Law firms are taking tough decisions during the economic downturn with many journeymen partners facing the prospect of being 'managed out'. Philip Hoult reports

WEAKEST LINKS

Imagine you are a partner at a leading City firm which just three years ago was basking in the glory of delivering one of the highest billings in the entire partnership.

Fast forward to the present day and you find you are being managed out because your practice or industry sector has suffered more than most as a result of the economic downturn. This may seem an unlikely scenario, but is in fact a real-life example of how brutal the impact of the recession has become at partner level.

"It is not just support staff and assistant solicitors who are being asked to leave, it is fixed share partners and full equity partners too," says partnership law specialist Ronnie Fox, principal of Fox. "What we have seen over the past two or three years is that more and more LLP members' agreements say that a resolution of the partners, or sometimes even a decision of the management committee, can result in a partner leaving for no cause. Nowadays, it is much more usual to find that no particular circumstances or reason need be given or argued through; it's just a decision taken for commercial reasons."

Jonathan Glass, founder of Glass Consultancy, believes there is barely a firm now that has not adjusted its partnership. "There have been a number of redundancies at partner level," he says. "The second trend is the de-equitisation of partners and/or partners being moved down the equity ladder."

It is hard to ascertain exactly how many partners have been affected by this, as law firms are naturally reluctant to speak publicly about what they are doing. Indeed, rank-and-file partners can even find it next to impossible to discover what is happening to their colleagues. There have, nevertheless, been predictions that up to 15% of partners in the top 100 firms – or almost 2,000 people – could eventually go.

"It probably won't be until next September that we actually realise how many people have left firms for these reasons," Glass argues. "You will have a first tranche leaving by April because those who are on six months' notice – or on 12 months' notice but who are leaving after six – will depart at the end of the financial year."

These departures relate to decisions already taken. Glass predicts that there is "more to come" in January and February as firms seek to put as much of the costs of restructuring into one financial year. This will be partly in an attempt to draw a line under the process as far as possible and partly for public relations reasons – given the market expects many firms' results to be dire, no one practice is likely to stand out. The impact of this next round is only likely to become evident after the summer.

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As yet, it is unclear whether certain types of partners are collectively being affected more than others. Tony Williams, founder of management consultancy Jomati, believes that the ranks of non-equity partners, which grew significantly during the boom years as firms sought to drive up their profits per equity partner (PEP), are under particular scrutiny.

"They are a fantastic resource when things are going well because you can hand work to them and you don't have to supervise them," he says.

"The problem is that in many cases – but not all – the reason they are non-equity partners is that they haven't got the broader range of client development and client-getting skills that you need of an equity partner."

Also likely to be particularly vulnerable are those partners that have only recently joined from other firms and are still in the process of building up their practice again – the ties they have to the other partners in their new firm will still be relatively weak. Similarly at risk are those who have gradually risen through the equity on the back of the good times but have not really established themselves as genuine rainmakers.

Dominique Graham, a director at Graham Gill, believes firms are trying to re-deploy people where they can. "However, if as a lawyer you are unable to re-tool because you lack the flexibility or the inclination or you are in an area where there isn't an obvious way of doing it, you are on the dole," she says.

While the recruitment outlook is undeniably gloomy, Graham adds that some law firms are still on the hunt for talent at partner level. "What they are doing is focusing on the real talent," she says. "Firms are doing a lot more due diligence at an earlier stage and they are very cautious about who they take on. Where there is a strategic need, they will carry on – albeit more slowly – to recruit."

Clare Murray, managing partner of niche employment and partnership law firm CM Murray, meanwhile warns that a lot of firms are keen simply to restructure, almost as a knee-jerk reaction, and this often leads to poor decision-making.

She claims firms typically start targeting female partners – often those either on maternity leave or recently returned from maternity leave, part-time partners and older partners, who are perceived as not working to the capacity of their younger peers.

"They are often targeted unfairly," she says. "Usually when you drill down, you often find that with the part-time partners, for example, management haven't bothered to take into account that their targets are pro-rata'd and that when you put them onto a full-time equivalent, they are often at the same level of performance as or even higher than some of their full-time colleagues."

Murray also expresses astonishment that management is often not aware of what the partnership agreement says about the way in which under-performance or exits should be handled.

"They just assume that they can do things that they want to do," she says.

The complexity of the task of choosing individual partners for de-equitisation or removal naturally means the scope for disputes is high.

Indeed, there is already anecdotal evidence of a significant increase in age and sex discrimination claims.

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However, Williams believes that few of these spats will become public, as it is usually in neither party's interest for it to reach that stage. "We'll see people pressing for better pay-offs or improved terms when it comes to de-equitisation or consultancy arrangements to soften the blow," he suggests. "If you haven't got anywhere else to go and you still have major outgoings, the temptation is going to be to fight."

