under Subchapter S of the Internal Revenue Code. I.R.C. §1362(a). Without the filing, the corporation will not qualify for S corp treatment.
suspension of the corporation’s charter and personal liability for the directors and officers. See C Corp Disadvantages” above.

- **Medical Expense Deductions.** Because S corp shareholders are not “employees”, they are not entitled to deduct 100% of payments made for health insurance and other medical expenses. C corps can take such deductions. Under recent changes, however, S corps are now able to deduct 30% of amounts paid for health insurance.

**Complexity and Hierarchical Structure.** Because the S corp is identical to a C corp for state law purposes, it also has the disadvantages of operational complexity and a hierarchical management structure. The unique tax requirements for S corp status impose further complexities.

**E Office-sharing**

Office-sharing is a traditional practice arrangement in which two or more lawyers agree to share office expense, but maintain separate practices. The office-sharing arrangements may be composed of individual lawyers (sole proprietorships) or any combination of lawyers and entities. For example, office-sharing occurs when a lawyer rents space from a law firm. The shared office expense may cover rent only, rent and personnel, or rent, personnel, furniture, fixtures and equipment, and library costs. The expense payment may be a fixed split of actual expenses or a fixed payment by one lawyer to a second lawyer, in which the second lawyer is responsible for the actual expense.

Office-sharing arrangements differ from partnerships in that the lawyers maintain separate practices. Each lawyer is individually responsible for his or her clients and matters, and for billings and collections. There are typically no shared responsibilities or duties.

While office-sharing arrangements are common, they are not as simple as they might appear. To maintain distinct practices and avoid responsibility for one another’s work, the lawyers must avoid the appearance of an affiliation. For example, a receptionist would not answer the telephone using the lawyers’ names. If the lawyers do not maintain separate lines, the receptionist typical answers with “law offices”. The lawyers would not use common letterhead or share a telephone listing. They must not denominate themselves in any way that would indicate an affiliation.26

Office sharing arrangements trigger a number of ethical considerations. Client files should be segregated to ensure confidentiality. The same

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26 See e.g., Wash. Ethics Opin. 178 (1984) (office-sharing lawyers cannot refer to themselves as “Law offices of Smith, Jones and Black” and sole practitioner cannot refer to himself as “Smith and Associates”); and Dallas Bar Ethics Opin. 1983-3 (1983) (“For example: where there is no sharing of responsibility and liability, ‘Law Offices of Jones & Smith,’ or ‘Jones & Smith Attorneys and Counselors at Law,’ would be misleading. Each lawyer should use separate stationery, with his own name and not that of a firm on it. He should not join his name on cards, in law lists, or in telephone directories. The door of the firm, when otherwise appropriate, may contain the names of the persons practicing therein no more closely connected than the following example: Law Offices Charles W. Jones Peter S. Smith.”).
protections apply to electronic data stored on a computer. Any shared employees must be instructed about the necessity of preserving client confidences. The lawyers must be careful about discussing client matters among themselves lest client confidences be revealed. If fees are to be divided between the lawyers, each lawyer must assume responsibility for the representation and the client must be advised.\textsuperscript{27}

Despite these steps, office-sharing arrangements risk public confusion about the relationship of the lawyers. If in the client’s eyes the lawyers appeared to be affiliated, the client might assume that all lawyers in the office owed ethical duties to him or her. Such duties might include the absence of conflicts of interest, the confidentiality of information, and shared oversight among the lawyers.

\textbf{F} \hspace{1em} \textit{Written agreements}

Like the cobbler’s shoeless children, many lawyers do not have written agreements for the arrangements between them. The omission is regrettable. The LLC Act and RUPA have “default” provisions that may determine some of the rights and duties of participants in a PLLC, LLP or partnership. But these default provisions are rarely definitive enough for a professional practice or consistent with the lawyers’ actual conduct. For a PC, the General Corporation Act has almost no “default” provisions. In case of a disagreement, the statute will provide little or no help.

What topics should the written agreement cover? At a minimum, the agreement must set forth each lawyer’s ownership interest, his or her management rights, his or her compensation rights, and termination rights. By termination rights, I mean the respective rights of the entity and the lawyer in the case of death, disability, retirement or termination, including obligations to repurchase the lawyer’s interest and the method of valuing the interest.

