It's so hard to say goodbye: some 'gotchas' about leaving a law firm

By Edwin B. Reeser

"You can check out any time you want, but you can never leave ... with your money."

Winter is abating, springtime is around the corner, and that means lateral movement season. Just as increased pollen count leads to watery eyes and running noses, so can the dawning financial reality of what it means to leave one's law firm, whether as equity partner, income partner or associate. Before leaping to that exciting new "platform" for your practice, it pays to understand the terms of departure not only from your present firm, but also from the new firm.

Here are a few "gotchas" related to leaving a law firm.

Return of capital: Typically applicable to equity partners, and now relevant to "income" and "senior" partner classes — these individuals are required to post capital "deposits." For equity partners, this customarily ranges from 25-40 percent, and for nonequity partners from 5-10 percent, of scheduled annual income. Though 20 years ago the return of capital was frequently full and immediate, recent years have witnessed the emergence of a tangle of preconditions and restrictions not written into partnership agreements, developed as situationally expedient and differentially applied "policies" or "procedures." These include installment repayments without interest extending over three, five or even 10 year terms. Execution of releases and nondisparagement covenants may be required, and a withdrawing partner's violation of those can result in forfeiture of undistributed capital balances. Meanwhile, your new firm will likely require full payment of your capital share on partnership admission, or shortly thereafter.

Earnings/bonus holdbacks: For equity partners, departure prior to fiscal year end can mean forfeiture of all profits and earnings above distributions made. As many firms hold back 40-50 percent of scheduled income for a partner, this becomes an increasingly heavy penalty for a partner, making departure after March 31 an expensive proposition.

Where there are discretionary bonuses, departure from the firm prior to announcement of bonuses can result in noneligibility. Giving notice as required under the partnership agreement of pending withdrawal will also probably eliminate any discretionary bonus. With allocations made after final tabulation of results, usually mid-February, the earliest departure date available to a partner slides well into March or April. Since departures forfeit earning shares above draw levels, equity partners are virtually assured of forfeiting the equivalent of at least one-eighth of their projected annual income. Some bonus programs condition retention of the bonus on being in the firm for the next full year, so there is effectively a clawback of some portion of a bonus if the partner leaves anytime the following year.

For income partners, while salary must be paid through the departure date, payments contingent on performance of the firm as an entity, (perhaps 20 percent of total annual income), require that the income partner "be there" at a date certain in the following year to get it. Any departure before the "you gotta be here" date, often well into February or March of the following year, means forfeiture of the entire holdback amount.

For associates, while salary must be paid through the departure date, performance bonus payments are usually paid in the first 60 days of the following year. Bonus amounts derived from billed or worked hours and other metrics may not be payable if the associate leaves prior to Dec. 31. The bonus is typically payable even if the associate leaves the firm prior to the payment date in the following year, if they worked through Dec. 31. Discretionary bonuses almost all require that the associate still be an employee in the firm at the date of distribution of bonuses. (This impacts associates and income partners who follow withdrawing equity partners to a new firm. The advent of spring bonuses also plays into this dynamic).

Compensation resets: The date for setting compensation for the new year has been pushed back. It is common for salaried partners and associates to receive notice of new compensation levels in February or March of the following year. A "catch up" distribution retroactive to Jan. 1 is made afterwards. Any attorney who has left after Jan. 1, but prior to the announcement, forfeits the increase in the new year, as they "had to be there to get it." Many lateral moves occur in the first quarter, so this aggregates to a meaningful sum.

Compulsory additional capital contributions: This firm frequently requires modest increases in equity partner capital each new year. Say $20,000 for the lowest tier partners. This amount varies for each tier, with contributions increasing for each higher tier of partner distributions. This new base of capital for the respective tiers is "absorbed" within any raises in distribution allocations to partners within tiers, which are later established in the event a partner receives a "raise" in their profit allocation. That is decided after Dec. 31 (as described below), so the $20,000 (or more) is withheld from the final partner distributions made in January. Irrespective of whether a partner leaves or stays, if they are a partner in the firm as at Jan. 1 of the new year, the contribution is required and withheld from final distribution. Partners departing the firm effective Jan. 15 are subject to a five-year return of capital.

