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COMPENSATION & BENEFITS FOR LAW OFFICES

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COMPENSATION

Administering Partner Compensation Systems

By Joel A. Rose

The organizational relationships among and between principals in a law firm will determine, to a major extent, the compensation system to be employed for allocating salaries and bonuses. Plainly stated, do the principals want their firm to operate as (1) a confederation of lawyers or (2) a unified firm?

In a *confederation* of lawyers, each lawyer develops individual client relationships. There is frequently an element of competition for clients within the

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FIRM FINANCES

Tough Talk About Alternative Fees

Jay Shepherd has a problem with lawyers' who describe their work as "practicing" law. He cites the definitions in his *New Oxford American Dictionary*:

> 1. perform (an activity) or exercise (a skill) repeatedly or regularly in order to improve or maintain one's proficiency: *I need to practice my French* | [intrans.] *They were practicing for the Olympics.*
>
> 2. carry out or perform (a particular activity, method, or

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BENEFITS

Plan Sponsors: Be Ready for DOL's New Fee Disclosure Rules

A BNA Special Report

Plan sponsors need to "get their ducks in a row" and be ready to comply with the Labor Department's (DOL) interim final regulations on plan service provider compensation arrangements, according to attorneys who spoke recently at a BNA-sponsored webinar.

The DOL pursued these ini-

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Which Law Schools Generate Best Career Satisfaction?

U.S. News and World Report divides American law schools into four tiers, with first-tier schools being the most highly ranked. Lawyers who report the highest levels of career satisfaction are graduates of law schools ranked in which of the following four tiers?

(A) Top tier
(B) Second tier
(C) Third tier
(D) Fourth tier

Answer: (D) Fourth tier

Source: Levit and Linder, The Happy Lawyer: Making a Good Life in the Law. *Oxford UP, 2010*

The switch many firms made during the recession to competency-based advancement models rather than lockstep promotion of attorneys based on a year's more experience has a better chance of sticking, Clay said. He added, however, that only the larger firms have the staff and resources to implement such programs.

So are law firms different than they once were? Changes described by Clay and Kowalski are a return to old practices. No longer is being a good attorney enough. The associates who will advance are those with business savvy and an understanding of process management, the experts say. Entering and succeeding in a law firm is getting harder. ❑

This article is an edited version of an article by Gina Passerella that appeared in the The Legal Intelligencer *of October 6, 2010 under the title Post-Recession Law Firms: A New Caste System Emerges.*

Compensation Systems

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office, since serving the more important or better paying clients provides rewards and advancement. Lawyers who prefer the confederation concept enjoy a level of independence and the lack of accountability that this organization makes possible. Each lawyer is viewed as the master of his or her work and client, and is permitted to practice with little supervision and limited accountability.

Many law firms that employ purely statistical or objective systems for allocating profits to principals are frequently characterized as confederations of lawyers for the following reasons:

- few, if any, firmwide initiatives are in place for marketing the firm's legal services as lawyers receive personal credit for originating and producing their own business, even though they may "buy" the time of other attorneys when assistance is required
- those lawyers originating client work may not use the firm's expertise most effectively since they are inclined to do the work they originate, even if others in the organization may possess greater expertise in that area of practice and, specialization may be eschewed;
- training of associates is minimal at best;
- there is usually little standardization of forms and work habits since each attorney usually practices alone.

A *unified firm* practice embodies a group of lawyers who desire to serve their clients as a single entity, rather than as a collection of individuals, i.e., a confederation. Principals in most larger firms prefer to practice in this manner because the many facets of the legal matters handled are too demanding for an individual attorney to perform alone. Unified firms generally recognize specialty practice areas and view clients as belonging to the firm rather than to any individual

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CBLO Calendar:

Firing on All Cylinders: Workshop for Practice Group Leaders, New York City, Dec. 1. Contact: Ark-Group Events, 773-281-4276; usa.ark-group.com.

Retirement Plans: Design Considerations and Administration, Atlanta, Dec. 1–2. Contact: World at Work, 877-951-9191; info@worldatwork.org.

Washington Healthcare Summit 2010, Arlington, Va., Dec. 6–7. Contact: American Bar Association, 800-285-2221; www.abanet.org.

2010 Professional Development Institute, Washington, D.C., Dec. 9–10. Contact: NALP—The Association for Legal Career Professionals, 202-835-1001; www.nalp.org.