The written agreement may take several forms. In a partnership (including a LLP), the partnership agreement will cover these matters. In a PLLC, the operating agreement will cover these matters. In a PC, you will have the standard constituent documents (a certificate of incorporation, bylaws and minutes/written consents) and should also have a shareholder agreement and some type of employment or compensation agreement or policy. I have attached a form of PLLC operating agreement, which gives you some idea of how these matters might be addressed.

\textbf{G} \hspace{1em} \textit{Compensation}

I think there are four basic methods of compensating lawyers. There are, however, innumerable variations of each of these methods and hybrid methods too. In the end, I doubt that any two firms compensate in exactly the same fashion.

The four basic compensation methods are:

\textsuperscript{27} A number of ethical opinions exist about office-sharing. See e.g., Calif. Ethics Opin. 1997-150 (1997); Colo. Ethics Opin. 89 (1991); Wash. D.C. Ethics Opin. 303 (2001); Mich. Ethics Opin. CI-1045 (1984); and Virginia Ethics Opin. 874 (1987).
Equal – as in the common partnership, the lawyers will share proportionately all expense and income. It assumes that each lawyer brings the same effort and abilities to the table. The risk is that the lawyers will not contribute proportionately, with one working harder, billing more or otherwise contributing more than another (the “free rider” problem).

Subjective – where management (the board of directors, the executive committee, the senior partner) decides what each lawyer should be paid based on a subjective determination of that lawyer’s contributions. As with any subjective determination, people may differ about what contributions should be considered and the value of such contributions. Trust in the decision-maker is imperative.

Production-based – the opposite of a subjective method. Compensation is determined by formulas largely driven by the lawyers’ collected billings (production), but which may include credits for origination, administrative contributions and seniority. The production-based method generally replicates the compensation that would exist if sole proprietors were grouped together. Some find this to be the weakness in the production-based method and criticize it for failing to build collegiality among lawyers.

Seniority-based – where compensation is allocated based on a lawyer’s seniority. It assumes that a lawyer’s abilities and contributions will increase over time. This method suffers from the same free-rider problem as the equal method. Talented younger lawyers may balk.

A perfect method of compensating lawyers does not exist, since what might be perfect for me may not be perfect for you. If you are practicing with another lawyer, work together to find a method that each believes is fair. After implementing the method, be open to change. You might discover inequitable aspects in the method. Circumstances may develop that warrant change. I think it best to view your compensation method as a work-in-progress.

III Locating

A Client needs and the type of practice. You perhaps have heard the old adage: Three things are critical in business – location, location and location. The adage was undoubtedly developed by a real estate agent and is greatly overstated. What might be critical for a retail operation is not critical for a professional practice.

But location is an important starting point. When considering a location, think about your client needs and your type of practice. If your practice involves a lot of face-to-face client contact, you might want a suburban location. If you are frequently at the courthouse, you might want a nearby location. If your practice involves both face-to-face client contact and frequent trips to the courthouse, you might want a compromise location.

When thinking about location, you should consider the image you want to project. A high-rise office might work for some. A storefront office will work for others. Like the automobile you drive, your office location and
appearance will create client perceptions about you and will affect the success of your practice.

**B Leasing.** Most lawyers will lease their offices. Once you have identified the general location you want, start checking on the availability of space and rental rates. This will give you an idea about the market. You ought to get at least three quotes. Once you narrow your choices, you can start talking. Keep in mind, most lawyers looking for space won’t rent enough to warrant a lot of negotiating. Most landlords will not come off their quoted rents very much. The same is true for the legal terms in the proposed lease. Tenant improvements are probably the most important part of your lease and perhaps the area of greatest flexibility for the landlord. Try to get tenant improvements that will ensure the space is suitable for your needs. The landlord may “finance” the tenant improvements by adding the cost to your lease.

Your relationship with your landlord is important. Do not jeopardize the relationship by trying to get the very last penny. Landlords don’t want (and most don’t need) a “difficult” tenant, and you will need the landlord’s cooperation during the term of the lease.

**C Buying.** Many lawyers buy their own buildings. The economics can be attractive. The owners get depreciation and interest deductions while building equity in the property. There are a number of risks to consider, however, especially if you are establishing a new practice. Buying a building is a much longer term commitment than a lease. If the practice doesn’t go as planned, you might find yourself trying to sell a building you only recently occupied. A commercial building that is not leased or occupied is not as attractive. Ownership also means that you will likely spend more time dealing with property matters, which will take away from your practice time. This will be particularly true if you only occupy a portion of the building and let other portions.

