

# The evolution of modern governance in law firms

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## 1. **The twilight of the traditional law firm**

Can the traditional law firm structure survive to the end of the 21st century? Even as contemporary corporate structures, such as limited liability partnerships, limited liability companies and professional corporations, have replaced the general partnership in most jurisdictions in the world, the basic way in which most law firm partners<sup>1</sup> govern themselves and manage their practices remains largely unchanged.

As law firms have attempted to navigate the fast-changing, often tempestuous seas of the economic crises of the first two decades of the 21st century, it has become apparent that most of them – especially small and midsize firms – are structurally ill equipped to respond efficiently and effectively to the external and internal challenges that they face, some of which are discussed in detail elsewhere in this book. Some of these pressures are due to the so-called ‘new normal’ in legal markets in most jurisdictions, characterised by phenomena such as increasing price sensitivity among clients; globalisation and consolidation of law firms; and increased competition to recruit and retain the best legal talent. Actually, this is not a ‘new normal’ in any sense of the phrase; instead, it is business reality finally catching up with the legal profession.

A major part of the difficulty that law firms have in responding to new demands and challenges originates from the traditional structural and management paradigms that drive most law firms, despite their adoption of a modern corporate structure or alternative business structure.<sup>2</sup>

Consider the multi-faceted role of the partner in a law firm. He or she is expected to carry out the duties of:

- an owner of the business;
- one of its principal investors;
- a manager of significant corporate functions;
- a prominent member of the firm’s marketing force;
- one of the firm’s major producers of revenue;
- a supervisor of other professionals;

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1 This chapter uses the traditional term ‘partner’ to describe an owner of a law firm. Except where specifically indicated to the contrary, the term ‘partner’ also applies to law firm owners with titles such as ‘member’ or ‘shareholder’ in other law firm corporate structures.

2 For example, alternative business structures were introduced in England and Wales by the Legal Services Act of 2007. For a practice note outlining the major provisions, see The Law Society of England and Wales, “Alternative Business Structures”, July 22 2013 at [www.lawsociety.org.uk/advice/practice-notes/alternative-business-structures/](http://www.lawsociety.org.uk/advice/practice-notes/alternative-business-structures/).

- a principal point of contact for clients; and
- an ambassador of the firm in the business and professional community.

Obviously, it is almost impossible for even the most talented and best-organised partner to do all of these things well, especially when one's partners expect 1,500 to 1,800 billable hours of legal work.

This dilemma is compounded by a realisation that as client needs and expectations for legal services become more sophisticated, and law firms find themselves in a maelstrom of market forces that many have never experienced before, basic principles of good management and business prudence require that partners, in their various roles, dedicate more personal time, attention and intellectual energy to management issues that previously were not priorities and could be delegated to staff or ignored completely.

As one equity partner in a fast-growing firm in Latin America said: "I feel as if I am being pulled apart into pieces."

Can law firms survive, or are we now entering the twilight of the law firm? Will traditional law firms as we know them disappear from most legal markets for significant commercial law matters and dispute resolution, to be replaced by something completely new and different? Or will they evolve into better-managed, more efficient, more responsive providers of sophisticated legal services, retaining at most the external shells of the quaint 18th-century models upon which most law firms are still based?

This chapter does not attempt to answer these broad questions. Some of them would require the simultaneous use of a crystal ball, tarot cards, tea leaves and the entrails of a chicken. Instead, it reviews the current scope and components of governance in law firms, as outlined in the *IBA Law Firm Governance Initiative Best Practice Guidelines*.<sup>3</sup> That document provided a useful checklist describing the modern scope and areas of priority concern for the governance of law firms. Finally, this chapter comments on three specific areas that the author has observed as dominant areas of concern while advising law firms about governance issues.