Williams advises law firm management to exercise care in how they treat individual partners or groups of partners because of the message it sends to colleagues and the damaging effect it can have on morale and commitment.

As well as having to carry on under the shadow of being asked to leave the partnership, many partners are already feeling effects of the recession as firms look to shore up their financial position.

There are a number of tools that management have at their disposal to do this. These include: reducing or controlling drawings and distributions of previous years' profits; persuading equity partners to contribute more capital or lend money to the practice; addressing working capital management issues; and promoting fewer partners in the annual round. Often a combination of all four measures is adopted.

IN NUMBERS

15%

The percentage of partners in top 100 firms that may lose their jobs

"There is a whole raft of firms where partner drawings have been reduced by 10% or 20% and that obviously affects those people's living standards," reveals Colin Ives, partner and head of professional services tax at BDO Stoy Hayward.

Some partners' noses will be severely out of joint, he suggests, as the trend in recent years for firms to link drawings to cash collection gathers further momentum and has a more painful impact.

Fox agrees that it is undoubtedly the "correct approach" to reduce payments to partners if there is less cash available. Surprisingly, not all firms adopt this discipline. "I've recently been instructed by a partner who has decided to leave a firm he is very closely associated with because the partners do not want to reduce their drawings," he says.

"They live on their drawings and have come to regard them as rather like salaries, which, of course, they are not."

Matters can become even more fraught when it comes to requiring partners to make capital contributions or loan money to the firm. "Where firms are under-capitalised, some partners are questioning why they should be required to put in more capital if there is a possibility that they may not be at the firm in five years' time, having been asked to leave early," says Murray.

International partnerships, meanwhile, have an additional source of tension, caused by the plummeting value of the sterling last November and December amid concerns about the long-term prognosis for the UK economy. According to Jeremy Black, associate partner in Deloitte's professional practices group, this could spark conflict between offices over the division of profits – with the UK partners at odds with their US or European colleagues.

As Black points out, with understatement, this is an area where partners are generally quiet if the exchange rate moves in their favour and not so quiet if it moves against them. "It's one of those issues that, ultimately, you have to say 'who is going to bear the risk and cost of exchange movements?" he suggests. "You can either share it between everyone equally or you can leave it with one particular group."

All these stresses are likely to test partnership remuneration structures to the limit. Which model – pure lockstep, 'eat what you kill' or a modified lockstep or similar hybrid – is inherently better suited to these straitened times is a difficult question to answer. Murray says it is easier instead to look at those structures that work worst. In her view these are the ones that are very much about the individual, where it is all about what you bring in and what you turn over as a partner. "It's bad for the firm because it means the partner's practice is much more likely to be portable," she argues.

This is particularly important at a time when financial pressures are already magnifying dysfunctional behaviours, as partners become defensive about their matters and keep work to themselves – despite clients clamouring for costs to be kept down.

"That can be a really damaging development for firms," Murray suggests. "The best firms are the ones where people are encouraged and educated to share work and be generous with their partners, and systems are set up to reward that approach."

'Where firms are under-capitalised, partners are questioning why they should put in more capital'
Clare Murray, CM Murray

Ives agrees. "There will be loads of partners sitting out there thinking 'if I get 90% chargeable, I'll be safe' and that's actually bad behaviour," he says. "That 'bunkering down' is understandable but it is something management have got to look out for."

It would in any event be a brave – or desperate – management team that attempts to change its partnership agreement and remuneration structure in the current climate. "People tend to get more conspiratorial in their view of why changes are being put forward now, so in many ways it can be more difficult to push them through," says Williams.

"It depends how extreme the position is. Changing remuneration is easy while profits are still going up because there aren't any losers. If you're doing it when profits are coming down, they all lose out to an extent."

Murray adds that trying to change structures at this time forces partners to focus inwards. "It would create more division in circumstances where really what you want is the partners being outward-facing – pounding the streets, bringing in business, doing the work and maximising profits for the firm," she says. "Trying to renegotiate a partnership agreement diverts attention from that."

For these reasons, the recession is likely to put moves to revamp partnership structures on hold.

It may also have the odd positive effect. One is that firms are likely to be less obsessed with league tables and PEP, according to Williams. "There will be less fretting about whether you are earning £10,000-£20,000 less than your peers," he says. "There won't be as much obsession about minor differences but firms will be seeing if their profits are going down relative to their peers and whether they are dramatically out of line."

Although such a waning in firms' fixation with PEP may be seen as a welcome development, it is a minor one and the reality is that the recession will put many partnerships under unprecedented strain. The key question then is: which ones will take the load and which ones will buckle?