



PROFESSIONAL PRACTICES ALLIANCE SEMINAR REPORT

SUCCESSION PLANNING FOR LAW FIRMS

Introduction

1. *“It is a bit like bereavement in that you need time to work out that there is life after work”*; according to one audience member at the Professional Practices Alliance’s interactive breakfast seminar on Partnership Succession Planning on 4 October 2016. Sitting on the panel were: Laurie Adams of Outside Insight, Clare Murray of CM Murray LLP, Alastair McQuater of Buzzacott LLP and Richard Turnor of Maurice Turnor Gardner LLP (as panel chair).
2. This seminar addressed key issues arising during the life cycle of a partner from succession to leadership positions through to retirement from the firm and post-retirement planning. The seminar focused broadly on developing a succession plan, supporting the next generation leaders, preparing for retirement and the financial aspects for the firm and the departing partner.
3. This report summarises key areas of discussion which took place during the seminar.

Preparation for leadership positions

4. In Laurie Adams’ view the key ingredients to effective leadership appointments are well-defined appointment processes, skills development and professional coaching. Laurie Adams led the discussion on how law firms can prepare individuals for leadership positions and finds that the most

effective way to identify and prepare future leaders is by adopting rigorous internal processes. This could involve, for example, a nominations committee responsible for selecting potential candidates, defined criteria for identifying candidates who possess the right skills, regular and open dialogue with partners, and importantly, support from the firm's senior management and HR function.

5. Preparations for leadership appointments (including identifying and training potential leaders) should start as early as possible in a person's career and ideally around the senior associate level onwards. It is essential that those identified as potential leaders do in fact desire such positions; open dialogue with senior associates and partners about their future plans in the firm should form an integral part of the overall process.
6. A nominations committee (analogous to a sub-committee of a board of directors) should have the necessary authority and the backing of senior management in order for the process to hold substance; it would be a fruitless exercise if decisions of the nominations committee could simply be disregarded or set aside by the firm's management or partnership council.
7. Firms should acknowledge that leadership skills do not necessarily come naturally to all. Those who are identified as potential leaders should receive training and professional coaching with the firm's support, tailored depending on the type of leadership role they want.
8. Firms should also discuss with candidates the prospect of not being elected, on an open and frank basis, and strive to understand what candidates consider their potential options to be in such circumstances (including, for example, whether they would want to work in a different capacity, or leave the firm and find other opportunities externally). This allows the firm to best manage any potential fall-out, particularly in contested election scenarios.

The handover process

9. There are going to be potential difficulties in encouraging departing leaders to cooperate in a handover process. It was suggested that the best way to deal with this is again through open dialogue and, to the extent possible, to have an agreed handover process in advance and over a number of years. Firms may need to incentivise a departing leader to cooperate but should be transparent in its dealings with individual partners.

The younger generation

10. Traditionally senior management will be made up of older generation lawyers and law firms may hesitate or struggle to encourage younger generations to seek out leadership and management positions.
11. Law firms should appreciate that there are differences in attitudes and career motivations across the generational spectrum. Recent studies have shown that millennial lawyers are not driven by traditional motivators such as high pay or status and instead prioritise a work-life balance¹. Firms should consider introducing specific initiatives aimed at engaging younger generation lawyers in business management. One panellist observed that in this digital age, traditional management styles are not always preferable; it was suggested that in theory there are now less hierarchical structures and a firm's processes generally and specifically in respect of succession planning, should account for the intergenerational context in which it operates.
12. An audience member discussed his firm's experience and the concerns raised by younger generation lawyers in relation to reintegration back from management positions, and suggested that firms should address these issues again with clear and effective processes dealing with the transition back from leadership positions.

¹ <https://www.ft.com/content/667cd618-5f0f-11e6-ae3f-77baadeb1c93>

Preparing for life after partnership

13. *“Some partners become so institutionalised after years in partnership that they need help with how they are going to be useful post-partnership”*. It is never too early to start thinking about life after partnership and firms should provide support to partners in this regard. Preparation should begin well in advance of proposed retirement, with suggestions from the panel and audience members ranging from 2 years to a decade in advance.

A partner’s perspective

14. Early preparation and open dialogue is mutually beneficial to the individual partner and the firm. Partners will need time to consider their options, particularly where they have had long careers exclusively in legal practice.

15. Lawyers may need to refine or repackage their skill set depending on the post-partnership role sought, which may not necessarily require technical legal skills. It was recommended that law firm leaders consider receiving coaching on how to adapt their skills for non-legal careers (for example non-executive positions or positions in risk and compliance) or taking refresher courses in areas in which they may not have rich experience as a practising solicitor.

16. The first step is to recognise where you start from as a lawyer from a recruitment perspective, and understand what skills you already possess and which you may need to redevelop. Partners can also consider taking on part time or non-executive roles, perhaps in the not for profit sector, whilst still practising law in order to gain experience.

