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Dealing with Tensions Surrounding Partner Compensation

by Joel A. Rose

Partner compensation is invariably the topic of most interest in every law firm . It is also a topic which involves the most fervent debate and encompasses the most varied points of view. Not surprisingly, partners will normally advocate a compensation system which most favors their particular strong points as an attorney. Partners who do not generate much of their own business, but have high billable hours, obviously promote a system based upon billable hours only. Partners who tend to bring in a great amount of "rain" and allow it to be serviced by others, normally would promote a system based solely upon origination.

One of the biggest concerns in structuring a compensation system for a law firm is to avoid creating a firm which is essentially a group of solo practitioners sharing office space. A firm seeking long-term success must recognize that all partners bring strengths and weaknesses to the process of creating revenue and the firm must balance the various needed contributions of partners to create a fair compensation system.

A firm cannot be composed of solely attorneys who develop business without any attorney that can service it. Not can a firm be composed of attorneys with administrative skills without actual business to administer and oversee. A firm solely staffed with productive attorneys will soon run out of work if business is not brought in by at least a significant percentage of partners.

Issues Surround Origination:

There are different kinds of origination: An attorney may be successful in developing business solely from a new source that has not previously been associated with the firm. On the other hand, the firm may have long standing clients whose business has been greatly expanded by a particular partner or group of partners. Obviously, both types of origination have value for the firm.

The presence of the firm itself does play a role in origination: While some clients and many attorneys, particularly heavy rainmakers, like to stress that clients hire attorneys and not law firms, the fact remains that a certain level and scale of work would not be able to be performed or serviced by a solo practitioner. Invariably, the size, resources and reputation of a law firm do play a role in an individual partner's efforts to obtain or expand business. As an example, a solo practitioner would not be in a position to obtain and handle business consisting of a large volume of liability claims for a self-insured corporation. Substantial corporate transactions could not be handled by a solo practitioner. The resources of the firm must be a consideration.

Basing compensation solely on origination: There are obvious dangers to a pure formula based upon origination. First, it discourages partners from working on business developed by other partners even when they are more suited for handling that particular case. It discourages partners from giving support to marketing efforts of others and, most importantly, fails to reward partners who maintain a client originated by another or provide the administration or servicing of that client. At some point, the line becomes blurred between a partner that originates the work and the partner or partners that are maintaining the work and providing quality representation that keeps the client coming back. There is also a point over a period of time in which a client moves from being a client originated by a partner to being a firm client because of the amount of contacts from other attorneys in the firm over the course of the year. This pure origination formula fails to reward good lawyering performed by attorneys who have not brought any original business and fails to look at the administrative needs of a law firm.

Origination vs. Personal Production:

Formulas considering both origination and production must consider the particular structure of the law firm and the nature of its practice: For example, a law firm specializing primarily in insurance defense litigation and operating at a much lower hourly rate can readily afford the luxury of having highly compensated partners who merely originate business without having significant billable time. In firms in which hourly rates are much higher for such work as labor or corporate transactional work, the firm may have the luxury of highly compensating partners who are primarily rainmakers. The first step is to look at the structure of the firm and the nature of the practice.

Personal production mut be recognized and rewarded: Successful rainmakers are ultimately only successful if they are supported by highly competent attorneys who can do the work, produce the results and keep the client happy. Many of these attorneys may be very skilled, but not have particular strengths in marketing and business development. Ultimately, a firm must recognize the need for both types of attorneys and develop a formula which recognizes and compensates attorneys not only for business origination, but for client service, skill level and results in actual case handling. The ideal partner who ultimately should receive the highest compensation is the attorney who is able to bring in significant work and also do that work at a highly competent level with great results. These are the individuals who will emerge as stars of the firm. Putting the stars aside, all partners must realistically develop some level of business or their earnings will be capped. All partners must also recognize the need to service business as well as develop new client sources.

