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Firms Make It Hard for Partners to Say Goodbye

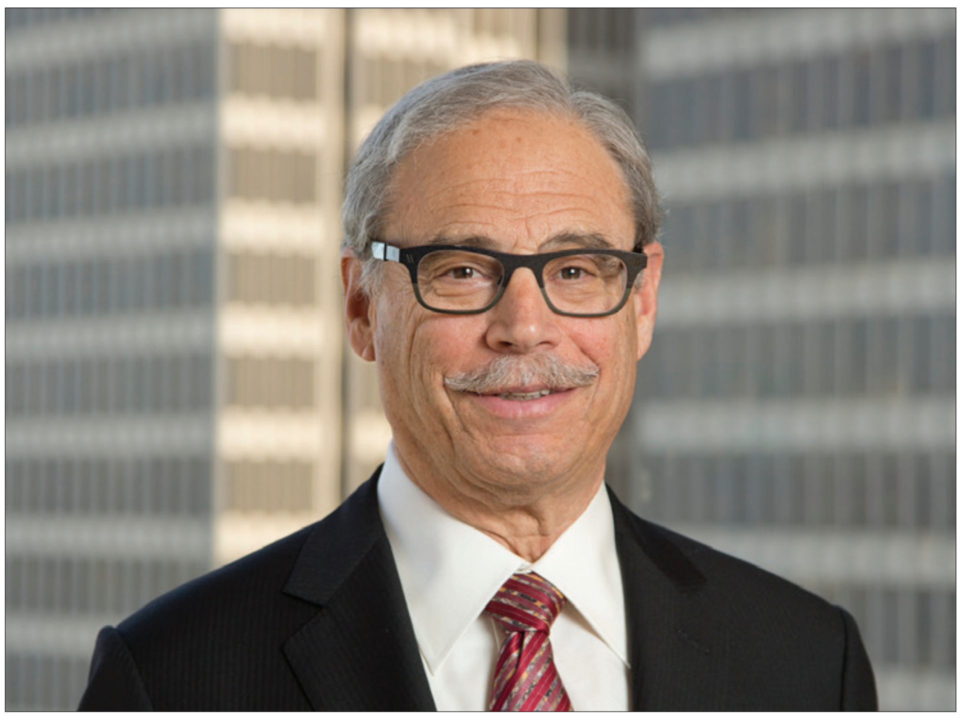
Quitting a law firm partnership can feel like leaping over a pit while dodging a swinging razorblade: Tricky.

By Patience Haggin

Joel Zeldin, who represents partners extricating themselves from law firm partnership agreements, had one client who needed to remain a partner until the last day of the fiscal year in order to receive a share of that year's profits. But the partnership agreement required 60 days' notice, and only permitted resignations on the last day of a month.

This left exactly one day in the calendar year Zeldin's client could quit with a minimal penalty. It fell on a Sunday. And he had to give notice to a specific person, in another city. In writing.

Breaking up is never easy, but Zeldin and others with a close eye on the lateral market see signs that more firms are playing hardball—either to deter moves, punish the movers, protect the firm from the financial hit that can come when partners move en masse—or simply to get more leverage in exit negotiations. Law firm partnership agreements increasingly contain a web of terms that can act like a silver seatbelt, making it difficult, and sometimes very costly, for a partner to move.



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Joel Zeldin, Shartsis Friese partner

"Often very sophisticated lawyers can't figure out what they're supposed to do from their own law firm's partnership agreement," said Zeldin, a partner at San Francisco boutique Shartsis Friese.

It would help if they read it, of course. Legal recruiter Larry Watanabe of Watanabe Nason said 90 percent of the partners he works with have never read their partnership agreements—which can be as long and dry as a phone book.

Weil, Gotshal & Manges, which saw about 37 partners depart last year, including a mass defection in Dallas, is taking longer to repay capital contributions, according to former partners. They say the firm used to return all funds in five years, but is now taking the full 10 allowed for under its partnership agreement. Weil Gotshal representatives declined to comment.

O'Melveny & Myers, which saw some 20 partners depart last year, including a high-profile group in Century City, amended its partnership agreement in December so that all money owed to departed partners is paid out at six months. A former partner said most of the money owed used to come at three months. Still, six months is sooner than most firms.

An O'Melveny spokesperson said the change was part of "a comprehensive rewrite of our decades-old partnership agreement that contained many hundreds of updates and clarifications."

Other firms are holding partners to notice provisions. Squire Patton Boggs held white-collar litigator Robert Luskin—said to have a $20 million book of business—to its full 60-day holding period before freeing him for Paul Hastings last month, *The American Lawyer* reported. Kasowitz Benson Torres & Friedman held Douglas Lumish and the rest of his IP litigation team for 89 days before they lateralled to Latham & Watkins in 2013.

Recruiter Valerie Fontaine of Seltzer Fontaine Beckwith said she once had a candidate who accepted a position and then had to wait six months before he could move.

Other partners can't get out fast enough.

"I always advise my candidates to be ready to be escorted out the door when they give notice," Fontaine said.

HARD BARGAINING

Giving notice can be just the beginning. Notice periods and timetables for payout of earned profits and paid-in capital are subject to management discretion, and often become bargaining chips.

