

the

PROFESSIONAL LAWYER

American Bar Association Center for Professional Responsibility · Standing Committee on Professionalism

2005

Volume 16

Issue Number 2

The Ideal Law Firm Compensation System

Peter J. Winders

Almost everyone has heard the hymn, “Amazing Grace”:
“Amazing Grace! How sweet the sound
That saved a wretch like me!
For I was lost, but now am found,
Was blind but now I see.”

Translated into Choctaw:

Shilombish Holitoba ma!
Ish minti pulla cha,
Hatak ilbusha pia ha
Ish pi yukpalashki.

Translated from Choctaw back to English:

My Holy Spirit!
Thou must come,
We are suffering men.
Bring us joy.

This exercise illustrates the difficulty of actually communicating strange ideas to or from people who are not already in agreement, or who see the problems differently, or don't see the problem at all. Hence the introduction to a discussion about compensation. Here goes. Be patient.

This is the 4th part of a trilogy. The parts get more difficult because they discuss actually doing something about problems rather than simply pointing them out. *See, e.g., Unintended Consequences (The Essence of Law Firm Management)*.¹

INTRODUCTION

In almost every large lawyer liability case, the plaintiff has been able to insert an element of greed. Whether true or not, personal motivation was made an issue in the case. The case was dangerous because there was a mistake *and* the mistake was made arguably because the lawyer was willing to cut corners for money. Or, the lawyer found himself trying to handle a matter outside his specialty *because* it was particularly profitable, or *because*

his hours were down so his compensation might suffer, or for similar reasons. This generalization applies to the savings and loan cases, the dot com cases and the corporate governance scandals.

The CLE courses for plaintiff malpractice lawyers must have a section on creative allegations of personal gain, because, even in the small cases, plaintiffs assert such motives. While some are arguable, others are forced. A suit against an accountant for an error in arithmetic will copy from one of the Enron complaints a section talking about the consulting business overshadowing the auditors.

The reasons for this are obvious. The jury may excuse a mistake, but are less likely to forgive a deliberate bending of the rules, or a decision to skate too close to the line if motivated by self gain.

This is one of the reasons that every loss prevention professional whom I have come in contact with believes that the compensation system in law firms is something to be feared. The system can be the source of the motivation argument that turns a simple mistake into an abuse of the system, a fiduciary dereliction, or a venal abandonment of the ideals of the profession, and thus make it more likely that the plaintiff's greed will be rewarded.

The other reason that those same loss prevention professionals cringe when they hear about certain common compensation systems is very closely related. Even if the exaggerated self-interest does not result in a claim, it results in an increased risk to the firm by preventing or making more difficult good loss prevention practices.

FORMULAS ARE THE WORST

The worst system from a loss prevention point of view is the formula system that allocates incoming dollars based on client originations, matter originations, and billed hours.

What's wrong with that? Aren't those the

Peter J. Winders is a shareholder with Carlton Fields in Tampa, Florida.

Continued on page 4

Compensation, from page 1

lifeblood of a law firm? Aren't those the factors that determine whether the firm operates at a profit? Of course they are! Those are vital concerns of the firm absolutely essential for the firm's existence, let alone its success. It is the formula idea for determining individual compensation that creates the problems.

Suppose a formula is agreed upon – a fee will be credited 33% to the lawyer who originated the client, 33% to the lawyer who originated the matter, and 33% to the lawyer doing the work. Each element is essential to create revenue.

All sorts of things will, or can, be argued to affect the day-to-day choices of lawyers in that firm, assuming they are conscious of the formula.

In the firm of Brown, Gray & Green, the originator of ACME as a client is Brown. ACME has a litigation problem. Green is the litigator. Green is reasonably busy with clients and matters he originated himself. Every hour Green works on ACME rewards him no more than 33% or 66% of the value to him of an hour spent on his own case, and he is tempted to favor "his own" clients, so long as he has plenty to do. The ACME litigation is not getting priority. Brown doesn't see this stepchilding of ACME as either fair to him or right, and begins trying to manage the litigation himself. Work is now being done on the ACME litigation, but supervised by the corporate guy.

Gray has a niche practice servicing major shopping center developers, with two principal clients. He is very happy because he is the originator and worker, and is credited 100% of the fees, and is completely occupied. Until the economy slumps and one client stops expanding and the other goes bankrupt. Gray now is desperate for clients because his income will otherwise be cut by two-thirds. He finds salvation in a person new in town, looking for a lawyer to help him set up his new business marketing investments in European currency futures with a guaranteed 40% return. