Planning for Partner Retirement

A partner's retirement can have an adverse financial impact on a law firm unless proper planning is done. This is particularly true of a firm's big rainmakers. Loss of even a few large clients when a rainmaker departs can have a severe impact on the firm's bottom line. Failure to successfully transition management can also have disastrous consequences, leaving a practice group or the entire firm directionless and stumbling. A firm's partnership agreement should clearly address retirement issues to plan for a successful, orderly transition.

Retirement Trends

Historically, law firms were much smaller and had more of a fraternal culture. There were few retiring partners, so there were enough partners remaining in the firm to finance payments to retirees. Unfunded retirement plans did not pose a financial burden on the firm. Retirement plans and policies were largely informal, with little or no written documentation.

Today, many firms have formalized their pension plans and policies for partners' retirement. Most firms have also established funded retirement plans and phased out unfunded obligations to lessen the burden of retirement.

Since as people age they can lose their mental sharpness, in addition to simply slowing down, many firms are establishing mandatory retirement age policies. By instituting a mandatory retirement age for everyone, firms can avoid having to make the unpleasant decision of when to tell a partner that it is time for him or her to retire. The firm's management may retain the ability to offer appropriate individuals annual "of counsel" contracts, thus allowing the firm to avoid losing the services of those lawyers who are fully able and willing to continue the practice.

Currently, approximately 60% of law firms have a mandatory retirement age ranging from 65 to 70 years. As suggested above, many firms permit flexibility and give their executive committee the authority to make exceptions to this policy, though this is done infrequently. When extensions are granted, they are normally for one year and are reviewed annually after that.

Retirement Planning

Many firms pay little attention to partners' plans for retirement. Approximately 35% of firms have no written agreements covering retirement and departure issues. Since it can take three to five years to fully transition a practice, a planned, orderly transition is essential to client retention.

Some firms' partnership agreements require six months' written notice of a partner's plans to retire. Firms may also require a retiring partner to prepare and submit a written transition plan to the firm's executive committee for turning clients and firm responsibilities over to other attorneys. Ideally, the firm and the partner should agree on a transition plan a few years before the partner's intended retirement date.

About half of all law firms use a phase-down, or scale-down, period for transitioning partners to retirement. Under this approach, there is a gradual reduction in the partner's workload and profit participation. There may also be a provision for residual profit sharing upon complete retirement from the firm. A phase-down period can last up to 10 years, though it normally ranges from two to five years. Typically, this reduction begins at age 65, with a 20% reduction in compensation each year through age 69 and complete retirement at age 70. Some firms will switch the partner to non-equity status during the phase-down stage.

Transitioning Clients

Successfully transitioning clients is a priority in planning for a partner's retirement. Obviously, this is especially true for a firm's large rainmakers. There are several things a firm can do to ease the transition process. Some firms separate client relations from legal work, designating a responsible or billing attorney who is in charge of managing the relationship, typically the person who originated work with the client, and a second lawyer to serve in the role of managing attorney. The managing attorney will perform more of the day-to-day legal services and is also involved in client relations. To institutionalize clients, they should be exposed to other partners and senior associates in the firm, both professionally and socially, in order to develop a well-rounded relationship.

The firm should solicit regular feedback from clients regarding legal services and client relations to be sure they are satisfied on all counts. This provides an opportunity for other partners to meet the client for cross-marketing purposes and to move the relationship from one in which they are clients of one attorney to one in which they are clients of the firm. This also demonstrates the firm's commitment to quality service, a point that will likely be remembered by the client when the key partner retires and the client reassesses its relationship with the firm.

The retiring partner should lead the effort to institutionalize clients. Require the retiring attorney to involve younger lawyers in client relations and report progress in this area to the practice group leader. During this time period, the partner's compensation should not be based on the firm's normal criteria. Instead, it should be aligned with the transition plan to fully motivate the retiring partner. Efforts to incorporate other attorneys into the client relationship should be rewarded. The partner should be compensated for transitioning his client base while continuing to log a reasonable, though lower, number of billable hours.

If the firm waits until the actual retirement date is looming to start institutionalizing clients, it may be too late. There is a time lag while a new relationship is being established, and the business may not be retained.

Transitioning Governance

The firm's governance should not be overlooked when planning for a partner's retirement. Many firms put an age limit in their partnership agreements for service as a managing partner or as an executive committee member. Sometimes the age limit for such positions is 65 years old, but a number of firms have lower age levels. This allows time for transitioning responsibilities to the new firm leadership while the outgoing leader is still available for consultation. In addition, although many older partners are very good leaders who take a long-term view--often against their own short-term financial interest--some firms believe that firms should be managed by those more likely to have a longer term stake in the firm's success. The same applies to practice group leaders and any other key firm positions.

Post-Retirement Arrangements

There are two basic types of partnership agreement-based retirement payment plans at law firms that still retain such plans: deferred equity and the retirement-allowance approach. Note, however, that most larger law firms have moved away from any form of non-qualified unfunded retirement or separation payment, with the exception of refunding the partner's cash basis capital contribution.

Under the deferred equity arrangement, the value of equity must be determined at the retirement date. This includes the partner's capital account, share of any undistributed earnings and, possibly, the share of work in process and accounts receivable. Typically, partnership agreements exclude any payment for the value of goodwill. The balance of equity is paid in installments over a number of years.

Under the retirement-allowance approach, the firm pays retired partners an annual amount. Payments may be for life or for a set number of years after retirement. Many firms using this method also scale down a partner's income in the years prior to retirement based on declining contribution levels. Some firms may set a cap on the amount of payments to former partners, for example, 5% of net income. Some use a combination of the two approaches for their retirement planning, though this is not recommended.

Retirees may be needed to perform legal work from time to time on a consultant basis. Many firms provide retirees with office space and secretarial and other office services support. For work performed after retirement, compensation is usually tied to the amount of work performed rather than to any rainmaking activity. Another approach is a formula for compensation such as a percentage of average partner income. If a retiree consults with clients or potential clients, be sure that the retiree is still covered under the firm's malpractice insurance policy.

In addition, after a partner has retired, the firm should provide incentives for him or her to continue to be involved in the client retention process. The firm should have the retiree occasionally join a business seminar or social event involving the client to help give the client the feeling that there has been no change in the attentive service provided by the firm.

Some firms pay membership dues for their retirees in professional associations or social clubs with the idea that the retiree's participation is good marketing for the firm. The retiree may also still participate in the firm's life and health insurance benefit plans, though sometimes at his own cost.

The key to a successful transition and client retention after a partner's retirement is planning. Be sure your partnership agreement clearly covers mandatory retirement age for general partners as well as managing partners and executive committee members. A retiring partner should submit a transition plan to firm leadership. The retiring partner and the firm should monitor the transition of clients and firm responsibilities to be sure the plan is progressing. Be sure to align the soon-to-be-retired partner's compensation with the transition plan. Careful planning well in advance of retirement will ensure that you make a smooth and successful transition.