Retirement benefits forfeiture: Some firms have unfunded retirement programs for attorneys that have been partners for 20-25 years. Some have partial vesting programs for partners starting at as little as 10 years, then ramping up to full vesting at 20-25 years. Vested partners who leave the firm and "compete" by continuing to practice law can forfeit all rights to this benefit. Such benefits are often calculated from partner earnings (say 25-30 percent of the average of the three to five highest earning years for that partner, paid annually from 10 years to life for the retired partner). As partners approach retirement eligibility (often 65, sometimes earlier, such as 60, subject perhaps to net present value discount for early withdrawal), the firm can begin squeezing current profits allocations to the partner, effectively holding the partner "hostage" to the retirement benefit.

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Many firms are eliminating or phasing out these retirement plans. One reason given is the "unexpected burden" these plans will have on younger generations. There is more to it than that. The bigger reason is that star lateral additions will never be in the firm long enough to vest meaningful participation in the plan. Accordingly, the cost of funding the plan immediately cuts into their distributable share.

Examine whether there is a cap on the amount of firm income allocable to the plan payout to retired partners (say it is 10 percent). Within the past few years, has that cap been reduced by partnership vote to a lesser percentage (say 7 percent)? If so, look at the demographic of the partners eligible for vesting over the next few years, and discover the impact that has on distributable cash. If the review demonstrates that retired partners are presently receiving 5 percent of income, and within 10 years will be bumping up against the 10 percent cap, the reduction will serve to shift 3 percent of the net distributable income of the firm back to then current working partners. That could easily be a $5-$10 million distribution strip from the retired partners.

What happens to the retired partners when the cap is reached? They typically receive a reduced share; in this example, 30 percent of previously scheduled retirement payouts. What happens later depends on plan wording, but it is likely that if they die, the unpaid "accrual" is not payable, and if the payout is limited to a term of years, it just expires and the accrual forfeit. Look to the outcome to determine the intent.

If you think you can effectively blow the whistle on outrageous and potentially unfair application of partnership provisions or policies, and educate the world (including potential lateral recruits and fellow partners), think again. You can contest these treatments (and there are many others as this list is not exhaustive) through the mandatory arbitration provisions of the partnership agreement, subject to the confidentiality provision applicable to all dispute resolutions and revelations about partnership business because partners have fiduciary duty to the firm. Breach those obligations by filing a public lawsuit, and you can kiss that capital goodbye — and send a warning flare to your new firm that you may not be the "team player" they want to admit to their firm.

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Concern grows over municipal bond debt

By Ben Adlin
Daily Journal Staff Writer

Municipal finance organizations are increasingly concerned that ambiguity in state law dissolving local redevelopment agencies could force cities and counties to default on bond payments due later this year.

In comments issued Friday, the National Federation of Municipal Analysts warned the law's lack of clarity "raises the potential for errors in administration, inconsistency of approach and unintentional violation of bond covenants and security provisions," the impacts of which "could have wide consequences throughout the state."

The federation, which represents mutual funds, insurers, ratings agencies and other stakeholders, urged lawmakers to clarify the law "as expeditiously as possible."

The state Supreme Court last year upheld legislation, Assembly Bill 1x 26, that dissolved California's roughly 400 redevelopment agencies in order to help close the state budget gap. *California Redevelopment Association v. Matosantos*, S194861.

Other groups, including ratings agencies Fitch, Moody's and Standard & Poors, have warned that uncertainty in the law's implementation could cause defaults, hurting municipal credit ratings and raising borrowing costs.

The problem is fundamentally a routing issue, said Chris McKenzie, executive director of the League of California Cities.

Under the new law, about $5 billion in property tax revenue that once went to the agencies now flows to county auditors to disburse. But bond debt — which totals roughly $30 billion — stayed with so-called "successor agencies," typically cities or counties.

"If cities and counties don't get enough money from the auditor to make those payments," McKenzie said, "there could be a default on those bond issues."