Controlling Legal Costs, New York City, Dec. 8–9. Contact: ALM Events c/o Incisive Media, 212-457-9400; www.almevents.com.

Virtual LegalTech, Online, Dec. 14. Contact: ALM Events c/o Incisive Media, 212-457-9400; www.almevents.com.

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principal. This style of practice calls for the subordination of lawyers' individual egos to the recognition that clients are better served by lawyers who are, at least to some degree, specialized and that the lawyers in the firm are all, in their own areas, competent to serve any client.

Firms that are organized in this manner do not generally divide income on a purely statistical formula basis which may not include client origination, work produced, and other intangibles, although they may expect principals and associates to work a certain minimum number of productive hours, produce a certain amount of revenue, or a combination of both. Firms that are structured in this manner usually:

"Unified firms do not generally divide income on a purely statistical formula basis."

- set firmwide standards for the acceptance of cases;
- tend to share support staff and manage the other principals and associates;
- develop firmwide marketing initiatives in addition to departmental and individual marketing strategies to further the interest of the firm.

Implementations of these initiatives usually call upon the expertise of all of the firm's members. A "full service" law firm is almost always organized as a unified firm.

Compensation: a committee function

A significant majority of larger law firms use a committee to allocate profits to their principals. This committee may be the firm's management or executive committee or a separate compensation committee. To the extent it is the latter, one or more members of the management/executive committee usually participate in these decisions.

Committee members may be appointed, elected, or chosen by a combination. Election or appointment may be representative of age groups or classifications of attorneys, i.e., senior, mid-level and junior principals, heads of substantive departments and offices; chosen at large; membership chosen in favor of a particular classification or equal, or for other reasons relevant to the firm. Tenure of all or some committee members may be permanent (at the pleasure of the principals), rotating or a combination.

Principals' concerns

Absent agreed-upon criteria for allocating profits to principals, committee members usually have their own preference about which contributions or criteria are considered to be more valuable than others and their appropriate weighting. Objective data may be overemphasized because of their relative ease to obtain; subjective contributions may be deemphasized because they are more difficult to obtain and/or value. Further, committee members may not be as aware of the subjective contributions of those principals they do not work with on a regular basis or that are in a different location.

Committees succeed when the principals understand the "rules of the game," the criteria for allocating profits, and how they will be weighted by the committee in making their decisions. Two common complaints about the committee system are that:

(1) principals do not know the criteria

against which they are being evaluated and

(2) the criteria, and how they are weighted, may change without notice or warning.

Unless principals have confidence in the members of the committee to evaluate fairly the contributions of every principal, and not "feather their own nests," take care of their friends, or take their charges seriously, the best compensation system will be doomed to failure.

Critical information

More of the larger law firms are gathering objective data about each attorney, department, office, and the like and are interpreting it subjectively. Also, more firms are actively seeking input from department heads about the objective and subjective contributions of each member of their department. More committees are seeking to obtain information from each principal about their contributions to the firm. This information is usually obtained through personal interviews by the committee with each principal. In those firms in which principals are required to prepare "partner game plans," a segment of their evaluation is predicated upon how effectively they achieved, exceeded or failed to achieve their "approved" plan and the reasons why.

"Bonuses are an effective tool to recognize significant, short-term contributions, but not routinely high quality performance."

Principals may be requested to rank every other principal or assign points or dollars of projected profits to every other principal, based upon objective data and subjective information provided about each principal. The objective data is compiled by the firm's accounting department. The subjective information is usually obtained through questionnaires completed by the principals.

A package which contains copies of the completed "subjective" questionnaires and the objective data about each principal is distributed to every other principal. Each is requested to award to every other principal points or a dollar amount of the "projected salary pot" for next year and the "bonus pot" for the current year. The allocated amounts are collected and submitted to the committee "for advice only." The committee then allocates the salaries from the projected salary pot for next year and awards bonuses to principals from the projected bonus pot for the current year.

Bonuses

Most larger law firms budget incentive bonuses into their compensation system. The bonuses in the incentive pool are usually "up to" 25 percent of the total net income. More firms allocate fewer bonuses, but bonuses to deserving principals are of higher dollar amounts, i.e., not less than $10,000, rather than smaller bonuses, $1,500 to $3,500, etc., to many more principals.