The firm’s perspective

17. From the firm’s perspective, early discussions about retirement and potentially agreeing a retirement date will help minimise issues which often arise with partners who stay on for too long and effectively bar junior

colleagues from reaching leadership positions. Firms should support partners in retirement planning, including by providing access to professional careers coaching and firms may wish to consider providing incentives on exit for a retiring partner's early notice of retirement.

18. Alastair McQuater spoke of his experience with one of his firm's most successful partner retirements which involved over two years' advance planning and practical financial recognition of his early notice by the remuneration committee.
19. Arguably being a good citizen and doing what is best for the firm even on exit is an integral part of being a leader. Whilst this is an admirable concept, in practice, for many partners there is little correlation between the contribution they have made in being a good citizen and the recognition they receive on their exit. Indeed Clare Murray finds, from experience in advising exiting partners, that it is often those individuals who strive to be good citizens, who then find they are most vulnerable on exit.
20. One panellist suggested that firms could define what it means to be a good citizen and build it into the appraisal process so there is practical recognition for it. However in reality there are difficulties with this idea since it remains the case that appraisal systems in law firms are based primarily on financial performance.
21. One audience member highlighted the distinction between leaving the business financially in terms of ownership and leaving the business but continuing to work in some other capacity, for example engaged by the firm on a consultancy basis (it was noted that this is common practice in the US). although it is recommended that firms and partners plan well in advance for a partner's retirement, a partner will not want to discuss publicly that they are going to be retiring years in advance given the obvious detrimental effect this would have on client relationships and referral prospects.

22. In some circumstances firms take the view that it does not make commercial sense to force a partner to retire where he or she is still performing well. There are tensions however with the extent to which allowing older generation partners to stay on because they hold key client relationships and still generate a sizeable income for the firm prevents associates from taking on those client relationships. On the other hand it was acknowledged that associates should be building their own portfolios as well.

Risks and pitfalls

23. Clare Murray led the discussion on the potential risks and pitfalls as firms train and appoint new leaders and prepare for succession, from a partnership and discrimination law perspective. Under English law there are a number of potential grounds of unlawful discrimination; the main risks in succession planning scenarios relate to age and/or sex discrimination (without limitation). Compensation for successful discrimination claims is uncapped and based on actual financial losses resulting from the unlawful conduct (subject to the claimant's duty to mitigate his or her losses), which means they can be significant and expensive risks for law firms. Such claims can also be potentially damaging from a reputational perspective. Nevertheless, the current case law² suggests that individual partners have struggled to successfully claim discrimination (on the grounds of age in these cases) where firms have been able (with appropriate documentation) to objectively justify internal policies and decision-making on partner retirement as a proportionate means to achieving a legitimate aim of the firm.

24. By way of example, there are risks of age discrimination in respect of the operation of a mandatory partner retirement age, or in circumstances where a partner believes they have missed out on promotion opportunities (or suffered some other form of less favourable treatment, for example, in terms of their access to certain benefits) in favour of a younger partner.

² See for example *Seldon v Clarkson, Wright and Jakes*; and *Fennell v Foot Anstey LLP*

25. Age discrimination claims can be defended if the firm can show that the treatment is a necessary means of achieving an objective and reasonable legitimate business need. For example, intergenerational fairness and improving poor associate retention rates could potentially amount to legitimate business needs, provided they are implemented through objective procedures and in a manner which is proportionate to the business need.
26. Sex discrimination in a partnership context often involves female partners who may struggle to get on to the succession pipeline because barriers they face when returning from maternity leave and in relation to childcare commitments generally³. Often the age that solicitors are generally expected to reach equity partnership coincides with mid to late thirties, the age at which many female lawyers start a family; some thereafter struggle to progress past fixed share partnership to full equity partnership. Female partners returning from maternity leave will sometimes find that the clients that they passed to colleagues for the period of their maternity leave are not returned to them and as a result are faced with the prospect of having to rebuild their practice after each maternity leave. When this is combined with a period of part-time or other flexible working for childcare reasons, it can be challenging for those female partners to rebuild their practice and billings to the required level, particularly if they do not have sufficient support to do so. It can result in their not progressing further in the partnership, and potentially being targeted for perceived underperformance and eventual exit.
27. Firms should consider introducing proactive initiatives and policies dealing specifically with female partners returning from maternity leave and integrating this into the firm's cultural objectives. Such initiatives could

³ The PPA discussed barriers some female partners face on return from maternity leave in the context of introducing female quotas at law firms, at the seminar on Female Quotas on 23 March 2016. You can read the full report here: <http://www.professionalpracticesalliance.com/news-events/2016/09/28/female-partner-quotas-for-law-firms-seminar-report/>

include for example, internal training for senior management and heads of Department on how to support and motivate partners on and returning from maternity leave, and also working flexibly for childcare purposes. They may consider tying the allocation of merit based profit share for heads of Department to their success in retaining and promoting female partners who take maternity leave, and any partners who work flexibly or take leave for childcare purposes. There are a number of firms which have particularly useful programs in that regard already in place.