## 2. What does 'governance' mean in law firms?

One of the central points of this chapter, as well as in this book, is that the concept of governance is expanding and evolving from its traditional scope. Here is a useful working definition:

*...governance relates to consistent management, cohesive policies, guidance, processes and decision-rights for a given area of responsibility.*<sup>4</sup>

Several points from this definition are important, because they refer to substantial shortcomings in the governance of many law firms today:

- Consistent management – although most law firm partners are conscientious and genuinely care about their firms, management styles in law firms

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3 International Bar Association, *IBA Law Firm Governance Initiative Best Practice Guidelines*, September 10 2008 (hereafter cited as *IBA Best Practice Guidelines*). This document is not currently in print, but may be downloaded in PDF format from the IBA website: [www.ibanet.org](http://www.ibanet.org).

4 "Governance", *Wikipedia* <http://en.wikipedia.org/wiki/Governance> (September 30 2013).

frequently range from being largely *ad hoc* responses to the crisis of the day to being rigidly consistent only in denying reality.

- Cohesive policies – as discussed later in this chapter, with reference to the *IBA Best Practice Guidelines*, outdated or non-existent policy documentation has been a major challenge for law firms, especially fast-growing ones in emerging legal markets.
- Guidance – overworked partners frequently complain that “We always can find time to fix the latest problem, but we can never seem to make the time to ensure that we will avoid the same problem in the future.” Decisions are frequently reactive, rather than proactive. As a result, some law firm partnerships spend inordinate amounts of time deciding anew how they will decide an issue almost identical to one they have decided before.
- Processes – decision-making processes are seldom documented in law firms, and many law firm partners can work for many years in a law firm without knowing how basic business operations are conducted.
- Decision rights – the rights and prerogatives of partners sometimes inhibit efficient decision making, especially with respect to important strategic issues. ‘Collegiality’ is often used to justify the *de facto* prerogative of any partner to veto a proposal, and can also inhibit the candid assessment and discussion of sensitive, critically important issues in areas such as sub-standard partner performance or a need for significant change.

None of these observations is characteristic of all law firms today. Indeed, some firms manage the governance responsibilities in each of these areas very well; but it has not been easy. The basic demands of good governance today, with respect to each of these defining points and other important issues as well, have required well-governed law firms to move from the limited, traditional view of governance to a modern one that envisions good governance as a central coordinating point for managing the most important issues affecting the current and future performance of the firm. It is no exaggeration to state that for some law firms, good governance has become a necessary strategy for survival.

### 3. Can your governance system do this?

The *IBA Best Practice Guidelines*, published in 2008 and updated in 2009, provide a conceptual checklist of the issues that law firm governance should consider. As the preamble points out, not every guideline is necessarily relevant to every firm:

*These guidelines attempt to identify certain general principles and standards that may help law firms manage their practices in a way that will achieve these objectives. Some of its points may be of more relevance to larger firms, or to those with a broader element of international work. Some may fit more naturally in certain cultures and less so in others. Some may need to be adapted over time to reflect changing conditions and concerns. There will be few firms (if any) that will adopt every provision. But all law firms should benefit by thinking about the extent to which each of the guidelines applies to them and could make them more effective and successful.<sup>5</sup>*

The guidelines are organised into seven major areas, each of which should be a

concern for every partner in the firm, even if some of the specific guidelines are not applicable. The seven areas are:

- the firm;
- its people;
- its culture;
- its clients;
- wider engagement;
- legal and regulatory compliance; and
- transparency.

### 3.1 The firm

The *IBA Best Practice Guidelines* suggest six guidelines to describe how the firm, as an institution, should be governed:

1. *The firm should set out in writing its governance and decision-making structure.*
2. *It should have a transparent process for the selection of leaders and the appointment of managers.*
3. *It should establish an appropriate mechanism for partners to communicate with each other and with the firm's leadership/management.*
4. *The capital structure of the firm should be described to partners in a clear way which distinguishes between different kinds of capital and explains the way in which capital can be contributed and withdrawn by partners.*
5. *The way in which the profits of the firm are distributed among the partners should be clearly described to all partners in the firm.*
6. *All those who are held out as partners should be treated as such, whatever legal and financial arrangements exist between them. Being a partner in a firm should involve the acceptance of a clearly defined role and a set of rights and responsibilities.<sup>6</sup>*

