



People management

A dramatic exit

The depth of the past year's recession has seen several significant restructurings at partner level. How can a law firm make the 'departure lounge' as comfortable as possible for all concerned when arranging a managed exit?

By **Clare Murray, managing partner, CM Murray LLP**

Here are a few questions challenging all managing partners at the moment when considering partner exits: what's more important – profits per equity (PEP) or partner loyalty? The power of the partnership board to ensure that the firm thrives in the long term, or the expectations of the individual partners who own the business now? The need to make deep partner cuts, or the need to respect individual partners' rights and expectations?

The efforts undertaken by senior management in many firms to balance these competing interests have been impressive. As alternatives to expulsion of last year's stars but this year's market underperformers, firms have looked at reduced profit-share arrangements; de-equitisation; part-time working; consultant status; sabbaticals; secondments; and voluntary exits. Many have sought to consult with partners about the options and seek agreement as to the preferred routes and applicable terms.

A small number, however, may have relied too heavily on the delegated authority of the partnership board to enforce

partner exits, with limited regard to (and often even awareness of) the obligations owed to individual partners, including the duty of good faith. While there may be arguments as to whether that duty applies between members of a limited liability partnership (LLP), it is often expressly restated in LLP as well as partnership agreements, and it is still regarded as the cornerstone of partnership, even in the most corporate and modern of law firm structures.

The duty of good faith, as described by V-C Bacon back in 1887, holds true 122 years later: "If fiduciary relation means anything I cannot conceive a stronger case of fiduciary relation than that which exists between partners. The mutual confidence is the lifeblood of the concern. It is because they trust one another that they are partners in the first instance; it is because they continue to trust each other that the business goes on".

Breaches of the duty of good faith towards a potentially exiting partner, by a small minority of firms, typically include adopting potentially discriminatory selection criteria or applying them in a discriminatory or otherwise inconsistent,

unfair way between partners to ensure a particular troublesome partner is included in the partner cull; providing incomplete or inaccurate reasons to voting partners justifying proposed expulsion resolutions; notifying clients, other partners and associates of a partner's departure before exit terms have been agreed or an expulsion resolution passed; notifying the press shortly after exit discussions have begun with the partner, for fear of a leak; diverting usual sources of work away from partners targeted for exit; requiring such partners to transfer new work to colleagues who are likely to remain; excluding them from e-mail groups and internal meetings in which they would normally participate; and excluding them from marketing initiatives. The list goes on.

Without the express right to do so, such activities are likely to amount to a breach of the duty of good faith owed to that partner, and may expose firms (depending on their structure) to such claims as unlawful discrimination and repudiatory breach of contract, and ultimately to the threat of potential dissolution of the firm.

Even without the threat of legal action, such firms face not only the loss of essential skills and experience that may take years to rebuild (hampered by negative sentiment towards the firm) but also the risk of significant loss of partner trust – the very fabric that ultimately binds partnerships together.

That loss of partner trust has an immediate and long-term effect on the firm, its gearing, and ultimately its finances. Many partners are no longer standing up and supporting each other either in adversity or in client matters. Not only are there more internal battles over the ownership of client relationships and where internal referrals should be placed, but at the same time many partners are hanging onto clients and new work rather than passing them on to partners and associates. They primarily do so in order to boost their own earnings, to help them satisfy individual partner performance/exit selection criteria, and to ensure their client base is as portable as possible.

Firms must cut costs to ensure long-term financial security, but there are also ways in which law firms and their partners can make the process less painful and preserve partner trust and collegiality as far as possible.

Protective steps

From the firm's perspective, the first step for senior management, without question, is to actually read the partnership agreement and understand the rights of a potentially departing partner. These are frequently overlooked or misunderstood.

