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Counsel's Corner: When is a Law Firm Partner a "Partner"?

by Tina B. Solis, Esq. and Christina E. Kurow, Esq.

Many firms have adopted a two-tier partnership structure, consisting of equity and non-equity partners. But to the outside world including clients, these individuals are simply known as "partners" of the firm. A common question that arises in the lateral partner recruiting process is whether there is a distinction between equity and non-equity partners that could impact a lateral move. The answer is "it depends." It depends on how the law firm is structured, how the partners are compensated, and the laws of the relevant jurisdiction. Below are three of the most frequently asked questions regarding when is a law firm partner truly a "partner."

1. Compensation

Equity partners typically receive K-1 forms for tax purposes as owners of the law firm and are responsible for paying their own taxes, assuming a partnership structure as opposed to a corporate shareholder structure. Despite their "partner" title, many non-equity partners receive W-2 forms and are treated as "employees" for tax purposes, similar to associates and other firm staff. But the tax treatment for non-equity partners depends upon the firm. Some non-equity partners also receive K-1 forms, similar to their equity partners. It is important to understand how non-equity partners are characterized for tax treatment purposes at their current firm and how these non-equity lateral candidates will be characterized for tax treatment purposes at any potential new firm. The tax treatment can impact cash flow for a non-equity lateral candidate that may require budgetary planning, at least with regard to the year of the transition. Non-equity partners that receive W-2s and are treated as "employees" have an advantage over their counterparts that receive K-1s because employees are protected by certain state wage payment statutes if the firm does not pay the non-equity partner upon departure. Partners receiving K-1s are not afforded such protections.

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Usually, only equity partners are required to make capital contributions to the firm. More recently, however, some firms have started to require non-equity partners to make capital contributions – *albeit* smaller than the contributions required from their equity ranks. Some firms also subject non-equity partners to deferred compensation, as they do with equity partners. Recruiters must be cognizant of these issues as they help navigate a lateral candidate through the process because these issues can materially impact a non-equity partner's bi-weekly or monthly "take home" pay.

2. Discussing possible lateral moves with others at the firm

Under the laws of most states, equity and non-equity partners can discuss making a lateral move together. For instance, under New York and Illinois law, partners can solicit other partners pre-departure, but not employees (associates and staff). See Gibbs *v. Breed, Abbott & Morgan*, 271 A.D.2d 180, 185 (N.Y. App. Div. 1st Dep't 2000); *Dowd and Dowd, Ltd. v. Gleason*, 352 Ill. App. 3d 365, 377 (1st Dist. 2004). Courts do not typically make a distinction between associates and staff members of the firm with respect to pre-resignation solicitation – partners may not solicit either before he or she departs the firm. *Dowd*, 352 Ill. App. 3d at 377.

Some firms include non-solicitation provisions in their partnership agreements in an attempt to prevent additional attorney and employee departures. Depending on how these provisions are worded, they may or may not be enforceable. It is critical to review these provisions in the partnership agreement in addition to the relevant state laws and ethics rules.

3. Notice provisions

Notice provisions in law firm partnership/shareholder/member agreements are commonplace in the profession today. Firms may hold equity and non-equity partners to the same notice periods, but not all do. Some firms do not have any notice period for non-equity partners. Others have shorter notice periods for their non-equity partners compared to their equity partners. It is critical to review the partnership agreement closely to determine which notice period, if any, applies to a partner departing the firm. To the extent a partner is subject to a notice period, the next consideration is making certain he or she complies with the requirements of providing the notice of the resignation/withdrawal, itself, and then complies with the terms of the subsequent notice period.

In short, a recruiter cannot simply assume that a candidate who has a "partner" title will be treated the same as another candidate at the same firm who also holds a "partner" title. The same is true of a group of partners that may be departing together. It is imperative that the recruiter and each individual candidate understand the specifics of his or her partnership agreement. Recruiters should recommend that the lateral partner candidates consult with counsel familiar with this area of law in advance of a partner departure.

ABOUT THE AUTHORS:

Tina B. Solis, Esq.
Partner, Nixon Peabody in Chicago
P: (312).977-4482
E: tbsolis@NixonPeabody.com
W: www.nixonpeabody.com

Christina E. Kurow, Esq.
Counsel, Nixon Peabody, Chicago
P: (312) 997-4642
E: ckurow@nixonpeabody.com
W: www.nixonpeabody.com