One of the common themes running through these guidelines is the need for documentation of these fundamental aspects of the firm. By contrast, most law firms in the world still operate from a partnership agreement or other operating agreement that meets only the minimum requirements for the firm to be registered in its domicile jurisdiction. When considering a law firm merger opportunity, one of the first documents that partners should ask to see is the current partnership agreement of the other firm. Approximately 20% of the time<sup>7</sup> at least one of the firms is unable to produce anything more than the original registration documents, signed by partners who retired from the firm decades previously.

### 3.2 The firm's people

The *IBA Best Practice Guidelines* are most extensive with respect to the management of the firm's staff and legal talent, even more so than with respect to clients. This reflects the recognition that management of talent has become a more important component of a successful law firm strategy than ever before:

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<sup>5</sup> *IBA Best Practice Guidelines*, p1.

<sup>6</sup> *Ibid.* Because the *IBA Best Practice Guidelines* are not in print, but available only online, they are quoted in their entirety in this chapter.

### **Recruitment and retention**

1. *The firm should set out its recruitment policies and processes in writing so that all potential recruits (partners, associates and support staff) have access to enough information to allow them to make an informed decision about whether or not they wish to pursue recruitment discussions with the firm.*
2. *Firms should adopt recruitment and promotion policies and processes that are non-discriminatory and that are designed to encourage diversity at all levels within the firm.*
3. *When hiring new recruits (at any level) who have previously worked for another firm, the hiring firm should do what it can to ensure that the recruit does not thereby breach lawful duties owed to the previous firm.*
4. *The firm should ensure that every new recruit receives an appropriate induction which introduces him or her to the firm, its values, policies and procedures.*

### **Training and development**

5. *The firm should offer appropriate support to those within the firm (whether or not they are lawyers) who are studying for or taking relevant professional qualifications.*
6. *It should give qualified lawyers associated with it appropriate support and encouragement to undertake relevant continuing professional education and to develop their personal and professional skills.*
7. *A firm should identify career transition points that are relevant to those within the firm and offer support to those reaching such points in their careers. A career transition point is a moment in a person's career when his or her role changes significantly. Examples in respect of lawyers include admission to the bar, admission to partnership, promotion to a management role and retirement.*
8. *A firm should encourage every person in the firm (at whatever level) to produce and maintain a written training and development plan which is suited to their needs and to the culture and structure of the firm.*
9. *Firms should ensure that all lawyers receive appropriate supervision and are given an opportunity to undertake a suitable range of work. Lawyers should be encouraged to develop a range of skills and to undertake a variety of work.*

### **Performance management**

10. *Firms should ensure that every person in the firm receives a clear written statement of the performance and behaviour expected of them. The role and responsibilities of each person and their duties to the firm should be clearly stated.*
11. *Firms should ensure that every person in the firm is given clear feedback in respect of performance and behaviour. Where appropriate, feedback should be gathered on a 360 degree basis including upward feedback from those supervised by the person concerned. Those giving feedback should be encouraged to express their views frankly and in appropriate cases in a confidential and non-attributable manner.*
12. *A firm should have a clear and transparent appraisal process and procedure. Appraisals should take place at least annually (for everyone, including partners) and should be properly prepared and, where appropriate, documented. The appraisal*

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7 This is based on the author's observations as a management consultant advising the parties in law firm mergers.