Obtain expert partnership law advice on the extent of your powers and obligations in relation to the proposed partner exits, and on matters such as the basis for selection for departure; the process and tactical options in terms of handling and achieving that exit; the options to seek to

mitigate the effects of partner exits (such as those alternatives to departure outlined above); the reasons and information to be put to partners to secure an expulsion vote in the absence of agreement; the extent to which a partner should have a right of response to such proposed resolution; the extent to which exit discussions and related matters should be kept confidential; and the sorts of detailed terms normally contained in partner-exit arrangements.

Also, put in place the internal paperwork to support the decision-making process regarding the need to make cuts in the partnership; where such cuts need to be made and why; and the basis of the assessment of partners for potential exit, including the selection criteria and processes.

Avoid adopting simplistic selection criteria, such as pure recent financial performance, which may disadvantage certain categories of partners and amount to unlawful discrimination. In our experience pure financial performance-based criteria are most likely to affect partners who are on, or recently returned from, maternity leave and/or are working part time or flexibly due to childcare; older partners, including those recently returning to full-time client work after stepping down from management; and partners who have had periods of sickness or absence due to serious ill health such as cancer.

Ensure all partners in the group to be affected are included in the selection pool and are assessed consistently against one another, with written assessment sheets in support. Be prepared to provide a copy of that assessment sheet to the partner on request.

Keep the number of people involved in this process to a minimum, and impress on them the importance of keeping the proposed departures confidential while discussions are ongoing. Confidentiality, agreed statements, non-disparagement and mutual co-operation for a smooth handover are key factors for both the firm and partner in protecting their respective reputations. Get this wrong at an early stage and you can potentially lose significant leverage in negotiations.

Prepare in advance a reasonable retirement package to provide to the individual partner on a confidential, without prejudice basis: heads of terms, followed by a more detailed retirement agreement once those heads are agreed. Try also to offer the two things that most exiting partners need upfront: as much time in the office as possible before departure to enable them to find another job (even more necessary now than ever before); and a sensible financial cushion to protect them if they simply aren't likely to find another job, at any time, in the near future.

Think carefully about the damage that may be done to the partner's career prospects by requiring an extended period of garden leave. If the exiting partner is really such a threat to the firm and its client connections, should the firm really be asking them to leave at all?

Keep the possibility of seeking a formal resolution under the partnership agreement in your back pocket in case negotiations don't proceed as planned, but in the meantime try to get agreement on an amicable settlement and allow a reasonable period of time to achieve this, safe in the knowledge that the confidential paper trail regarding business reasons and selections are already in place if needed.

Ensure that those members of senior management involved commit nothing to e-mail or paper about the exiting partners that they don't wish to be seen. Under the Data Protection Act 1998 partners can require certain personal data held about them by the firm, including in electronic format, to be provided to them within 40 days on payment of £10 to the firm. Such a request may reveal ill-advised e-mails between partners commenting on the departing partner in terms which create potential difficulties for the firm.

Also, please bear in mind that the partner may also be entitled to call on the provision of information and documentation under the partnership agreement (depending on its terms). Furthermore, any partner claiming unlawful discrimination by the firm and members of senior management is additionally entitled to submit a discrimination questionnaire to the firm in advance of tribunal proceedings, with which the firm is required to comply within eight weeks. The firm will run the risk of adverse findings by the tribunal of unlawful discrimination if it fails to respond, or, if its responses are evasive or incomplete.

Senior management will rarely be criticised for holding proper consultation with the partner group about the prospect of potential partner exits generally and considering ways of trying to avoid exits as far as possible or, if unavoidable, then to mitigate the effects for the individual partner by agreeing a standard enhanced exit package.

Offering assistance

For partners who find that their role is at risk, the process adopted by the firm will normally depend on whether the partner is, in reality, an employee (for example, a salaried partner with employment rights) or a genuine equity partner. Their rights and obligations will depend on such a status, and so some thought should be given by both the firm and the partner as to whether they are in fact a genuine partner. Being aware of the types of points, and requests, a departing partner may raise in negotiations will assist any managing partner to consider, and, where possible, to address these in advance in any proposed retirement agreement. It may help speed up the negotiation process and make the firm more aware (and seen to be aware) of the partner's likely concerns.

