

# Practising what you preach

*Cultural and legislative changes are challenging the legal profession's long-established employment, recruitment and remuneration practices, say Ronnie Fox and Anne Parkinson*



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Significant changes in the marketplace for legal services over the past few years are affecting the way in which law firms manage their people. New structures and remuneration policies are emerging in the competitive market for talent. We are seeing law firms find new ways of incentivising staff and rewarding star performers.

Market pressures force law firms to run themselves as businesses. Thanks to the increasing sophistication of the legal press and conversion of many firms into LLPs, the relative financial performance of most law firms is no longer a secret. In addition to the cultural changes that have occurred in response to market forces, recent employment law reforms have challenged long-established practices and customs within the legal profession.

In this article we focus on employment law issues that are particularly relevant to law firms in today's competitive market. First, we look at the different categories of workers within firms and how their rights vary. We consider the position of trainees working under fixed-term contracts and then discuss the impact of the age discrimination legislation on recruitment. We touch on the long list of policies that law firms are adopting in order to minimise the risk of employment disputes and any associated unwelcome publicity. Finally, we examine the hot topic of partner and employee remuneration schemes and identify some of the key developments.

## Partner or employee status?

The question of who is and who is not a genuine partner is becoming more difficult to answer as firms adopt more complex structures.

Many firms have introduced arrangements designed to enable solicitors who are not full equity partners to benefit from

a more liberal tax regime (schedule D rather than schedule E) and to secure significant savings in national insurance. At one time there was a rank of senior solicitors who were described as salaried partners and taxed under schedule E; they were employees and enjoyed the full range of employment rights. Today, that rank is called fixed-share or income partners. To minimise the risk that such partners will be considered employees, it is best practice to ensure that part of their income varies with the profits of the firm and to give them limited voting rights. Inevitably, the line between genuine full equity partners and others is becoming increasingly blurred.

Her Majesty's Revenue and Customs (HMRC) has changed its approach where an individual is wrongly treated as self-employed rather than employed. The Special Commissioners in *Demibourne v HMRC* [2006] ruled that an employer is liable to pay retrospective income tax and national insurance on the earnings of such an individual without any set-off in respect of tax paid directly by the individual. Firms might want to include provisions in partnership deeds and LLP members' agreements requiring fixed-share partners to pay to their firms any tax refunded because it has been determined that they ought to have been treated for tax purposes as an employee.

The distinction between a self-employed equity partner and an employed salaried partner alters the framework of rights applicable to the individuals concerned.

In the US case of *Equal Employment Opportunity Commission v Sidley Austin Brown Wood* [2002], 31 full equity partners were demoted to counsel or senior counsel status. The relevant US age discrimination legislation applies only to employees and the US Supreme Court

decided that the full equity partners should be treated as employees

While employees in the UK have the benefit of statutory rights, such as the rights not to be unfairly dismissed, to

quences if that individual later brings an employment tribunal claim

If a firm has failed to comply with the statutory dismissal procedures when dismissing an employee, the dismissal will

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receive redundancy pay and to be covered under the whistleblowing provisions of the Employment Rights Act 1996, the rights and obligations of partners are determined by the partnership deed and partnership law (or in the case of LLPs, the LLP agreement and LLP Act 2000)

A major implication of employee status is that individuals are covered by the statutory dispute resolution procedures introduced by the Employment Act 2002 (Dispute Resolution) Regulations 2004. A firm's failure to identify an individual as an employee, that leads to a failure to comply with the statutory procedures, could have serious conse-

be held to be automatically unfair. If a firm has failed to follow the statutory grievance procedures in response to a grievance brought by an employee, any compensatory award made by a tribunal may be increased by between 10% and 50%. An employee who has failed to raise a grievance in compliance with the statutory grievance procedures will be barred from bringing certain tribunal claims

Although there is no definitive test, the table (opposite) illustrates factors that would indicate employee or partner status. None of these factors is on its own conclusive and a court or tribunal would look at the overall pic-

ture. Employees and partners are protected by the discrimination legislation. Discrimination cases brought against law firms often become high profile in the media and create bad publicity for firms. It is therefore important that firms handle discrimination complaints properly from the outset, partly to avoid claims for victimisation


Larger law firms are adopting policies and procedures for partners that are similar to those in place for staff, covering issues such as:


- grievances;
- disciplinary procedures;
- sickness and absence;
- e-mail and Internet use;
- whistleblowing;
- bullying and harassment;
- maternity, paternity and compassionate leave; and

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The result is that we often hear even full equity partners complain that they no longer feel like partners at all

**Trainees**

Law firms employ trainees under fixed-term contracts, so they must follow the statutory dismissal procedures for trainees whom they do not wish to retain at the end of the training period. Despite the fact that 'contracts of apprenticeship' are usually excluded from the scope of the regulations requiring compliance with the statutory procedures, it is widely accepted that trainees are not apprentices. To comply with the statutory dismissal procedures, firms must observe the statutory three-step procedure.

