

Lawyers think radical thoughts as downturn means old ways are untenable

The new economic realities mean that the ways City firms do business could undergo fundamental change, writes **Jonathan Ames**

RADICAL changes are afoot in the legal world. With more lawyers losing their jobs, there are rumblings about seismic shifts in the London scene. Most dramatic is the possibility that big names are contemplating mergers. "We will see shot-gun marriages," says one well-placed observer of City law firms. He forecasts changes at the top level, saying that "at least one of the magic circle will do something with an American firm" in the next few months. All eyes will be on Linklaters, Allen & Overy and Freshfields.

Whatever happens, the downturn means that other changes are being floated that would alter the structure and culture of law firms. For example, firms are flirting with the idea of adopting LLP (limited liability partnership) status, of reforming lock-step remuneration schemes and even changing billing structures.

Firstly, some firms are considering adopting LLP status as the recession pushes some commercial law firms to rush to convert their traditional structures into limited liability partnerships. But the tightening fist of the banks that is causing particular concern. While many view the LLP model as being a safer haven in a contracting market, developments over the last few weeks have triggered concerns.

"The recession will certainly encourage those firms that are not LLPs seriously to consider transforming," says Richard Linsell, the partner in charge of the professional practices and LLP group at City law firm Addleshaw Goddard. "But the difficulty is that the banks are getting much tougher on the security they are requesting from partnerships that want to go across to LLP status."

CHANGING FEE STRUCTURES

Linsell points to the now predominantly tax-payer owned Royal Bank of Scotland as recently having presented a law firm in the process of conversion with "a set of documents that would never have seen the light of day 18 months ago". The bank is asking the firm for a debenture – the right to appoint a receiver over the practice if anything goes wrong with the business. But more importantly, RBS has asked for personal guarantees from the potential LLP members on a partnership-type basis, meaning that if disaster strikes and there is a claim on the firm, all the members will be in the frame jointly and severally.

That, in effect, say Linsell and other

experts, negates most if not all the benefit of LLP status. "There is going to have to be a robust negotiation [with the banks]," forecasts Linsell, pointing out that the bank's position has been exacerbated by demands for a £10,000 arrangement fee for doing the deal. "This is the grim world that we are in," says the lawyer. "Banks are asking for staggering arrangement fees for getting out of bed."

Peter Gamson, a professional partnership expert at London-based accountancy firm Grant Thornton, reports that banks are charging arrangement fees of up to £20,000. But he maintains that there is a more profound problem: "The banks are starting to say that they no longer want to lend to firms, they want to lend to the individual partners and insist that they put the money into the firm as an increase in capital. That is going all the way round the financial liability protection of LLPs."

OUTDATED AND INFLEXIBLE

Secondly, large City law firms are also finding themselves hamstrung in the recession by outmoded and inflexible remuneration structures, not least the old-fashioned lock-step remuneration schemes, which (in simple terms) reward partners on a time-served rather than a merit basis. Many practices still have in place at least a version of the lock step system, with potentially the most damaging aspect being an inherent inability to jettison quickly under-performing partners, something that could make all the difference to law firm success and failure in a contracting market.

According to Ronnie Fox, senior partner of

Large City firms are hamstrung by outmoded and inflexible pay structures, which can make it hard to jettison underperforming partners

City niche employment law firm Fox Solicitors and the founder of the Association of Partnership Practitioners, the most important tool in a corporate law firm's recession survival kit is an "up-to-date members' agreement [for LLPs], or partnership deed, which provides the ability to remove partners without giving a reason, and ideally a clear statement of what partners are entitled to when they are asked to leave."



New partnership structures might be needed if law firms are to stay strong.

Picture: GETTY

Grant Thornton's Peter Gamson agrees: "You want to have a great deal of flexibility because firms are having to make decisions – about letting people go, looking at cutting service lines – that a year ago they didn't even envisage might be on the table. That can be very difficult if you have a rigid constitution."

Gamson points out that some City and other commercial law firms still require a unanimous vote of the equity partnership before a partner can be sacked or a department can be wound up. Such constitutional fine print makes it difficult for managing partners who want to ditch lagging practice areas as they will need to win the support of the partner heading the targeted department.

UNANIMOUS APPROVAL

And while unanimous approval structures are rare, Gamson points out that quite a few firms maintain a 90 per cent requirement and that "an enormous number" requires a 75 per cent partnership approval, which still presents serious problems. "Managing partners are pulling their hair out at the moment as they look at constitutions that were not drafted to react to times like this," comments Gamson.

Addleshaw's Richard Linsell argues that City law firms should borrow aspects of "managed lock-step" systems that are prevalent in the US and that allow for more of a performance analysis in the equation. "UK firms would benefit from a change of culture where partners' profits

can be moved down without there necessarily being the stigma of under-performance," he says. "There are some good examples of managed situations in US law firms where partners get moved down as well as up and they recognise that is fair compensation for the contribution that they are making and feel comfortable within the firm."

Finally, one area where the larger corporate law firms have some existing flexibility, says Ronnie Fox, is with their fees. He predicts that firms will be so keen to drum up work in this recession that they will resort to the almost unheard-of tactic of cutting their rates and in some cases sidelining the hitherto sacred cow of the billable hour.

"The larger firms will reduce their rates to keep some activity within their groups," Fox predicts. "And they will go for all sorts of deals that were once the preserve of the smaller firms – for example, coming off the hourly rate, fixed price deals, and doing some deals at very low cost to build relationships."

Ultimately, Fox says there are three key ingredients for law firm survival in this market – strong, cohesiveness ("lots of firms claim to be collegiate, but we know that they are backstabbing places") and transparency, which amounts to the simple ethos of being honest with the many partners and other staff who are going to be badly affected by the economic downturn. With uncertainty stalking the sector, many lawyers will hope that they start now.