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LAW FIRM PARTNERSHIP LAW

Expert Analysis

Separation Agreements: a Necessity Now That Lawyer Mobility Is Routine

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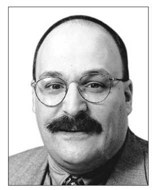

Today, the topic of "lawyer mobility" is boring. Twenty-five years ago, when this author began representing lawyers and law firms, the concept of lawyer mobility was novel if not revolutionary. The norm was for lawyers to begin and end their careers at the same firm, and law firms rarely asked partners to leave.

Today, the pendulum has swung to the other extreme. Lawyers routinely move firms to benefit their careers and provide better services to their clients. In addition, law firms, for good or bad, are run more like businesses (well sort of) and partners who are perceived as unproductive or whose practice is deemed not to be compatible with their current firms are often asked to leave.

The bottom line is that lawyers change firms with regularity. Just like partners who are planning on sticking together should have a solid partnership agreement to govern them, partners who are moving on should have a solid separation agreement to govern their departure.

While there is no "one-size-fits-all" separation agreement, in this month's column we discuss the topic of separation agreements and analyze and suggest some worthwhile provisions that should be included in an agreement.

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Exit Compensation

Often the most contentious and important issue to negotiate in a separation agreement is exit compensation. The time of year, the circumstances surrounding the departure, and the type of practice often determine the complexity of the agreement and the difficulty of the negotiation in this regard.

Partners who leave a firm voluntarily often do so after a bonus is paid. In those cases, they are determining their own departure date and are not leaving much behind.

Partners who leave prior to receiving their bonuses are often concerned that they will be deprived of a share of firm profits earned from their efforts in the year to date. Firms often take the position that such amounts are not owed to partners unless they have spent the full year as partners. A fair compromise, which is often reached, is to pay the departing partner a pro rata share of firm profits. This amount is often calculated by multiplying the partner's percentage share by the firm's annual profit and a fraction the numerator of which is the last day of the year in which the partner was a partner and the denominator is 365. The resulting payment is then paid when the remaining partners receive their bonus.

The above compromise, however, does not fairly compensate a departing partner or her firm in all circumstances. For example, a partner who departs a firm whose fees are based upon a contingency, such as plaintiffs' personal injury or plaintiffs' class action firms, are not fairly compensated by limiting their pay-out to a single year. This is the case because in such firms, the partners have, in essence, financed the firm's contingency cases and upon their departure should be entitled, assuming the cases stay with the firm, to be paid a share of the fees when earned by the firm for the work they financed.

Partners who are moving on should have a solid separation agreement to govern their departure.

Conversely, if the partner leaves with cases, the firm's remaining partners should be paid from a share of the fees ultimately earned by their former partner. In such circumstances, the firm and departing partner often negotiate and include in a separation agreement a schedule of such cases that include a percentage allocation of attorney fees. The allocation is typically based upon the work done and anticipated to be done on the cases in question with the majority share going to the party who is required to do most of the remaining or more meaningful work.

Return of Capital

A related issue is the return of capital. A partner's capital account in a law firm is either the amount contributed by the partner as cash from an initial or periodic capital contributions or is a partner's accumulation of yearly undistributed earnings. Taxes are paid on these contributions and accordingly the return of capital to a partner is tax-free and the loss of capital is therefore the loss of tax-free money which should be avoided.

The return of capital is, therefore, an important piece of a departing partner's exit compensation, and the amount to be returned and the timing of such a return should be addressed in a separation agreement. In addition, since partners moving laterally are often required to make capital payments to their new firm the release of capital from their former firm may be the means of paying capital at the new firm making an agreement for the return of capital with set times and amounts even more important.

Protection From Liabilities

Also important in a separation agreement is a provision that protects a partner against liabilities of her former firm. A separation agreement should include a broad indemnity provision requiring the firm to indemnify and defend a departing partner to the fullest extent permitted by law for acts while the partner was a partner of the firm.

Similarly, a provision which ensures that the departing partner is covered by the firm's professional liability insurance to the same extent as the firm's current partners for acts while a partner is an important part of a comprehensive separation agreement. If the agreement contains a general release it is important to include a provision in the separation agreement that the release is not intended to invalidate any partner's (including the withdrawing partner) right to professional liability insurance.

The agreement should also address liabilities owed to third parties such as leases or lines of credit. If the partner is personally obligated concerning these liabilities he, with the firm's assistance, should seek to be removed from these liabilities. If this cannot be accomplished the separation agreement, in addition to the indemnification provision set forth above, should include a schedule of any known personal liabilities and a representation that the firm will assist the partner in trying to be released from these obligations.

What Can Be Said

Separation agreements should also set forth the nature and duration of so-called bounce back messages on the departing partner's email and voicemail. These messages are important and provide necessary information to clients and third parties that the partner is no longer a partner and to honor the client's choice of counsel and should provide the partner's new contact information or at a minimum direct the caller or email sender to someone at the firm who can direct the call as appropriate.[1]

Separation agreements sometimes include non-disparagement and confidentiality provisions. Depending on the relationship of the firm and departing partner, a non-disparagement agreement may be called for. In some circumstances it is not needed and in others the parties would prefer to speak freely about one another and such a provision is not included. In addition, at a large firm it is very difficult to monitor and enforce such a provision among all the partners nonetheless diluting the efficacy of such a provision. Confidentiality provisions are more common and typically require the reasons for the departure and the economic terms of the departure to not be disclosed.

Collection Assistance

Separation agreements often contain provisions by which the departing partner will assist her former firm in collecting fees from clients of the former partner. Sometimes this cooperation includes a direct monetary component by which the former partner is paid a percentage of the fees collected. In other situations there is no direct correlation. Regardless, separation agreements often contain such provisions requiring reasonable cooperation in collection of client receivables including the finalizing of bills.

Releases

It is not uncommon for separation agreements to not have releases. While it is desirable for the parties to move on with the protection of a release, it is often difficult to obtain a release concerning the departure of a partner from a firm. Often the parties, believing that their relationship is complex, cannot come to terms concerning a broad general release. In the situations where such an agreement is reached, a broad general release should be included which carves out, among other things, the separation agreement, any pension plans, and insurance coverage.

Conclusion

"Get it in writing." When partners leave a firm, lawyers and firms should take their own advice and set out their terms of the departure in a comprehensive agreement that spells out the parties' rights, obligations, and expectations for the future. These agreements, like most, should eliminate further controversies and permit both the departing lawyer and the former firm to move on productively.

1. The New York State Bar Association website contains important information for attorneys departing from their firms. Among other things, the website includes procedures and content to be placed on a departing attorney's email account to ensure a client's choice of counsel and the maintenance of client confidences. See, e.g., http://www.nysba.org/Content/NavigationMenu/LawPracticeManagementResources/DepartingaLawFirm/EmailCommunicationsforDepartingAttorneys.pdf.