



The following is another topic in a series of articles on a practical as well as workable approach to managing a law practice for economic gain while still avoiding professional liability claims and other security risks.

Partnership Succession and Compensation Planning

There are few issues which are more difficult to address than that of the succession of partners or shareholders in a law firm. For an older and more senior lawyer, dealing with succession in the law firm context is not unlike making out a will. It's an acknowledgment of mortality and an understanding that what has been commonplace for 30, 40 or even 50 years is coming to an end. For the firm itself, it's sometimes literally a question of survivability. Can the entity go on after the progenitors of the firm have resigned/terminated their interest? The subject matter is so difficult and complicated that few firms accomplish much in terms of planning for succession. This column can only scratch the surface of some of the questions which have to be answered.

What's Involved?

The existing partners/shareholders have provided a degree of capital, management and leadership to the firm. If they wish for the firm to continue (and not all of them may have that desire), they must ensure that those elements will be provided for in the firm of the future. Those who may succeed must not only be qualified (experienced, entrepreneurial and capable as leaders) but they must have the skills necessary to maintain the existing client base, bring in new work and attract and retain quality in lawyers and in staff. There are many examples in law firms where the senior partners or shareholders wanted the firm to continue but where the less senior partner/shareholders simply did not have the ability, experience or the intangibles necessary to perpetuate the entity. These are circumstances where the possibilities include the firm merging with another firm and/or one practice subsumed to another. There are also circumstances where the firm simply comes to an end; it is wound up and dissolved and existing lawyers who want to continue

to practice must find another entity. There are circumstances where a firm will bring in a leader or a group of lateral hires to whom the secession may be made. There are any number of alternatives.

There is no substitute for planning well in advance. To plan for succession, however, means understanding the firm: its marketability, its finances and its potential for future success. Not everyone has the ability to objectively measure and understand what their firm is really all about. For many lawyers, grappling with the issues involved with succession can be the first time that they actually address the realities of their practice. This can be a very hard and difficult undertaking. Many if not most law firms have issues which had been comfortably swept under the rug for decades. Everyone in the firm may know that certain senior partners have not carried their weight for years. Because of friendships and even close family ties, these lawyers have remained in the practice and their remuneration has probably increased. When the issue of succession is placed on the table those kinds of very personal questions can make or break the ensuing discussion. If the law firm is serious about wanting to plan for succession it must also accede to the realization that things will simply not be as they have been. The practice will change. The lawyers involved will change and the power structure which has existed (for what could have been decades) will be altered. Planning, therefore, includes this realization. Many firms reach this point and never go any further for fear of the realities involved.

Hard Decisions

The truth is that succession most often devolves into issues related to compensation in one way or another. That in turn relates to the new pecking order, the weight given to new, versus existing clients and certainly the ability of members of the firm to maintain the client relationships and so, retain the business. How does work which has been managed for thirty years (and for which perhaps only one lawyer or a small cadre of lawyers have benefitted) become "firm" business and transferred over to other lawyer(s)? Who benefits? How is the compensation to be handled? Often times the senior lawyer who commands the business has maintained that cadre and those are the lawyers who have accomplished much of the work. Those individuals who find themselves at the right place, at right time, inherit the client as well as some or all of the accompanying compensation. As a corollary to that "inheritance", since the amounts billed in a law firm often tend to determine a degree of hegemony and status, the inheritance includes a greater say in the operation of the firm. In effect, in this context,

compensation equates to different roles and additional control not just of the clients but also of the firm's actual operation. That is one of the reasons that succession, if not managed properly, ends up with lawyers' departures, firm fractures and sometimes actual dissolution. Succession planning should therefore be seen as to a large extent compensation planning and long term strategic planning as well. For that reason, smart firms see the issues as a whole and come to the realization that since (unhappily) nobody lives forever, questions related to compensation need to be put to bed before the departure of a senior lawyer rather than during or after. How can that process be managed to the betterment of the entity?

Altering Formulas

The first step is to evaluate the practice, the clients and the methods by which compensation is derived. For small and medium sized practices (defined as 15-40 lawyers) generally, 10% of the lawyers will often generate 80-90% of the business and new business generally comes in the form of new matters spun off from the primary client rather than new clients developed by lawyers other than those who maintain the larger client bases. In order to try and change those circumstances it is necessary to first have a plan or strategy in place. That strategy is determined by the strengths and/or weaknesses of the lawyers in the firm. A firm of litigators, for example, may wish to target other practice areas which are a corollary of the existing client base. Litigation for insurers is relatively fungible. Experienced complex litigation is remarkably similar in many different types of litigation including intellectual property, land use, pharmaceutical and several other arenas. A firm of litigators can therefore target those other areas in order to broaden the marketing base and expand the practice so that a greater percentage of lawyers are involved in developing those new practice areas. Oftentimes, that may include non equity owners who will appropriately see the opportunities in that development and put their energies into marketing to those areas. That being a set target, the firm must then provide a compensation program which properly rewards the new business. Generally speaking, that will involve setting out rewards which may be in some cases heavily weighted (at least for a time) toward new business development in these alternative practice areas. One client firm actually termed these as "bounties" for such business getting. Others have simply continued with the idea that a certain percentage of net profit is utilized to in a sense "over compensate" for these efforts. A system which is less formulaic is sometimes easier to alter than those with set formulas which require an entirely new structure in order for change to take place.

Conclusion

The client here is the ongoing law firm entity, not necessarily the principals or associates of the existing firm. Questions involving the evaluation and valuation of client business, questions involving the survivability of the entity and questions involving the structural requirements of the new entity are all matters which have to be addressed and laid to rest. It's difficult enough for the firm to go to the conclusion that they must address the question of succession. For most, handling these issues themselves, internally, means that they are never addressed in a manner consistent with a plan and positive outcome. After all, succession, at the end of the day, will eventually and inevitably take care of itself for good or ill. Not addressing the issues involved is effectively making a decision. Handling the circumstances in terms more favorable to an ongoing entity, and allowing that entity the opportunity at least to continue and hopefully prosper, is what *planning* for succession and compensation is really all about.

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