

The Law Gazette

When opportunity knocks: making a decision on partnership offers

by Anne Hughes and Ronnie Fox

23/03/2011

We probably advise 10 partners on their departure arrangements for every partner who consults us about the terms on which he or she is considering joining a new firm.

Why is that? An offer of partnership is a prestigious career-defining moment for a lawyer: the acquisition of eagerly awaited status and the longed-for badge of recognition.

It is tempting to snatch your first offer of partnership with both hands – whether it comes from your own firm, or in the course of your being recruited as a lateral hire.

Excitement can lead the most diligent of lawyers to become blind to the small print. New partners often feel that they do not have much bargaining power.

But none of that is an excuse for going straight into a law firm partnership without weighing up the relevant issues. It is an important move: as with most things in life, there is a right way and a wrong way.

We see many lateral hires move on after a relatively short period. In our view, a lateral hire is much more likely to be a success at their new firm if they have asked a few fundamental questions at an early stage in their negotiations with a new firm and, after careful thought, decided that they are happy with the answers.

Here are some of the issues that we suggest should be addressed at the outset.

Do your homework

Often the focus of the negotiations is remuneration (whether calculated by reference to profit share or status), especially if a head-hunter or a recruitment agent is involved.

A senior associate addressing their first partnership offer will usually be familiar with terms such as restrictive covenants and notice periods in their own contract of employment; they will probably look at comparable provisions in a partnership deed or an LLP members' agreement as though they had been set out in an employment contract and then treat them as non-negotiable.

Smarter candidates recognise that partnership is a very different animal from employment, and the same wording may well be construed differently according to the context. It is important to know what you are signing up for – attending partners' meetings and signing up to billing targets is just the beginning.

The partners in a traditional partnership have unlimited liability for the debts of the business.

It is easy to assume that if you become a member of an LLP you are protected because your personal liability is limited by law.

Unfortunately, it is not that simple. If you are a partner, or have ambitions to become one, have you checked that the firm has carefully crafted terms of business and ensures that all client work is covered by those terms?

Is the level of professional indemnity cover appropriate to the nature of the firm's business?

It is still possible for a solicitor inadvertently to assume a personal duty of care to clients and end up on the wrong end of a negligence claim even if they are a member of an LLP.

On an insolvent winding-up of the business, members can be required to pay back any money that they have received from the LLP (including salary or profit share payments) within the previous two years (section 214A of the Insolvency Act 1986).

There is no contracting out of that. So personal liability is a big consideration.

Often partners will be indemnified against certain liabilities by other partners or by the LLP. But what if the person or entity that has given you the indemnity cannot afford to pay up when the worst actually happens?

Some years ago a single sentence, 'I stand by my audit', resulted in a £60m claim against accountancy firm Binder Hamlyn, which was substantially more than the firm's professional indemnity cover.

The bottom line is that there is no substitute for doing your homework.

You need to understand the financial dynamics of the business to understand the risks involved. Then you can decide whether the level of risk associated with the position offered is reasonable.

You need to know that the firm is not a sinking (partner)ship that could take you, your assets and your career with it.

There are many financial pressures on law firms now: even some well-known firms are struggling to maintain profitability.

We advise partnership candidates to compare the firm's annual accounts for the previous three years and current management accounts with budgets.

Are profits increasing each year, staying at a similar level or heading south? Why is that? How does the trend fit with the firm's business strategy over the same period?

Many firms publish PEP (profit per equity partner) figures, which you can usually find in the league tables published by the legal press. We look critically at those figures.

We question whether a few, high-earning partners are taking home a large proportion of the profits while the majority of the partners earn far less than the figures would suggest to outsiders.

We know that some firms have culled dozens of partners recently with the intention of making a significant positive impact on PEP figures.

What is the plan?

Failing to plan is planning to fail. In addition to requesting a copy of the firm's business plan – or at least an explanation of the firm's business objectives – ask if outside consultants have been engaged during the previous couple of years to work on business planning, and whether there are any reservations about sharing their report with you.