Salaried partners

Salaried partners put at risk should try to find out as much as possible about the redundancy process. There are steps

that the firm should follow, including identifying objective criteria to select those at risk, providing those criteria and the partner's own individual assessment, and identifying whether there are any suitable alternative roles available. The individual should be given an opportunity to challenge the criteria during individual consultation meetings if they are unfairly weighted or biased.

Equity partners

Equity partners who are notified of a proposal that they are to exit the firm will normally consider the following points.

They too will need to read the firm's partnership agreement and obtain advice on the circumstances and required vote on which they can be expelled, whether they have any right to respond or to object to the proposed expulsion, and what their notice period and financial entitlements are likely to be on retirement from the firm. They will need to consider whether the firm has acted in accordance with the duty of good faith owed relating to the planned departure, and also whether their selection over colleagues may have been influenced by any element of unlawful discrimination, including sex, age, race, disability, sexual orientation, religion or belief. Bear in mind that the partner will normally only have three months from the act of discrimination to bring a claim to the employment tribunal. The partner will need to act quickly if they wish to raise this as an issue, and to submit a discrimination questionnaire and/or a 'subject access request' to obtain more information and documentation regarding selection. Often neither the partner nor senior management are sufficiently aware of these issues and the tight timescales that apply. Occasionally this can have a dramatic effect on negotiations.

Exiting partners will also need to consider whether departure is the only option. As indicated, there may be other alternatives, which can, and should, be suggested to the firm.

If the partner is in discussions with their firm regarding the terms of an exit agreement, there are a number of key commercial areas on which they may want to focus, including early return (or repayment to the bank) of capital, early release of tax reserve and acceleration of outstanding profit share payment – possibly with an agreement to fix the amount of profit share to provide certainty for the partner and an incentive to agree to early exit.

In negotiations, the partner should request that any drawings and profit share received to date are theirs to keep, and cannot be subject to any subsequent demand from the firm to return money if a hole is later found in the accounts. They may also request the right to participate in release of bad debt/liability provisions in the accounts if they are eventually distributed to partners.

Restrictive covenants are more likely to be binding on partners than employees, as the firm is asking the partner to

leave because it no longer needs their services. The partner will ask for any restrictions to be waived, or at least varied, to improve their prospects of securing a role at another firm. The firm should think carefully about the extent to which it needs, and wishes, to enforce restrictions, and what it can offer in this regard in negotiations to encourage early settlement.

Agreement should also be sought on the content and timings of internal and external announcements, including to clients, and to agree the terms of a reference. If senior management gives thought to, and prepares, helpful drafts in advance of opening discussions with the partner, this can go a long way to speeding up exit negotiations. Including confidentiality and mutual non-disparagement provisions in the draft agreement are usually advisable too.

Consideration should also be given to the extent to which the exiting partner is protected from liabilities as a partner in the firm. For example, they may be an LLP member now (which gives some significant protections), but if they were previously, pre-LLP conversion, a partner in the general partnership, the partner will need to understand, preserve and, if necessary, seek to extend indemnities against any remaining liabilities. They will also usually request their prompt release on departure from, and indemnity against, any personal liabilities incurred as a partner or LLP member, such as in relation to

overdrafts, other bank borrowings, directorships of service companies and premises, and so on.

A mutual waiver of claims is often appropriate as far as possible, and an exiting partner will normally request that the firm covers their legal (and any other professional fees) in full. Certain firms have an agreed budget identified in advance for the benefit of exiting partners so they have, and are seen to have had, the benefit of expert advice in their exit negotiations, and have not faced the might of the firm and its greater resources alone and unsupported.

Of course, there may be additional requests from individual partners in negotiations, but a little forward planning by senior management, to take account of the needs of the firm, and also the rights and likely expectations of individual partners, is likely to ease the burden and result in a better solution for all. ■



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