Assembly Speaker John Perez has already introduced a bill, AB 1585, to clarify certain details in the dissolution law, which critics say was drafted hastily and with little foresight. An Assembly committee is set to consider the cleanup bill on Wednesday, a Perez spokesman said.

McKenzie said the league is working closely with the speaker to make sure successor agencies can pay their debt service, adding there's broad support in Sacramento to ensure the law is clear.

"Everybody in this government who's touched this issue has assured us they don't want to see any defaults."

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Talks between SF court and employees stall

By Saul Sugarman
Daily Journal Staff Writer

SAN FRANCISCO — Contract negotiations between the San Francisco County Superior Court and some of its employees stalled last week when the two parties failed to agree on a new deal.

Discussions with the Service Employees International Union, which represents 265 employees in the court, began last month when the union's contract was up for renewal. Court negotiators argued that they needed employees to take a 5 percent reduction in wages because of massive slashes in funding.

Last year, more than $350 million was sliced out of the judiciary's budget. About 70 employees lost their jobs at San Francisco Superior Court, which also had to close 10 of its courtrooms.

"It's no doubt that the past four years have been difficult," said J.M. Muñoz, a lead negotiator for the court. "Pay raises have been few and far between, but this is the first pay cut in a long time that the employees will experience."

On Wednesday SEIU Local 1021 members rejected the court's offer on a vote of 126 to 68, with 71 members not voting.

Steve Stallone, a spokesman for the chapter, said the union made several requests, including a guarantee to not have more layoffs or to take some of the wage cut as furloughs.

"It was all stick and no carrot," he said. "This isn't because we didn't want to make a deal. We kept trying to do so, and they kept saying no."

Ann Donlan, a spokeswoman for the court, said the court could not agree to no layoffs because it does not know what funding it will or will not receive in the future. In addition, she said that if more budget cuts are made "we expect to face another round of layoffs."

Donlan said the court is operating at what it believes is the minimum staff level possible and that hiring staff to cover furlough days would cost $600,000.

The other three unionized groups of court employees, including managers and court reporters, all agreed to the wage cut earlier this year.

The fact that SEIU has not signed a contract means some employees are no longer eligible for an increase in health benefits offered by the court.

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Teacher dismissals: an expensive, cumbersome process

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school district is required to provide notice to the teacher. Importantly, such notice cannot be provided between May 15 and September 15.

After the charges are adopted, and notice provided, the teacher has a right to demand an appeal. Under the appeal process, largely prescribed by Education Code Section 44944, the teacher must submit a demand for hearing within 30 days of the school district's notice to dismiss. If the teacher fails to demand a hearing, the dismissal is considered uncontested and the employee is dismissed. After receiving the demand for hearing, the school district submits to the Office of Administrative Hearings (OAH) a request to set. The OAH is the nation's oldest and largest central panel agency, established by the Legislature in 1945 as a quasi-judicial court that hears administrative disputes. It is not, as is largely believed, operated by any school district, but is independent and provides the administrative law judge for the hearing. After receiving the request to set, the OAH sets a trial setting conference, and the teacher submits a notice of defense, which is effectively his or her answer to the charges. At the trial setting conference, dates are calendared, including the last day to conduct discovery and designate a panel member.

The last point is significant and often impedes the timely process. Unlike most administrative hearings, a teacher dismissal hearing is not heard before a single hearing officer, but by a Commission on Professional Competence. The commission is made up of an administrative law judge, one panel member who may be selected by the teacher and one panel member who may be selected by the school district. There are, however, strict requirements as to who can serve as a panel member, including, at a minimum, that they: cannot be related to the teacher, cannot be an employee of the district initiating the dismissal, and must hold a valid credential and have at least five years of experience in the past 10 years in the discipline of the employee. A proposed panel member cannot receive any additional wages for their service, although they can be reimbursed by the OAH for reasonable expenses.