When two or more lawyers buy a building together, they typically buy the building in an entity distinct from the law firm. A separate entity creates more flexibility. A non-lawyer can participate in the building’s ownership. Adding a lawyer partner later on would not necessarily adding a new partner in the building. The separate entity also limits liability. Liabilities that might arise from the building would not necessarily attach to the practice, and vice versa.

But the joint ownership of property also poses special risks. As a practical matter, most lawyers do not stay together for the length of the typical mortgage. We should anticipate a separation and agree upon an exit mechanism. Partnering with someone to practice law and to own property is more complicated than a single partnership. Joint ownership of property complicates the relationship, which can add stress. If the ownership of the property is not identical to the ownership of the firm, conflicts of interest might arise.

**D Home officing.** As the business world has launched into telecommuting (a byword for at home employees), many lawyers are exploring the notion of practicing from their homes. Some advantages are obvious: lower overhead, tax advantages and no commute. Those who tout home officing claim a
simpler existence with less stress. But home officing is not for everyone or perhaps even most.

Home officing requires first and foremost a very high degree of self-reliance. Since few home officers have any staff, you must be prepared to do it all. You will handle the computer, telephone, copier and fax. You will do your own documents and get out your own mailings. A person who enjoys working alone and is fairly well organized may adapt well to home officing.

Another consideration is client perception. Clients pay dearly for legal services and expect a typical office. The typical office connotes a degree of professionalism that a home office lacks. For most people, a home office appears less formal, less permanent and less committed than a typical office. But I am speaking in generalities and exceptions always exist. Some lawyers maintain close personal relationships with their clients. Other lawyers have little client contact, such as a lawyer who maintains an appellate practice. Lawyers in these situations will be less affected by common client perceptions.

A final comment on home officing involves zoning. Many lawyers live in areas zoned as residential. Technically, a lawyer cannot conduct a practice (a commercial activity) from his or her home without violating the zoning ordinances. Most lawyers avoid this problem by maintaining a relatively low profile – no signage, no parking lots and little come-and-go activity. Still, the issue exists and must be considered.

IV Staffing

A Working with your staff (and the hidden costs of not)

You and your staff share a common goal, which is to provide the best possible legal services to the clients at a reasonable cost. This goal is best attained through a cooperative effort. You will act as the manager and the staff as the assistants. But remember this essential maxim: your staff does not work for you; they work with you. Your ability to interact with your staff in a cooperative atmosphere is crucial to maintaining office moral, reducing staff turnover, decreasing development costs and aiding client perceptions.

This is not to say that there is a single way to manage. Just as people differ, there are different styles of management. Your personal style might be like that of a coach or a politician. But be forewarned, management studies indicate that managers who demand immediate results or expect excellence and self-direction will not likely have a productive staff.28


“Coercive leaders demand immediate compliance. Authoritative leaders mobilize people toward a vision. Affiliative leaders create emotional bonds and harmony. Democratic leaders build consensus through participation. Pacesetting leaders expect excellence and self-direction. And coaching leaders develop people for the future.” Pg. 80.
The importance of a productive staff is especially critical in a law office. We have knowledge-based businesses. We do not sell tangible products. We sell legal services. And we lawyers are not the only ones selling. Our staff is in frequent contact with our clients. In many cases, the client talks with staff nearly as much as the lawyer does. Clients can tell whether the office atmosphere is positive or not, and their perceptions will affect your revenues. Hence, if we are maximize our “invested capital” – the knowledge of everyone in the office – we must spend time with our staff. As the eminent Peter Drucker has advised, “Get to know them, mentor them and listen to them; challenge them and encourage them.”

B Compensating employees

Most sole practitioners and small law firms will employ at least one person, and may employ several. The cost of staffing will vary greatly depending on the training and experience of your personnel. Experienced legal secretaries often start at $25,000 or more. Paralegals may be even higher. If you are comfortable producing your own documents, you might find a capable assistant with nominal legal experience at lower rates and train him or her as you go.

The out-of-pocket salary is only part of the cost of employment. As an employer, you must pay one-half of the employee’s FICA costs (social security, Medicare and unemployment). You must have workers’ compensation insurance. To meet the employment market, you may have to offer benefits such as health insurance. Depending on location, you may have to pay for parking. Each employee will likely have a desk and chair and computer. Depending on the level of benefits, an employee’s non-salary costs can easily be twice the salary amount.

The experience of the higher priced assistant presumably increases office productivity, which justifies the higher compensation. The lower priced assistant offers a lower out-of-pocket burden, which may be important to a lawyer beginning a new practice. There are risks and rewards with either approach.