Firm managers may want leverage since they'll need the partner's cooperation in collecting outstanding client bills, Zeldin said.

Arnold & Porter partner Jonathan Hughes warned that a partner withholding cooperation could get into shaky legal territory. While a partner of the old firm, the partner has a fiduciary duty to help collect bills.

"A threat to not cooperate while the partner is still at the firm is a dangerous threat, and normally would be ill-advised," warned Hughes, a litigator who represents law firms and attorneys. "That's the kind of thing that will give the old firm the ability to argue that the lawyer did some wrongdoing in his leaving."

Firms are also known to demand fees from bills that clients will pay the partner's new firm down the line.

"Firms try to require fee-sharing whether or not it's properly characterized as 'unfinished business,'" said Robert Hillman, a professor at the University of California Davis School of Law who has written a book about partner mobility.

Wrangling over fee schemes, or over which clients a partner will take, has been a staple of departure negotiations. But a court decision from last year has led some firms to cede ground. Unfinished business claims, blessed by a 1984 California First District Court of Appeal ruling in *Jewel v. Boxer,* have permitted failed law firms such as Howrey and Heller Ehrman to recover profits from client matters that partners take with them to new firms. But in June U.S. District Judge Charles Breyer of the Northern District of California rejected the Heller Ehrman bankruptcy estate's claims to such fees.

"A law firm—and its attorneys—do not own matters on which they perform their legal services," Breyer wrote. "Their clients do." The matter has been appealed to the Ninth Circuit.

Breyer's ruling has given partners a stronger bargaining position when it comes to client matters. Zeldin said a partner he advised a few months ago used it to fend off a fight over whether he could take a major client.

"We started citing Judge Breyer's opinion, and that [dispute] faded into the woodwork, and the departing partner took the client without incident," Zeldin said.

Negotiations can get emotional, Hughes said. "These are business divorces. Both sides feel like promises were made, but not kept. There can be feelings of betrayal."

Edwin Reeser, who represents departing partners as part of his Los Angeles solo practice, said both sides have reason to keep negotiations simple and civil. "This is not the bazaar where we're negotiating over a rug," Reeser said. "If they start to get into a pissing match, it's going to hurt everybody."

CASHING OUT

Capital repayment is one aspect of partner departures that is less negotiable.

A three-year payback schedule, like that used by Pillsbury Winthrop Shaw Pittman, is becoming typical, recruiters and consultants said. Pillsbury, which saw 11 partners decamp to Winston & Strawn last month, pays back capital in three annual installments, beginning the first anniversary of a partner's departure. A spokesperson for Pillsbury declined to comment.

But there are provisions that can slow down distributions even further. To avoid letting a mass departure tip them into insolvency, some firms have added clauses allowing them to defer or stretch out repayment of capital under certain conditions. More common, Hughes said, is a clause stating that the firm can never spend more than X-percent of its income on return of capital in a given year, triggering deferments in a year where many partners are leaving.

For a departing partner, slow payback can be a minor nuisance—or a major one, if a partner needs to fork over capital to a new firm. Some lucky partners join firms that allow them to earn their capital contribution over time, or allow them to delay contributing until they until get all their cash from the old firm. Others take out a loan.

But nothing stings more than not getting your money back at all. The penalties partners most resent take a bite out of the payouts owed to departing partners. One of the most common versions of this penalizes partners who leave during the first quarter, while firms often run a loss, and have to borrow to pay salaries and draws. If a partner leaves while the firm is still running a loss, the partner is often required to repay whatever share of her draw was borrowed.

SENDING A MESSAGE

Of course, whether and how much of the prior year's profits are paid out can depend on when you leave. Loeb & Loeb stretches out its profit distribution over the course of the year, so payouts for 2014 profits are paid in February, April, June and September of 2015, according to a former partner. If you leave before the date of the distribution, the money gets rolled over into your capital account—and you may not see it for awhile.

In acrimonious exits, Hughes said firms often accuse a departing partner of damaging the firm and claim a chunk of money that would otherwise be owed. Experts said these penalties can help a firm keep its financial house stable when a group leaves, but it's not clear they're effective deterrents. Reeser said he's never worked with a client who shied away from quitting because of the penalties a firm imposed.

Law firm consultant Kent Zimmermann of the Zeughauser Group recommends that firms invest in a platform that motivates partners to stay, rather than punishing those who leave.

"If you need to play a game of cat and mouse that leads to a game of gotcha, then you need to ask yourself if your firm is not as sticky as it should be," Zimmermann said. "You end up leaving a trail of disgruntled partners in your wake that may do that firm harm when they leave by speaking ill of the firm to reporters and other talent and clients."

Then again, he allowed, "sometimes firms get screwed and really should fight,"

Group exits are dicey because the fiduciary duty the partner owes to the firm would seemingly forbid recruiting other partners or associates before resigning. Sometimes the penalties meted out aren't about deterrence, or fiscal prudence, but about exacting revenge.

"This is horrible but it's true: it's a means of being able to make a bloody mess of someone who's misbehaved in front of all the other partners," Reeser said.

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