28. There are though many situations of genuine partner underperformance where the firm unfortunately leaves itself exposed to potential allegations of discrimination, and significant risk, by creating a vacuum of evidence. Often there are no procedures or policies in place dealing with partner performance (or indeed conduct) management and partners will be faced with a conversation about their exit seemingly on performance grounds out of the blue. It is therefore important that clear and objective policies and procedures, including performance management procedures, are adopted and that there is a clear paper trail documenting the objective business reasons for the firm's decisions. This will put the firm in a stronger position to be able to defend, as far as possible, against any related unlawful discrimination complaint.

Financial consequences and considerations

29. Alastair McQuater headed the discussion on the financial aspects relating to and arising from succession planning. Alastair discussed in overview the ownership model in place at Buzzacott LLP in which partners buy and sell interests in the firm from an absolute number of shares. When admitting a new partner, or increasing ownership of an existing partner, a committee of partners (which changes annually) must decide whether to dilute an individual member's interest (for example if a member has underperformed) or to dilute interests across the board. This model has allowed members to

realise some or all of their value in the firm when they may not be performing as well as they used to or when they retire.

30. The panel discussed the concept of goodwill in the context of law firm succession planning. Whether or not the value of goodwill is recognised in your firm, particularly for smaller firms, will depend partly on the extent to which a sustainable practice, recurring income and client relationships remain after the founding partner retires. For example, in circumstances where client relationships of an outgoing partner migrate to senior associates or other partners once they have left, there can be said to be goodwill in what they have developed. It is important, particularly for smaller firms, to be conscious of these issues and the need to build a practice past the original founder's name as part of succession planning generally.

Financial issues for partners

31. The panel discussed financial issues for individual partners including payments for goodwill and tax treatment of those on retirement. In circumstances where a buyer agrees to pay a sum for the goodwill attributed to an exiting partner, that exiting partner (the seller) will likely qualify for entrepreneurs' relief if they have been a partner for more than a year. The acquiring partner(s) will purchase goodwill as a capital asset. The expectation is that the acquiring partner is buying into the firm for the long term with the idea that they get a return on their purchase in the future.
32. Alastair discussed issues with partners failing to save enough money on retirement and how being made partner (and the often associated increase in remuneration) may affect the level of savings on which they are able to save tax efficiently through a pension. There can also be issues where firms do not encourage partners to save for their pensions and sometimes that can lead to partners failing to make adequate provision for retirement.

Financial issues for the firm

33. Whether an outgoing partner leaves the firm as a good leaver or a bad leaver can potentially affect the basis on which they are paid on exit. Often firms will withhold a partner's balances as a tool in holding a partner to their restrictive covenants.
34. Payments in respect of goodwill and retirement annuity payments have different advantages and disadvantages. While entrepreneurs' relief is available for goodwill sales, the payment is not deductible for income tax purposes, unlike annuities. However, annuities give rise to an accounting issue because the capitalised negative value of the obligation may appear on the firm's balance sheet, arguably even if it is structured as a personal liability of the continuing partners.
35. It is also important that law firms prepare for partner retirement to avoid cash-flow issues in terms of withdrawal of capital and undistributed profit share. Firms should consider repaying capital in tranches over an extended period of time as opposed to one lump sum and when new partners join and contribute capital, this gives the firm a cash-flow benefit.
36. In terms of undistributed profit share it will depend on the profit share arrangement in place at the firm. Where partners leave undrawn profits credited to their current account, in order to fund the firm, the issues can be particularly acute. At its most extreme, this can create an imbalance of risk between the partners as undrawn profits may effectively rank alongside partner capital in a winding up. To avoid this imbalance in situations where working capital is an issue for firms then they should consider asking partners to increase their capital contributions in an evenhanded way (i.e. equally or in proportion to ownership/points) whilst allowing partners to draw their profit shares.

Third party successors

37. The panel discussed situations in which there were no internal successors and the firm is forced to look externally for a willing buyer (often indicating that there is not much value in the goodwill). Generally selling the business to a third party is considered a last resort.
38. However there have been situations in which selling the business to a third party has been successful provided there are sufficient protections built in to the arrangement to preserve the firm, for example, in terms of earn-out arrangements and restrictive covenants on the selling partner(s).

Conclusion

39. It is often the case that considerable time and money is spent attracting partners to the firm but comparatively less attention is given to financial and organisational planning for partner retirement, leaving both parties exposed to various risks in exit scenarios.
40. The seminar highlighted the importance of early preparation, and open and honest discussion as part of the succession planning process and in mitigating such risks, both from the firm's and the individual partner's perspectives, which ultimately best serves the client who will benefit from effective and efficient law firm leadership.

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