The Necessity of Evaluating Potential Lateral Partners

Once it was the exception for a partner to leave a firm. Now the revolving door of partner departures has been deemed a "modern-day law firm fixture."[1] Driven by the escalating needs of clients whose businesses have expanded exponentially in an increasingly global market, law firms similarly have experienced geometric growth. Highly specialized practice areas have emerged as the law tries to keep pace with entirely new industries spawned by rapidly changing markets and technologies. The lure of a bigger platform and the limits that a revenue model based largely on hourly billing rates imposes have caused attorneys to explore the opportunities available to them at other firms.

For a law firm, a successful acquisition of a lateral partner or lateral group can instantly create a new practice area, add depth to an existing group or breathe life into a withering one. The most sought after laterals bring with them significant portable business which can quickly add millions of dollars to the firm's revenue, with the potential of much more. A lateral who is a recognized expert in a field or who has extensive contacts or experience can greatly enhance a firm's reputation. Synergies with the firm's existing practice areas or clients can multiply the positive impact of the right acquisition many times over.

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[1] Graubard Mollen Dannet & Horowitz v. Moskovitz, 86 N.Y.2d 112, 629 N.Y.S.2d. 1009, 1010, 653 N.E.2d 1179 (1995).

There are, however, high stakes and significant risks inherent in lateral acquisitions. To attract a highly profitable lateral or lateral group, a firm must make a considerable economic commitment. Not only are there high compensation and start-up costs, but generally it takes several months for the new group and its clients to get acclimated and reestablished before revenue is received, and even longer for any profit to be shown. If the anticipated business does not materialize, what was initially seen as a profit center could turn into a major drain.

Equally serious consequences may result from issues often overlooked in the vetting process. For example, one of the driving forces of the acquisition may have been contemplated synergies because the lateral group had clients in the same industry as that of a significant existing client of the acquiring firm. Once the acquisition becomes public, however, the acquiring firm may learn from its existing client that, as a matter of policy, it does not want its law firm representing any of its competitors. Or, once the new partner advises the largest client he expected to come with him of his new firm affiliation, the client may decline to follow him because of a prior bad experience with the acquiring firm. In an age of Sarbanes-Oxley (which increases penalties for securities fraud and heightens financial reporting requirements) and government charges of lawyer complicity in corporate malfeasance,[2] the ethics and integrity of both the potential laterals and the anticipated clients become critical. The acquiring firm's own competence and reputation can become sullied if it turns out that the lawyers it is seeking to acquire do not share the same standards of ethics and integrity. Personal conduct of the potential laterals, such as prior incidents of discrimination or sexual harassment, alcoholism or drug use, or just plain bad behavior, can also have a serious impact on the acquiring firm.

The acquisition process itself is fraught with minefields that could transform the dream acquisition into a nightmare. If the vetting and hiring processes are not handled in the proper manner, both the departing partners and the acquiring firm could find themselves as joint defendants in a lawsuit brought by the former firm asserting a panoply of claims, such as breach of fiduciary duty, disclosure of confidential information or trade secrets, tortious interference with the former firm's relationships with its clients and/or employees, and unfair competition.

[2]For example, a lawyer for Enron's accounting firm, Arthur Andersen, was accused of instigating a seventeen day document shredding marathon via an email to Andersen employees describing how long financial documents need to be kept and when they may be discarded. *See* Thomas, "Called to Account," *Time Magazine*, June 18, 2002; Arthur Andersen LLP v. U.S., 544 U.S. 696, 708, 125 S.Ct. 2129, 161 L.Ed. 2d 1008 (2005).

The best way to avoid these and other pitfalls endemic to lateral acquisitions is to thoroughly vet the potential laterals and make sure that none of the rules that govern the partners' obligations to the former firm are broken. Unfortunately, this is not so easy, as much of the evaluative information the acquiring firm might like to know would require precisely the kind of disclosure that could form a legitimate basis for a lawsuit by the lateral's existing firm. Moreover, the law setting out the rules is still in its nascent stages. Nonetheless, certain guiding principles have emerged which, if followed, can greatly reduce the risks and potential liabilities.