NEW TIMES, NEW STRUCTURES

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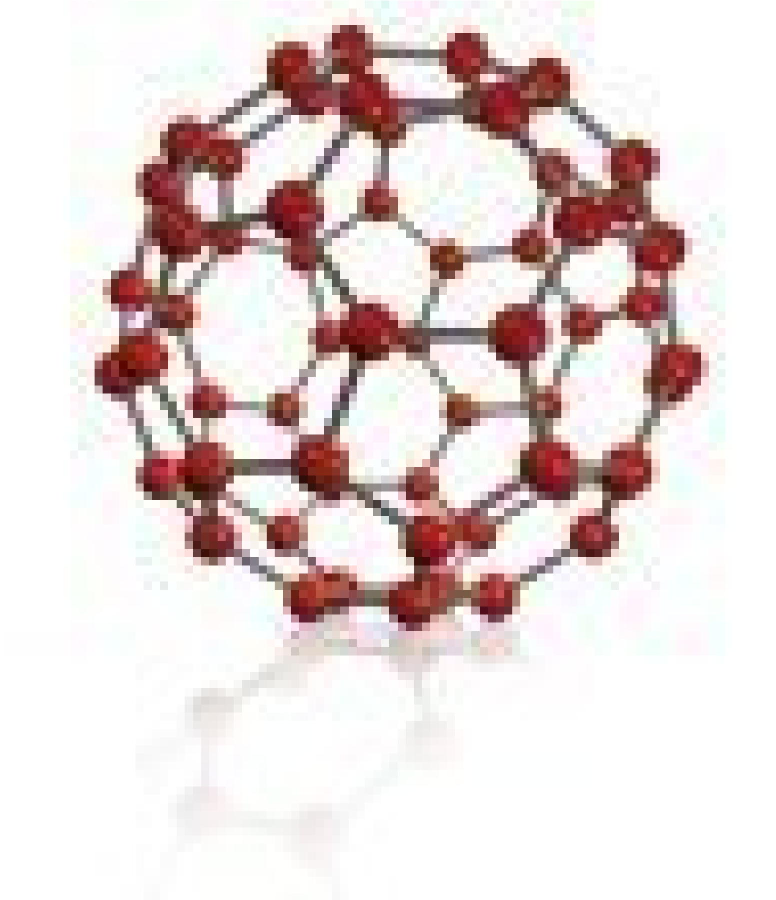

Category: Archive

It was clear that the postcrisis terrain for firms will be different – the new "new" – but prospects for 2012 are not looking good. The transactional train has finally been derailed and with it a core driver of law firm revenue and growth. Some very senior lawyers are wondering what they will be doing come the new year.

En este contexto de incertidumbre económica, se afirmaba que los despachos de abogados con sus prácticas anticíclicas serían capaces de afrontar las peores de las crisis. Sin embargo, no ha habido ningún sector inmune al golpe, y hasta los despachos han tenido que reconsiderar sus estructuras. Las reestructuraciones más recientes en cuanto a socios reflejan un deseo de abrir los procesos de toma de decisiones además de incrementar el sentido de responsabilidad colectiva.

The announcement by Garrigues that it is to expand its equity pool and do away with the concept of salaried partners has mirrored developments at a number of other major international firms, which have sought to balance out partnership disparities and to reassess firm's size andshape.

Among the issues firms are hoping to address are seniority, remuneration and voting rights and the democratisation of decision-making, in light of perhaps more difficult management decisions to come.

The announcement by Garrigues that it is to restructure its equity makes it the first major Spanish law firm to announce a reorganisation following the changing market conditions.

The partners of the firm, which saw revenues rise one percent to €355.2m last financial year (up from €352.8m) and is the largest in Continental Europe, have voted to abolish salary partners and create an all-equity group. Also agreed was an increase of the firm's retirement age from 56 to 60 and dividing the current co-Managing Partner roles into Managing Partner andSenior Partner positions.

The changes follow a deep review of the firm's structure, begun after the 2009 election of Fernando Vives and Ricardo Gómez-Barreda as co-Managing Partners.

The reforms were agreed separately, by unanimous partner vote, so that going forward, Vives will become Managing Partner while tax lawyer Gómez-Barreda will take the Senior Partner role.

The most significant change by far however is the removal of the equity and non-equity partner distinctions. It will almost double the number of equity partners at Garrigues to 239, and put it alongside other full-equity firms in Spain including, Pérez-Llorca and Uría Menéndez.

Since the start of the financial crisis, law firms in Portugal and across Europe, have widened their equity pool as part of a capital increase strategy. This is not, however, believed to be a factor behind the changes at Garrigues. New equity partners in Spanish firms typically make only a symbolic cash investment, if at all. Spanishfirms likewise tend not to hold debt.

Financial parity
DLA Piper is another firm to have opened its equity pool. Now the largest firm in the world by size, with around 4,200 lawyers, it is doing away with its tier of "fixed share" partners resulting in one class of partner across the entire firm.

"The US arm of the firm did away with any partner differentiation last year and we are now going through the same exercise in Europe, Asia and Australia," explains Juan Picón, the firm's Madrid-based Global Head of Corporate.

