Benefits of Law Firm Partnerships
Other Ownership Options
Other Partnership Matters

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The Evolution (Life Cycle) of a Law Firm

All businesses go through a business life cycle. Law firms do as well and go through a typical evolutionary pattern. Thinking about the evolutionary patters will help you address questions such as:

1. How quickly and how much will the firm grow?
2. How will the firm be lead and managed during various phases?
3. What provisions should the partnership agreement include to address the admission of new partners or the division and distribution and assets if and when the firm ultimately dissolves?

The evolution of a law firm generally includes the following phases:

Early Existence

This phase can be compared to our preteen years. It is the period in which the firm grows quickly and learns its early organizational lessons. It is guided and nurtured by the founders, who are also the rainmakers, the persons providing new clients. New lawyers and other staff members are hired to serve the growing needs of the new clients and of the firm. Lawyer compensation is usually based on seniority. During this period, support systems and the firm’s culture are fine-tuned.

Gaining Momentum

This phase is often referred to the teenage years. It, too, is a period of growth and learning as well as growing profits. Growth often depends on the founders and, possibly, on a few other lawyers. At the same time, the lawyers (particularly the rainmakers) who joined the firm during its early existence experience growing independence. Thus, this period frequently leads to an organization and resembles a group of individual practitioners merely sharing space, rather than a true firm. The compensation and professional advancement systems often emphasize securing new work (net fees) even if that work does not produce an adequate profit or is outside the mainstream of the practice (an eat-what-you-kill system). As a result, this period taxes the leadership skills of the founders or their successors.

Stagnation

This phase can occur at any time before the maturity phase if (1) the founders retire or phase out without adequately planning for succession, or (2) the founders fail to exercise the leadership skills necessary to bind together the firm members into a cohesive, team-orientated unit.

This phase is typically marked by an emphasis on personal production, a lack of teamwork, flat or declining profits, and growing lawyer and staff dissatisfaction. It is a period of organizational dysfunction.

There are two paths out of this phase, if it should occur: reentry into the gaining-momentum phase (usually the result of strong leadership emerging from inside the firm, from lateral admission, or from a merger), or entry into the losing-momentum phase.

Maturity

This phase is marked by normal growth, teamwork, solid leadership, and reasonable profits. There is a balanced emphasis on the needs of all the firm's constituents.

This period has two key characteristics. First, clients are firm clients, not clients of individual lawyers. Second, the firm's compensation system rewards all lawyers on their overall contribution to the firm, not just their chargeable hours or fees managed.

Firms can stay in this phase for many years or they can move into two other phases – slipping backward into the stagnation phase or returning to the gaining-momentum phase.

Returning to the gaining-momentum phase often results from substantial economic growth similar to that experienced in the 1980s. Strong leadership will focus this growth on profitable, mainstream work, which will lead the firm back into the maturity phase. Weak leadership will result in less-than profitable work outside the mainstream of the firm's practice, which leads to the losing-momentum phase.

Losing Momentum

Entering this phase is not a happy prospect (unless a joint decision to enter this phase has been consciously made). The losing-momentum phase is typically preceded by a long stagnation phase. It is characterized by the loss of key lawyers (taking with them key clients), declining profits, and bickering over how to divide the shrinking pie.

If this phase continues too long, the firm will slide into the demise phase. But if strong leadership emerges, the firm could return to the gaining-momentum phase. It could also hold on a little while longer in a stagnation phase if the remaining stakeholders decide to stick together in hope of finding a new leader or of being saved by substantial economic growth.

Demise

This is a period of, one hopes, dignified and orderly shutdown. If there is a lot of animosity among the remaining stakeholders, dignity and order may not be possible. If so, it is time to call in an outsider to oversee the funeral of the firm.

Benefits of Partnership (And Other Ownership Options)

Can a law firm offer its lawyers a measure of value independent of the skills, talents, and contributions of its partners? The answer can only be answered by recalling the advantages that the best law firms have over sole practitioners or groups of lawyers who share overhead and nothing more. These advantages include the following:

- Shared skills and expertise
- Backup or additional help when needed
- A safety net during economic downturns
- Shared resources, such as technology, library and research access, forms, and work products
- Cross-selling and/or referral of work
- Access to the expertise of lawyers in various disciplines
- Highly trained associates, legal assistants, and support staff
- A firm name or reputation that makes marketing easier
- More-sophisticated and highly skilled management
- Opportunities for individual lawyers to become highly specialized
- A system of partner coaching that brings out the best in each partner
- Emotional support, encouragement, and personal recognition
- Flexibility that allows lawyers to be more involved in probono, community, and bar activities
- Continuation of the firm beyond the tenure of the current owners

