

## Managing Partner Disputes Top 40's Methodology and Accuracy

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This year, our firm was once again solicited to disclose its confidential financial information in connection with the compilation of the "NJLJ Top 40" [published June 20]. The *Law Journal's* use of the word "top" in the name of this list in my opinion illustrates one problem with this process. The *Law Journal* ranks law firms with New Jersey offices by gross revenue — specifically the 40 firms with the highest gross revenue from their New Jersey practices. I believe that neither the number of attorneys nor the amount of gross revenue necessarily correlates with the quality of the legal services provided, yet the use of the word "top" surely implies this.

There is a serious problem with the manner in which the *Law Journal* reports the financial information contained in the list. In addition to gross revenue, the NJLJ Top 40 compiles the number of attorneys, partners (equity and nonequity), "profits per equity partner," net profits, compensation per partner, revenue per lawyer and the American Lawyer Profitability Index for each firm on the list. Clearly, one of the *Law Journal's* functions is to report on the business of law and there is no doubt that this information is of interest to its readers — including me. But unlike *Fortune* magazine, which ranks public companies on similar matrices, the law firms on the list are private entities that do not routinely report their results, do not compile their financial results in a consistent manner and as noted by your publication, have various structures (LLC, C-Corp., LP, LLP, S-Corp.), which make comparisons difficult.

Public companies are required to report their audited financial results, which are compiled using a mandated

methodology designed to insure consistency and accuracy. Public companies also have defined ownership units — shares — that allow their results to be readily reported on a per-share basis and, more importantly, in a manner that permits the public to reliably compare financial results with those of other companies.

Unlike the audited financial information of public companies, the information compiled by the *Law Journal* on these law firms is not compiled by the reporting firms in any consistent matter, is subject to manipulation by the reporting firms to suit their specific agendas and notably, as in the case of our results, is not disclosed by the firms on the list. Instead, the financial information for our firm (and I suspect others) is compiled by the staff of the *Law Journal*. I was told that you use sources within firms, fee applications made to various courts that are public and other information to compile the results.

In fact, the financial results for nonreporting firms such as ours are merely guesses by the staff of the *Law Journal*. Remarkably, the *Law Journal* does not indicate to its readers which information was reported by the firms and which information was estimated by its staff. In our firm's case, the *Law Journal* provided us with its estimated numbers in a not-too-subtle attempt to coerce us to report our results. [As an aside, please note for the record that the estimated results for our firm are grossly inaccurate.] For the reasons discussed herein, we declined to disclose our results and believe the *Law Journal* should distinguish the financial information that it has estimated from information reported to it by the firms.

With respect to the information itself, I'm on record with my concerns regarding the harmful effects the reporting of this information has had on our profession. [See "Profits Per Partner: The Bane of the Profession," *The Pennsylvania Law Weekly*, Business of Law Supplement to

*The Legal Intelligencer*, September, 2006.] Specifically, I feel it has motivated firms to sacrifice long-term strategic objectives for short-term profit, caused firms to treat their attorneys less as individuals with varied talents and contributions to the firm and more akin to uniform interchangeable profit centers.

From the individual firms' perspectives, I wonder what motivates them to disclose private information? Clearly some must have succumbed to the coercive effect of the process itself. After all, our shareholders debated whether we should relent and provide our financial information and some felt that not doing so would hurt our chances of attracting attractive lateral candidates to our practice. They reasoned that candidates would reference the list when contemplating a move to another firm and base their decision in part on the financial information contained therein. Clearly, the purpose of the list is to provide a snapshot of the financial performance of the largest firms in the state, with the expectation being that attorneys could gauge the relative financial performance of their firms when compared to their peers. Unfortunately, the data is unreliable.

For example, profits per equity partner ("PPP") is the average compensation received by the equity partners in a particular firm. Today, firms have an innumerable number of partner classifications. Do a 10 percent partner and a 1 percent partner count equally in the denominator of this fraction? Voting vs. nonvoting? Full-time vs. part-time? What constitutes full-time? In a corporation, all shareholders are equity holders. I submit these questions are resolved very differently among the reporting firms with material effects on the resulting numbers. Focusing on profit — the numerator of the fraction — how does profit equate if at all to what is actually distributed to the partners? Is profit their share of taxable income on their Form K-1? Do capital contributions get subtracted from profits? What about "voluntary contributions" to a firm's political action committee?

Instead, when contemplating a career move or evaluating their firm's relative profitability, attorneys should spend time evaluating the financial health of their current and any prospective firm they may be considering.

- How much debt does a firm have and is it personally guaranteed?
- Does the firm have unfunded liabilities to retired or soon to be retiring partners?
- Are my target clients and anticipated billing rates compatible with the target firm and consistent with its strategic plan?
- What level of compensation would my anticipated contribution to the firm (originations, client responsibility, firm service and personal hours worked) earn at the target firm vs. my current firm?
- Are the sources of the target firm's revenues concentrated among a few clients, originators or industries?
- What is the target firm's strategic plan and how does it plan to replace the revenue from retiring/transitioning attorneys?

The items above are but a few of the factors that truly illustrate a firm's financial health. Realistically, the only reliable method of gauging a firm's financial health and profitability is to ask the above questions and thoroughly investigate a firm before contemplating a move or reaching conclusions on relative profitability. Placing any reliance on the figures reported in the "New Jersey Top 40" is, in my opinion, misguided.

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