What are the firm's projections for profitability over the next three to five years? Previous editions of Chambers and The Legal 500 may help you reach conclusions about both total numbers of lawyers and gearing – the ratio of partners to other fee earners.

Do you think that the business plan is realistic and does the plan have buy-in from the rest of the firm?

When recruiting new partners, the firm will be assessing how each candidate will fit into their business plan. What are you bringing to the table? What will be expected from you? You need to decide whether the targets and other key performance indicators are achievable.

Unfortunately, we often see partners who were recruited as lateral hires leaving after a year or two because the practice that they brought with them to their new firm turned out not to be a good fit. It is important to ask the right questions before attempting to move a thriving practice to a new firm.

How will your clients react to the new terms of business, increased charge-out rates and different culture of the new firm? Will you be able to provide the same level of service at the new firm? Are you confident that you will have the necessary resources and support for your way of working?

That is difficult to assess until you are inside a firm, and to some extent you are taking a leap of faith as a lateral hire.

But there are ways of gathering relevant intelligence. Speak to as many people as you can. Consult people who have done business with the firm.

Talk to people who have worked at the firm.

Ask a partner who has left the firm about their reasons for doing so, how they feel the firm dealt with their departure and what relationship they have with their former colleagues. You cannot rely on everything everybody tells you, but you will probably start to build a picture.

Scratch the surface

The more senior the capacity in which a lateral hire is joining a firm, the more deeply the firm is entitled to probe.

Has a candidate ever been reprimanded, warned, fined or suspended by the Law Society, the Solicitors Regulation Authority or the Solicitors Disciplinary Tribunal? What is their record on professional complaints and claims for negligence?

The candidate will have to think long and hard about whether to ask similar questions of the partners he is considering joining.

Can you make each other happy?

And it's not just about profits and keeping your clients happy. It is also about your own happiness. Every firm has its own culture and office politics. How will you fit in? Do you like the people? Do the other partners share similar values and ethics to you and can you work harmoniously together?

If you do not like or respect your colleagues, life can be miserable. Most firms dedicate a significant amount of time and effort to the partnership recruitment process, so that candidates have the opportunity to spend time meeting and getting to know their new team before they join.

That is invaluable.

Don't get caught out

The interview process can present dilemmas for candidates who are asked to present a business plan of their own, and who often feel under pressure to provide details about their clients and billings at their current firm.

The candidates need to remember their legal obligations to their existing firms, including their duty of confidentiality.

When planning the move, they also need to be cautious not to act in breach of restrictive covenants that may prevent them from working for certain clients or from poaching clients or staff from their existing firm.

Team moves can cause real financial damage and often provoke a great deal of hostility from the partners losing out.

There can be tough partners' meetings and threats of legal action. We always warn candidates to look carefully at their existing contractual obligations and to make sure that they have a carefully planned strategy.

Have you read the pre-nup?

With the best intentions in the world, things might not work out. What happens then? It is amazing how many partners never look at those provisions of the partnership agreement or LLP members' agreement that relate to partner exits until it is too late.

How easy would it be for you to move on with your practice intact? Are there restrictive covenants? Could the firm put you on garden leave and keep you out of the market (and away from your clients) for an extended period?

How easy is it for the firm to de-equitise you or remove you as a partner without your agreement? All of these could seriously affect your future career. Do not let them take you by surprise.

Even if you are told that those terms are 'non-negotiable', it is better to go into the partnership with your eyes open to the risks. There is much to think about before you sign on the dotted line.

Do your homework and ask the right questions to make sure the whole package is right for you. Addressing any concerns upfront could save you a lot of heart-ache down the line. If you get it right, this could be the start of something beautiful.

Anne Hughes and Ronnie Fox specialise in partnership and employment law at City law firm Fox: www.foxlawyers.com