The Fair Labor Standards Act requires that employers pay nonexempt employees a minimum wage (currently $5.15 per hour). Employers must pay for overtime at the rate of one and one-half times an employee’s regular rate of pay for hours worked in excess of 40 per week. The overtime requirements apply regardless of whether an employee is paid on an hourly or monthly basis.

In Goleman’s studies, the most productive styles were the “authoritative” closely followed by “affiliative”, “democratic” and “coaching”. Those who positively affected the work atmosphere obtained much better financial results than those who did not.


30 The Fair Labor Standards Act affects employers engaged in interstate commerce. “Interstate commerce” is defined very broadly and, as a practical matter, covers virtually all employers.
The Oklahoma Minimum Wage Act applies to employers with more than ten employees or that do gross business of more than $100,000 per year. Oklahoma law requires the payment of regular wages at least twice each calendar month.

Neither Federal nor Oklahoma law requires an employer to provide employees with vacation time off or vacation pay. When an employee is terminated, Oklahoma law requires that the employer pay the terminated employee his or her accrued wages and vacation time by the next payday, unless a bona fide dispute exists over the amount due.

An employer is not required by law to provide health, retirement or other benefit plans to employees. The marketplace may, however, require that an employer offer these plans to attract and retain qualified and capable employees. Professionals especially should establish a retirement plan, which represents one of the best tax planning opportunities. Generally, a professional employer must cover all employees to maximize the tax benefits to the professional. Certain qualification requirements, such as minimum length of employment, may apply.

C Office policies

Many large offices have comprehensive office policies. These policies would be excessive for the small office. But some basic policies should be in place to avoid any misunderstandings. For example, basic policies should define the workday, describe overtime pay, identify paid holidays, describe vacation, sick leave, jury duty, voting time and other paid time off, and cover entitlement to any employee benefits. There are a number of websites that provide same employment policies. CCH has a business owner’s toolkit with a wealth of sample forms (http://www.toolkit.cch.com/tools/tools.asp#DZ30). The Alexander Hamilton Center has a web-based Employment Law Resource Center, with many forms, especially government forms and notices (http://www.ahipubs.com/forms/index.html). Yet another resource is All-Biz.com (http://www.all-biz.com/).

A warning about office policies. You must keep office policies current. Although you may retain the ability to change your office policies, you may be contractually bound to abide by the provisions of the policy while the policy is in effect.

D Non-employee functions

A small law office will use a number of outside service providers. Few lawyers can handle every need and even fewer still can do so efficiently. A common management mistake is to retain control over too much. Do not hesitate to delegate your non-legal responsibilities.

Functions typically outsourced include tax matters, accounting and computer needs. Finding good, reliable providers will allow you to focus on your practice. I suggest you talk with other lawyers for advice and referrals.
V  Risk Management – about insurance and other stuff

A  Insurance

The typical small law office will carry several types of insurance – workers’ compensation, general business insurance, professional errors and omissions and health insurance.

The State Insurance Fund is typically the source for workers’ compensation insurance, especially for small offices. If the law office has employees, workers’ compensation insurance is required. General business insurance is a package of coverages, which may cover losses relating to general liability, building coverage, business contents, records, employee dishonesty and non-owned automobiles. A reputable insurance agent can assist you in obtain appropriate coverage.

Oklahoma Attorneys Mutual Insurance Company, which was formed by the Oklahoma Bar Association, is the typical source for errors and omissions insurance. Errors and omissions insurance protects against losses arising from a lawyer’s negligence.

B Other risk management

While insurance is a critical component of risk management, the best way to manage risk is to make no mistakes. Conduct your practice with due care. Comply with your ethical obligations. Meet your client’s expectations. Maintain client contact. Promptly return all calls and emails. Develop a docketing system with redundancies for all deadlines. Use information retrieval systems (with regard to both your paper files and computer files) that allow you to access all documents promptly.

These brief suggestions do scarce justice to this all-important subject. Other speakers will discuss these matters and these matters are dealt with in many of the materials in the bibliography.

Good luck and long life in your new practice.

Gary W. Derrick
BIBLIOGRAPHY AND RESOURCES

ABA Law Practice Management Section. The Section has a number of materials about the management of the solo or small law firm. Visit the website at http://www.abanet.org/lpm/default.shtml. Most of the following books are available online from the ABA.


Munneke, Gary A. and Anthony E. Davis, The Essential Formbook, Vols. I and II.