If either the school district or the teacher cannot locate a panel member that meets these requirements, the right to select a panel member is waived and the county Board of Education must make the selection. Finding a qualified panel member is frequently challenging. Many suggest, and I agree, that the Legislature should repeal the statutory Commission on Professional Competence requirement and permit an administrative law judge to hear the appeal with the right of writ review, as is the process with many termination appeals.

> While it may seem straightforward to simply terminate accused teachers, the complex and multi-faceted due process requirements prescribed by state law make it anything but simple to do.

The rub in all of these requirements and limitations is that the Code requires that the hearing "shall be commenced" within 60 days from the date of the demand for hearing. The 60-day period, however, can be waived by the parties or otherwise continued for good cause. Moreover, the preparation for the first day of hearing is not insubstantial. For any administrative proceeding, discovery is possible pursuant to Government Code Sections 11507.5-11507.7, which takes the form of a "request for discovery" that effectively asks each side to list all their witnesses and produce pertinent documents they intend to rely upon at the hearing. Second, the Education Code expands permissible discovery beyond administrative rules into the typical extensive civil procedure discovery options.

The hearing itself is conducted pursuant to the Administrative Procedures Act, and may occur continuously or may be broken up into nonsequential days over a period of months. The Commission on Professional Competence hears the evidence presented by the parties. The school district, however, bears the burden of proof (by a preponderance of the evidence) at the hearing. *Gardner v. Commission on Professional Competence*, 164 Cal.App.3d 1035, 1038-1039 (1985).

Presuming that the school district and the teacher are able to secure a panel member, and that the hearing can commence as scheduled, there are still restrictions of what type of evidence may be presented in support of the dismissal. The statutory scheme requires that no testimony shall be given or evidence introduced relating to matters that occurred more than four years prior to the notice. Evidence Code Section 44944(a)(5). There are very limited exceptions to this rule. For example, in *Atwater Elementary School District v. California Dept. of General Services*, 41 Cal.4th 227, 232-235 (2007), the state Supreme Court determined that the four-year requirement was not absolute, applying the doctrine of equitable estoppel (if there is proof that a "delay in commencing action is induced by the conduct of the defendant *teacher*" such delay "cannot be availed of by him as a defense.")

After the presentation of evidence by the school district, and the rebuttal by the teacher, the matter is submitted to the Commission on Professional Competence for a decision. As to the Commission's ultimate decision, they must determine whether the teacher is considered fit to teach — that is, whether the school district is entitled to dismiss the teacher. Education Code Section 44944(c)(1). "Fitness" is determined pursuant to the standard set forth in *Morrison v. State Board of Education*, 1 Cal.3d 214 (1969), as well as the cases that follow and interpret it. In determining whether a teacher's conduct constitutes unfitness to teach, the governing body may consider the likelihood that the conduct may have adversely affected students or fellow teachers, the degree of adversity anticipated, the proximity or remoteness in time of the conduct, the type of teaching certificate held by the party involved, the extenuating or aggravating circumstances, if any, surrounding the conduct, the praiseworthiness or blameworthiness of the motives resulting in the conduct, the likelihood of a recurrence, and the extent to which disciplinary action may inflict an adverse impact or chilling effect on the constitutional rights of the teacher involved or other teachers. A teacher dismissal based on the cause of "immoral conduct" will be measured by the standard of if the teacher poses a significant danger of harm to either students, school employees, or others who maybe affected by his or her actions as a teacher.

If the Commission on Professional Competence determines, by a majority vote, that the teacher is unfit, she or he is dismissed. If it determines the employee is fit, the employee is ordered reinstated and awarded backpay and attorney fees. If a school district is successful at the dismissal, however, there is no reciprocal attorney fee provision that allows it to recover its fees and costs. Although the Commission's decision is considered a final decision of the governing board, if either the teacher or the school district believes the decision was made in error, they can take an administrative writ of mandamus to the Superior Court. The Court, on review, exercises its independent judgment on the evidence.

Recent media coverage of teacher allegations understandably focuses on the severity of the facts of each case, and the traumatic impact on students and the community. While it may seem straightforward to simply terminate accused teachers, the complex and multi-faceted due process requirements prescribed by state law make it anything but simple to do.

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