Expectations That Partners Should Have & Advantages of Equity Partnership

P – Participation in equity, primary in excess profits (reward for individual contribution return on capital, and share of profits.
A – Certain level of autonomy
R – Right to become a part of the decision-making process
T – Tenure – to some degree, although in today’s world this may not always be possible.
N – Net income increase in the long term, usually – although I have seen situations where associates more money than younger partners.
E – External status and recognition.
R – Recognition among one’s peer group, which is very important to lawyers.

However, sometimes a partner gets:

1. Missed pay checks
2. Large capital contributions
3. Guarantor on huge firm debt balances

Characteristics of Successful Firms

While law firm take many different paths, successful firms typically have many of the following characteristics:

- Focused Lawyers
- Commitment to Quality
- Collegiality and Esprit de Corps
- Loyalty
- Leadership
- Accountability
- Shared Financial Rewards
- Sense of Fairness
- Willingness to Place the Interests of the Firm First
- Understanding of Where the Firm is Going
- Progressive Attitude and Spirit
- Client-Driven Decision Making
- Clear and Positive Culture
- Diversity

A group of lawyers becomes a firm to the extent there is some sense of common purpose, approach, and values. The lawyers in a firm must be willing to help each other out in the many small ways that are the essence of a legal practice – they must assist, support, encourage, and cooperate with each other.

This does not mean that everyone is the best of friends. However, unless the firm is more than a compensation arrangement, it is doomed to have many problems and defections.

As a person looking to build and maintain an effective law firm you must provide the glue that holds the firm together. As a leader, you must establish and maintain the characteristics of a successful law firm, this giving lawyers of your firm every opportunity to excel professionally and personally, as a group and as individuals.

Does the firm want to be a firm or a group of lone rangers?

Firm First vs. Lone Rangers

Firm First Firms – No Room For Mavericks

Partnership Management Structures

The partnership agreement should describe how the firm will be managed. There is no best way to manage a law firm. The appropriate structure is one that works best at a given time in a firm's life. The management structure should be part of the partnership agreement. It is prudent, however, to have management duties and roles described in an office procedures manual or some other written document. The failure to define management structure and roles can lead to misunderstanding, lack of accountability, weak management, and general confusion.

The following are some of the most common management structures found in law firms:

- Benevolent Dictator
- Executive Committee
- Committee of the Whole, or Rule by All
- Managing Partner/Practice Group Leaders assisted by a Director of Administration

Voting

1. *Per capita*, or one person, one vote.
2. *By interest*, which weighs individual votes based on capital, business, experience or compensation.
3. *A combination of the two.* Typically, a combination is used for significant decisions, such as whether to merge. Weighted voting is often destructive in smaller firms. One alternative is to require supermajority votes on significant issues, such as a merger, partnership admission or expulsion, and liquidation of the firm. It should be noted however, that the most effective management is through consensus, not voting.

Income-Sharing Determinations (Who Decides)

Various approaches

1. The benevolent dictator approach
2. The committee-as-a-whole approach
3. The allocation committee approach
4. The executive/management committee approach
5. The formula approach

Capital

Who owns the firm's assets? Investment in WIP/A/R? Various approaches:

1. Ignore it
2. Have new partners buy into the firm

3. Have new partners earn an interest over a period of time. (No interest in WIP and A/R that existed prior to admission) The new partner then earns an interest in the increase or decrease either as it occurs or as that partner is vested over a period of time, say five to ten years.

These issues are further compounded if there is a significant amount of contingency fee work performed and/or unpaid over several years.

Documenting Decisions

Ownership issues of a general nature are best documented in a firm's partnership agreement.

The many other decisions made during the formative process do not warrant inclusion in the partnership agreement. These decisions should be part of the firm's minutes, policy manuals, or other written materials. They include the following:

- Initial capital-sharing percentages/points and amount
- Initial profit-sharing percentages/points
- Duties of an executive committee
- Duties of a managing partner
- Duties of an executive director/administrator
- Changes in capital amount and/or capital and income-sharing percentages
- Term debt and line of credit
- Designation of tax matters partner
- Lease and other major contract approvals
- Election of new partners
- Other decisions reserved to the partners

It is also recommended that meeting minutes be maintained by all committees formed by the partners.