*process should include a face-to-face meeting with the person being appraised and should be conducted on a confidential basis. In appropriate cases immediate oral feedback should also be encouraged in the day to day working environment.*

**Remuneration and benefits**

13. *Firms should adopt a remuneration and benefits policy which is designed to ensure that the firm takes a consistent approach when determining the remuneration and benefits to be received by all its people. This policy should be clearly communicated to all those within the firm.*

**Dealing with problems**

14. *A firm should ensure that everyone in the firm has an appropriate opportunity to complain about or comment on the work or behaviour of any other person in the firm. Complaints should be dealt with fairly and with due regard to the well-being of all concerned. Once a complaint has been investigated all those involved should be given appropriate feedback and guidance. In appropriate cases complaints should be dealt with on a confidential basis.*
15. *Firms should have a written grievance procedure. This should seek to ensure that any grievance of any person in the firm is dealt with in a fair and sympathetic manner.*
16. *Firms should adopt clear policies and procedures for communicating both exceptional performance and poor performance to persons in the firm (including partners). Firms should identify a member of the firm to be responsible for this.*
17. *Firms should pay due regard to any personal problems experienced by anyone in the firm. In appropriate cases firms should offer help and support to those seeking to overcome such problems, provided that doing so is consistent with preserving a high performance working environment.*

**Career development**

18. *Firms should state clearly and openly the basis on which people are promoted to higher positions in the firm (including partnership). Selection criteria and processes should be clearly and fairly described to all interested parties (both those currently within the firm and potential recruits).*
19. *Where possible, firms should seek to allow people in the firm to undertake secondments to other parts of the firm, to other firms or to clients. Secondment opportunities should be clearly and fairly described, as should the terms of any secondment.*
20. *Firms should state clearly whether and in what circumstances flexible working is permitted. In this context flexible working includes part-time work, reduced working hours and increased holiday entitlements. Firms should also state their policies on parental leave.*
21. *Firms should recognise and support efforts by persons in the firm to balance the demands of their job with the need to have a rewarding life outside of the office environment (work/life balance).*
22. *Firms should seek to ensure that their support staff are respected and included in the firm's activities. Integration between support staff and lawyers should be an objective of every firm.*
23. *Where possible, firms should seek to maintain contact with people who have left the*

*firm (alumni), providing them with appropriate information about the firm and fostering a continuing relationship between such persons and their former firm. In this context, firms should regard both former members and future recruits as relevant stakeholders.<sup>8</sup>*

Many small and midsize law firms follow almost none of these guidelines, dismissing them as “only for the big firms”. However, some progressive smaller firms are making substantial investments in their people, not only to improve the quality of service offered to their clients and the efficiency of their operations, but also to be more attractive in the competition for legal talent. These initiatives are not abdicated to the human resources department, but are instead closely guided and managed by one or more partners, and are a continuous concern of the entire partnership.

### 3.3 The firm's culture

There are five guidelines relating to the values of the firm and the way that they are expressed in the community:

1. *Firms should seek to define and communicate a limited number of fundamental values which underpin and inform decisions taken by the firm.*
2. *Firms should encourage their lawyers to undertake pro bono work. They should develop and communicate a policy for pro bono work undertaken by the firm and by members of the firm with its support. The policy should explain how the firm decides whether to undertake a particular piece of work on a pro bono basis, how that work is allocated and valued if it is undertaken and how the policy of the firm is affected by relevant bar requirements.*
3. *Firms should develop, communicate and encourage participation in their community service policy. In this context community service means voluntary work in or with local communities in countries where the firm operates.*
4. *Firms should develop and communicate a policy on charitable giving. This should deal with giving by the firm itself and also any support which the firm offers to charitable efforts by persons in the firm.<sup>9</sup>*

This is probably the weakest area of the *IBA Best Practice Guidelines* because it totally misunderstands the concept of the culture of a law firm. A good argument could be made that these are not really governance concerns, but rather marketing and public relations tactics. It could also be argued that, compared to other guidelines, these are relatively trivial.

### 3.4 The firm's clients

The *IBA Best Practice Guidelines* with respect to clients have a strong risk-management flavour, especially with respect to financial risks and professional responsibility:

1. *A firm should ensure that it has a clear understanding of the needs and expectations of its client before beginning any piece of chargeable work for that client. Where possible, client requirements and expectations should be recorded in writing.*
2. *A firm should adopt procedures and processes designed to ensure that every client*

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8 *Ibid*, pp2-4.

9 *Ibid*, p4.