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The legal cost of a British tradition

By John Gapper
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There are some British traditions, such as playing tennis on grass, taking summer holidays on the Lancashire coast and staying on board sinking ships, that once made sense and still have a certain charm but have outlived their usefulness. Another is the way in which law firms reward their partners.

British lawyers adhere to a system called lockstep. Partners in most City law firms such as Clifford Chance or Freshfields Bruckhaus Deringer are paid on length of service. In strict lockstep, how much a lawyer makes for the firm, where he works and his field of practice are all irrelevant. All the partners who have been there a set number of years are paid the same amount.

Lockstep always applied in the UK and, as British firms expanded globally through mergers such as Clifford Chance's amalgamation with Rogers & Wells of the US in 2000, lockstep came too. A partner who specialises in property in Bangkok takes home the same as a New York mergers and acquisitions adviser.

City firms have closed less-profitable offices rather than compromise this: Freshfields did so in Thailand.

Compared with investment banks, where there are constant arguments over how to divide up the spoils, law firms are run on equitable principles. British lawyers talk disdainfully of the "eat what you kill" culture of Wall Street firms and the strife it brings. Partnership is fading across professional services but lawyers march proudly in lockstep.

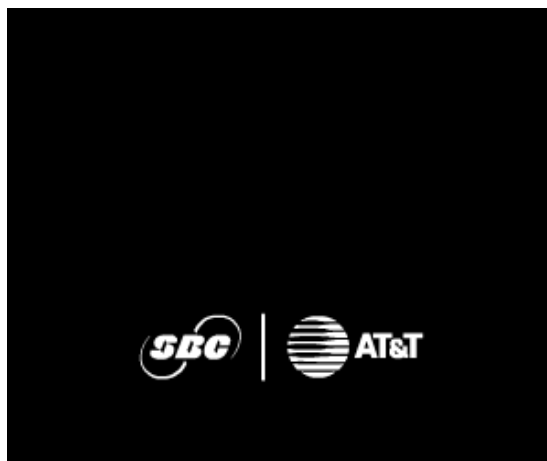
Lockstep has its advantages. A global company that hires a lockstep firm gets lawyers who are more likely to work seamlessly. They will be less tempted to structure deals to reward one set of specialists or the partners of one office. Partner is not just a title; it means something.

But global law firms can no longer afford that luxury. Clifford Chance holds a vote next week on whether to vary lockstep and is likely to end up paying partners in some countries less than London rates and those in others more. This would only allow regional variations but it cannot be long before City firms pay partners according to their value as individuals.

Unless they do so, they will lose a lot of talent. The biggest, most global law firms - the British ones - are not making enough money to support lockstep. Partha Bose, a consultant who used to work at Allen & Overy - one of the "magic circle" of big City law firms - says that lockstep is "tearing apart at the seams" under the strain of global growth.

Revenue growth recovered at City firms this year after two tough ones but a gap has opened between their profits per equity partner and those of top New York firms such as Wachtell Lipton Rosen & Katz and Sullivan & Cromwell. Figures from The Lawyer magazine show US firms taking nine of the 10 top places on this measure this year, with

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only Slaughter & May sneaking in beside them.

That allows New York firms to poach lawyers in the world's financial centres: even in London, the City firms are losing partners. Loosening lockstep will help - one partner in a City firm says it will allow the firm to recruit litigation and mergers and acquisitions specialists earning up to \$3m (£2.5m) a year. But he admits "the big gorillas" - lawyers earning more than \$5m - will stay out of reach.

This is worryingly reminiscent of the period in the 1990s when City merchant banks such as S.G. Warburg and Schroders tried to make the leap into global enterprises. They found it impossible to break into Wall Street and the costs of expansion sapped profits. They ended up succumbing to takeovers from US investment banks such as Merrill Lynch and European banks including UBS.

In some ways, the City law firms' predicament is worse. Not only do the New York firms have a far bigger domestic revenue base - there are advantages to the litigiousness of US society - but they have been pickier about expansion. Instead of following their big clients around the world, as the City firms have done, they have stuck to big centres such as London, Frankfurt and Shanghai.

So the City firms are attempting a bigger task from a smaller home base. It would be easier if they had broken into New York through mergers, but that has not yet worked. Peter Cornell, Clifford Chance's global managing partner, has spent this year in New York trying to fix the fallout - and loss of partners - from its merger with Rogers & Wells in 2000.

The City firms need not end up as losers. Although the New York firms are very profitable, they depend on the goodwill of US multinationals. It unquestionably suits a New York firm only to have a Shanghai or a Beijing office in China, for example, but as the General Electrics and Wal-Mart's expand into other cities - and across Asia - they may question why their lawyers are not there too.

If City firms can make enough cash while expanding globally, New York firms may regret their timidity. But lockstep stands in the way. It imposes costs on firms operating in low- and high-wage countries and penalises younger and more valuable partners. Lockstep may work well for small, specialised firms - some New York firms are lockstep - but a global enterprise is a different beast.

In their hearts, the City firms know this. Even those that espouse lockstep pay bonuses to the best partners. But events often overtake enterprises that are sentimentally attached to outdated traditions. The City ought not to stick to lockstep like the band that played on as the Titanic sunk: quaint, selfless and admirable, but doomed.




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