Bonuses are an effective tool to recognize significant, short-term contributions of principals. Quality performance is not an attribute for which a principal should receive a bonus. After all, principals are expected to provide high quality service. However, if some principal sacrifices himself/herself in behalf of a client that is clearly above and beyond the performance level expected of a principal, or the principal has contributed tremendous

value to the firm or to a client, etc., then that principal may qualify for a bonus.

Allocating bonuses to deserving principals for their short-term contributions to the firm is preferable than progressing a principal to a higher compensation level with the expectation that he or she will continue at that accelerated pace, only to find that they are unable to do so and have to be demoted to a lower compensation level two to three years later.

Compensation tiers

The trend has been to reduce, rather than increase, the number of tiers within the compensation system. Values of dollars or compensation points are set forth for each tier. This trend is designed, in part, to minimize the smaller relative differences between and among the compensations of principals and to emphasize that greater contributions to the firm will be required for principals to progress to higher tiers.

Progression between the tiers occurs when contributions are not only meaningful, but also of a continuing nature. Short term or one-shot contributions of principals are recognized through bonuses, without changing their tiers. Changes in tier placement may occur as the result of a principal's continuing contributions to the firm over time, for example, based upon two succeeding annual evaluations by the committee.

In those firms in which compensation reviews occur every two years, principals whose evaluation results suggest the possible reductions of a tier are usually reevaluated as to placement the following year. In the event this reevaluation does not result in the change of tier placement, the biannual evaluation cycle will resume. In the great majority of firms, movement of principals does not exceed one step up or down between tiers. However, in appropriate circumstances movement may be greater than one tier.

Compensation for what?

The following list includes those criteria most frequently considered by compensation committees when assessing the contributions of principals. The formal or informal weighting or value placed on each of the below factors is usually a function of the firm's immediate and longer term needs and priorities.

- Business development, client retention and new work from existing clients
- Financial achievement beyond expectation
- Encouragement of "young stars" showing exception promise
- Lawyer management—legal and administrative
- Entrepreneurial enterprise
- Quality performance
- Production-hours worked
- Collection of fees
- Profitability of performance
- Training of younger lawyers
- Overall contribution to the firm
- Seniority, loyalty
- Enhancement of the firm's reputation
- Replacement value

Evaluation process

An effective evaluation process might involve an advance plan prepared by each principal for his or her own performance, approved by their department chair or designee. A standard form for this evaluation process is distributed to each principal. At the end of each evaluation period, each

principal provides to the committee a written self evaluation of his or her fulfillment of their individual advance plan and describes their total contribution to the firm during the current period. Emphasis is given to the particular needs and priorities of the firm at any given time, as well as to the interests and abilities and the track record of each principal.

Of great importance to nearly all firms is the production of new business and the retention of business from existing clients as well as the attraction of business from potential clients.

The importance of attracting new quality and profitable clients is obvious. Client retention/expansion/management is the activity of cementing relationships with existing clients by the effective and timely delivery of legal services. Many large law firms are allocating to principals "origination" or other credits which recognize their achievement in proliferating new matters from the clients that have been brought in originally by other principals.

Administration

The allocation of salaries/points for next year and bonuses for this year may be determined prospectively or retrospectively. Most firms allocate salaries/points prospectively and bonuses recognizing performance for the current year, retrospectively. Salaries/points determined prospectively may be for one year or two years at a time. To extend the compensation period beyond two years is simply not practical. To minimize wide swings in a principal's salary/points, some firms use a rolling two- or three-year average of the principal's salary/points and their projected salary/points for next year.

Also, to protect a principal from any dramatic compensation swing downward in any given year, some firms have set a percentage figure beyond which a principal's salary may not be reduced, absent some significant event, which calls for special review by the committee or all of the principals.

Some firms employ a profit center approach to allocate income to principals. The objective of this is to allocate income and expenses to each principal to determine their profitably or costliness on a cash received basis. The resultant data may be interpreted subjectively and judgment may be utilized to factor into the equation the qualitative contributions of each attorney, or the data may be interpreted objectively, in compliance with a strict mathematical formula.

Administration of compensation systems can be a complex, albeit quite important, function of firm management and administration. One might be tempted to ask, "Why bother?" The answer is direct. As a firm evolves, changes to its compensation system should evolve as well as a natural and inevitable course of events. The firm that succeeds in establishing a sound compensation system is one in which principals view the decisionmaking process as a dynamic, fair procedure and understand that it is not etched in stone. ❑

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