Doing the work or referring it: A compensation formula that encourages a partner to perform all work that the partner brings in personally and discourages referral to other attorneys in the firm is ultimately shortsighted and leads to problems. First, partners cannot be discouraged from referring work to other attorneys in the firm. Particularly in terms of lower paying hourly rate work, such as insurance defense, profit is limited unless the work is leveraged by using other attorneys, particularly associates. By encouraging work to solely be performed by the originating partner, there is an obvious cap to the amount of work that can be performed and developed by the particular partner. Discouraging any contact from another attorney in the law firm for a particular client ultimately leads to a divisive legal practice. It is, quite simply, the antithesis of the proper operation and attitude of a law firm and ultimately leads to the situation where solo practitioners share office space and some expenses.

A commitment to business development: A compensation plan based solely upon billable hours fails to recognize both the value and absolute need for business development. Firms which are dealing with lower hourly work must, of course, set and maintain billable hours requirements. On the other hand, marketing efforts over and above billable production must also be recognized and rewarded. If the work is not brought it, billable hours will obviously become non-existent.

Firm management vs. personal production: Managing partners or other attorneys with administrative responsibilities may often have a difficult time producing the same billable hours as attorneys without such responsibilities. Again, the nature of the law firm practice must be considered. Firms dealing with high volume civil litigation practices may find it difficult to have the luxury of a managing partner with full-time administrative responsibilities and no billable requirements. On the other hand, firms doing work at higher hourly rates may feel that a managing partner who does not have personal production requirements is a necessity. It must be considered, however, that attorneys performing administrative duties must be wary of giving up all ties to their personal practice since they are obviously giving up a certain amount of leverage and power within the firm by doing so. On the other hand, attorneys producing significant billable work and also performing administrative duties should justly receive additional compensation for those duties.

Evaluating revenue based upon profit margin: Obviously, certain practice areas are more highly profitable because of the level of hourly rates or the lucrative nature of the particular types of files. Other work may be less profitable on a per attorney basis, but can be highly profitable if leveraged using lower paid associates. In order to properly analyze the profitability of business being generated and administrated by a partner, it is necessary to factor in salaries, overhead and additional costs per attorney, as well as administrative costs for marketing in other related matters into the practice to determine whether it is truly profitable. Obviously, partners should be better compensated if they are creating work with a higher profit margin. On the other hand, to take an extreme example, a partner cannot be expected to be paid $500,000 if he generates $750,000 work of work which costs the firm $300,000 to generate before his draw is even paid.

Is There an Ultimate Solution to Setting a Partner Compensation Formula?

The obvious answer to this question is "no." There are no absolutely fair partner compensation formulas. Compensation cannot ultimately be formulaic in nature, but must consider a number of factors on an individual basis.

Formulas based solely on originations can be disastrous and lead to disgruntled partners who are servicing clients generated decades before by a partner with little contact. Compensation solely favoring rainmakers creates dissatisfaction and turnover by partners who are actually handling the work and producing the results. There are very few firms in which areas of data can simply be input in a neutral manner to arrive at a perfect formula for a draw.

It is suggested that all the factors discussed above must be given weight and balance to arrive at a fair formula. A great trial lawyer who does not bring in business directly, but handles the most difficult cases, produces the results, and achieves a national reputation, has great value and plays a great role in bringing in business, albeit through an indirect process. A firm with many excellent, high paying clients can still falter if it is not properly managed and administrative skills of the managing attorneys are not recognized. A truly integrated law firm recognizes the need for many different types of attorneys in order to complement one another.

There is no perfect formula and setting fair compensation will always be difficult. It is essential, however, to factor in origination in rainmaking. The firm must recognize the partners who have significant billable hours, to acknowledge and reward partners who have developed a reputation or skill level to better service clients, to set a formula which recognizes and rewards marketing efforts, as well as billable hours, and to look at an analysis of profitability in the type of work being generated by particular partners. It is a difficult balancing act, often subject to adjustment and compromise, and one that must be tailored by the nature of the practice. All of the factors discussed above are important to the operation of a healthy law firm and all must be recognized and compensated in an appropriate manner.