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By Bob Sherwood, Legal Correspondent

Published: January 31 2005 02:00 | Last updated: January 31 2005 02:00



Almost half of the top 25 law firms axed dozens of their own partners in last-resort moves to cut costs and shore up profits last year.

A snapshot of the UK's corporate law industry will reveal on Monday that the biggest firms are still struggling to raise revenues in the wake of the slowdown in corporate activity. As a result, law firms are being forced to run themselves along more "corporate" lines than ever before, a closely watched report says.

Although the survey, by PwC, the professional services firm, criticises some firms for being slow to respond to tough market conditions, it found many had taken an unprecedented "strategic approach", dumping underperforming partners and waging war on costs.

PwC says that about 10 of the country's biggest firms forced out partners last year in response to the tough market conditions, demonstrating that partnership at the biggest corporate law firms is no longer the guarantee of a fat income for life that it once was.

The findings come just weeks after Lovells, one of the five biggest London-based corporate law firms, announced the most public cull yet, removing 25 partners and stripping another 10 of their equity stake. Most of the other big law firms have quietly "managed out" some of their partners to try to avoid attention.

The cuts will take time to filter through to the bottom line though, as most departing partners will insist on at least a year's pay: £500,000 or more at the top firms.

Alistair Rose, head of PwC's professional partnership advisory group, said: "Law firms are not used to reducing their partner numbers and that creates uncertainty because it's not a pleasant experience if you have been operating in a collegiate atmosphere. But firms have been forced to become more strategic. They have taken a long hard look at their cost base and I don't think they have had to do that in the past."

Correspondingly, many big firms are also creating fewer new partners "but that has lots of knock-on effects in terms of motivating the people at the next level down," Mr Rose added.

In addition, 56 per cent of the top 25 firms cut the number of junior lawyers after years of expanding their headcounts. As many as 61 per cent also jettisoned some of their support staff.

After years of international expansion, many law firms were also reviewing their overseas operations, which "have failed to deliver the expected returns". The survey - based on responses from 72 per cent of the top 25 firms and 47 per cent of the top 100 - found more than half of the largest firms earned less than 10 per cent of their profits overseas.

In general, the biggest firms saw only modest increases in fees billed per partner in 2004. Just over half of the top 25 reported relatively small increases in profits per partner but 41 per cent reported a decline. By contrast, many mid-tier and regional firms reported impressive fee growth.

Although there were signs of improvement in M&A activity and financial markets in the latter half of last year, Mr Rose warned that law firms could not rely on a sustained recovery this year. "I wouldn't think there was appetite for cutting much deeper. The question now is whether the big firms can hold their costs down."

In spite of the cuts, chargeable hours to clients - the crucial targets by which junior lawyers are judged - remained relatively low last year, with many newly qualified lawyers

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being under-utilised by their firms, according to the report.

Most top UK law firms, unlike their US counterparts, share profits among partners according to a strict seniority scale rather than performance. But such a rigid model, known as "lockstep", is becoming unsustainable as high-performing partners resent large payouts to their less effective colleagues, the report says.

It found 57 per cent of firms now have a provision for moving partners back down the lockstep scale for underperformance, while 50 per cent have a similar mechanism for partners approaching retirement. More than 80 per cent of the firms that have the ability to downgrade partners did so last year.

**MORE OF THE TOP 25 TRY TO LIMIT LIABILITIES IN FACE OF INCREASING LITIGATION** More of the big law firms are trying to limit their liabilities in the face of increasing litigation, writes Bob Sherwood. The PwC survey found 29 per cent of the top 25 firms "routinely" set limits for potential damages claims in contracts for client assignments, a jump from just 12 per cent who did so in 2003. Across the top 100 firms, 22 per cent were regularly seeking to protect themselves against huge negligence payouts, up from 15 per cent. Limiting liability as a term of the lawyers' client engagement letter is still contentious in the corporate legal world. Many partners resist the concept, fearing that it will alienate clients and make them less competitive. However, even among those firms that do not cap potential damages for specific work, an awareness of risk limitation is growing. Just a quarter of the top 25 firms that do not limit liability said there was no perceived need to do so, down from 43 per cent in 2003. More of the large firms are also converting to limited liability partnership status, which protects partners' personal assets in the event of a catastrophic negligence claim. The survey said 41 per cent of the top 25 had either converted to an LLP or planned to do so. Last week Herbert Smith, one of the 10 biggest firms, became the latest to convert. Iain Rothnie, executive partner at Herbert Smith, said: "We believe this is the right thing to do for a modern, international law firm operating in today's increasingly litigious business environment." However, smaller firms are still sceptical about the benefits of converting to LLP status.

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