The intention, he explains, is to create better alignment across the firm as well as to open up decision-making and talent pools. "Fixed share partners have not been able to vote on specific issues, nor take up roles in the Management Boards, and that distinction will now be removed. But fundamentally we think it gives better direction – if gives the sense that we are all in this together."

Such a change will have only limited financial impact, he says. The downturn has removed some of the financial barriers to becoming an equity partner while increasing the feel-good benefits of a unified partnership. At DLA the new equity partners will have to contribute capital, but this will be managed through a progressive (and increasing) draw down entitlement to align them with existing equity partners' stakes.

"The gesture is in a sense symbolic. We carry very little debt and the firm's financial position as a whole is very good. So for the individual partners the financial implication of the switch is practically nil. Partners' compensation will still be decided by the Remuneration Committee which will simply take into account our 'new' partners equity obligations."
Such a move also therefore helps focus partners' attention on the financial management of the firm as a whole, adds Picón. "Cash collection and billing are significant factors in partner remuneration assessments and so now we will all share the financial hazards as well as the rewards."

In Spain at least, the move away from salaried partners avoids what some see as their ambiguous position under Spanish labour law. It is only in the last five years that lawyers in law firms have been regarded as “employees”, and recent case law in the UK has helped highlight the still uncertain position of “salaried partners” as regards the rights and obligations to a firm.

In any event, a conversion to an all equity partner pool removes any potential liability for withholding tax and social security contributions, a change which, alongside their salaries passing to the profit pool, can also clearly help improve a law firm’s financial results. “There is no doubt that a move to equity can help ‘massage’ the figures, but it is also an excellent way of managing out under-performers,” says one Madrid Managing Partner, off the record.

More for less

Greater awareness of a firm’s financial well-being may help galvanise the collective responsibility, and the enfranchisement of all the partners in decision-making may encourage cohesion but it also brings with it collective responsibility. The continued success of the institution is more important than the individual, and therefore just because more people have a say in the running of the firm does not mean that their positions with the firm are any more secure.

Allen & Overy has now announced that it is to reduce its equity partner numbers by up to three percent, following an earlier nine percent reduction in the aftermath of the financial crisis in 2008-2009. The latest decision is based on a desire to return to what it says are more “normal rates” of partnership management. Likewise, Simmons & Simmons has revealed an eight percent decrease in equity partner numbers over the last financial year. Figures published in the firm’s first set of limited liability partnership (LLP) accounts in the UK reveal that equity partner numbers fell from 103 to 95.

The fall was part of a wider reduction in staff costs and total head count that saw total numbers at the firm fall from 1,523 to 1,447. But the filings also reportedly revealed an 11 percent increase in pre-tax profits and a 14 percent rise in profits available for distribution, with overall revenues reaching £248.6m – down one percent on the previous year.

Defying gravity

Like much of the legal sector, the search is clearly on for “more from less” and in this sense, a greater sense of cohesion may help embolden some firms´ management to take more difficult decisions, suggest some. As the economic outlook particularly across Europe continues to look challenging, firms finally need to assess whether they are the right shape and size for the economy as they find it.

“How well firms come out of the crisis will depend on how ready their management is to take some difficult decisions. Firms have to define their strategies and this will define their structures. Supermarkets, after all, do not do deliveries in Ferraris,” says José Luis Blanco,Managing Partner at Latham & Watkins in Spain.

In 2009 and in the face of a rapidly souring economy, his own firm made a 12 percent cut in associate numbers, losing 190 lawyers alongside 250 support staff; at the time the largest reduction in lawyer numbers of any firm.

“In the US, what has been interesting to see is that if cuts were needed to be made, they were made, across all business sectors including the legal sector. The players had to adapt to the new reality, no matter how uncomfortable it may have been. Here, in Spain at least, we tend to mess around at the edges and to avoid the major issues.”

Picón agrees that firms have to be realistic to the challenges that they face. His firm recently appointed Tony Angel as Senior Partner with responsibility for helping to oversee the firm’s operations in Europe and the US. The former Managing Partner of Linklaters for eight years up until 2008, Angel’s tenure coincided with a dramatic increase in revenues and profitability, but also a significant restructuring of the firm and a renewed focus on a core tier of global clients.

"It is not possible to defy gravity, and I think that as law firm leaders we have to be realistic. There is a sentiment that change is coming and that it needs to be made. Many firms have grown very large, including our own, and we have to define what it is that really differentiates us," says Picón. "A unified partnership can better identify where DLA Piper can compete effectively and add value, and where we cannot. We cannot be all things to all clients."

Among Spain's leading firms, Cuatrecasas Gonçalves Pereira, Gómez-Acebo & Pombo and Roca Junyent continue to operate two-tier partnership models, but a number of firms in the market are expected to assess the issue as they look not only to recalibrate their internal structure but also their size and shape.

There is no hint of course that Garrigues' decision to expand its equity pool is related to any major change to come, but it has helped reinforce the firm's reputation for placing management issues high on the agenda. The firm's focus on building an institution rather than promoting the expertise of a few star lawyers has though given wider significance to the restructuring.

Undoubtedly some firm partners may be reluctant to dilute their equity, and their authority, but for Garrigues the move does help welcome a larger, younger and more diverse group of lawyers into the decision-making process. The prospect of four years' additional practise may be pleasant news to its most senior equity partners, but few of them are now likely to believe that their final years at the firm will coincide with a soft economic landing.