**Recruiting qualified lawyers**

The time-honoured practice of recruiting solicitors on the basis of post-qualification experience is under attack following the coming into force of the Employment Equality (Age) Regulations 2006 (the Regulations). These Regulations prevent employers from using age as a recruitment criterion. It is widely believed that requiring a certain number of years of post-qualification experience for a specific job amounts to age discrimination, is hard to justify objectively as a proportionate way of achieving a legitimate aim and is therefore unlawful.

Many firms have changed the way in which they advertise vacancies, including Clifford Chance and Simmons & Simmons. Rather than specifying post-qualification experience, firms are focusing on the type of skills and experience that they require.

**Remuneration policies**

The way in which firms remunerate partners and staff alike is also coming under scrutiny following the introduction of the Regulations. The legislation means

that firms cannot base remuneration or succession planning on age alone. This challenges the traditional lockstep profit-sharing arrangements commonly seen in many law firms. Many firms are taking strategic decisions to change their remuneration policies to incorporate (to a greater or lesser extent) performance-based elements.

Eversheds has abandoned its old lockstep system in favour of a scheme based on performance criteria, including fee-income generation, profit and strategic value, client service and behaviour. Introducing robust partner appraisals goes hand-in-hand with performance-based remuneration. The goals are to

*Clarke v Nomura International Plc* [2000] IRLR 766

*Demibourne v HMRC* [2006] SpC 486

*Equal Employment Opportunity Commission v Sidley Austin Brown Wood* [2002] 315 F3d 696 (7th Cir. 2002)

*Keen v Commerzbank* [2006] EWCA Civ 1536

*Midland Bank Plc v McCann* (Unreported, 5 June 1998)

confidence. In *Midland Bank Plc v McCann* [1998] the EAT confirmed that an employer exercising a discretion is under

*Discretion in relation to bonuses paid to employees must be exercised so as to preserve the relationship of trust and confidence.*

bring objectivity into the process for fixing remuneration and to minimise the risk of age discrimination claims when partners are required to retire.

In the war for talent, firms are increasingly incorporating bonus elements into employee pay packages. Some bonuses are linked to the value of partner profit points (as at Allen & Overy), while others are based on individual performance (as at SJ Berwin). In November 2006, SJ Berwin announced that it was changing its bonus structure to allow associates to earn bonuses of up to 75% of base salary.

Bonus schemes may be discretionary or contractual. Often, they are a mixture of both. Eligibility is often a contractual matter. There are rules governing the timing of announcement and payment of bonuses. The amount of bonus that an individual receives, on the other hand, is usually entirely discretionary.

Discretion in relation to bonuses paid to employees must be exercised so as to preserve the relationship of trust and

no obligation to do so reasonably but must exercise it in such a way as not to undermine trust and confidence, in other words not capriciously or in bad faith. In *Clarke v Nomura International Plc* [2000] it was held that discretion must be exercised without irrationality or perversity.

In the case of *Keen v Commerzbank AG* [2006], discussed more fully on pages 2-4 of this issue, Mummery LJ similarly held that an employer's discretion is subject to an obligation that it should not be exercised irrationally or perversely. He held that, consistent with an employer's duties to preserve trust and confidence, it ought to supply an employee with an explanation of the reasons for the exercise of discretion when awarding additional pay. He was concerned about the lack of explanation and evidence in this case. Nevertheless, he held that the bank's decisions on the size of Mr Keen's bonuses were not irrational on their face.

**Rising to the challenge**

The challenge facing the legal profession is to adhere to high professional standards and to provide a friendly, collegiate working environment for partners and staff alike while increasing profitability and improving business performance. The trend is increasingly to reward partners and staff by reference to performance. Managing staff and partners in the right way and responding to recent changes in employment law will help law firms rise to that challenge. ■

**Employee or partner?**

**Employee**

- Fixed remuneration
- A full indemnity from the partners in respect of liabilities of the firm and financial risk of the business

**Partner**

- A share in the firm's profits and losses
- A degree of personal exposure to debts and liabilities of the firm
- Contribution to the firm's capital
- Authority to sign cheques on behalf of the firm
- A vote at partners' meetings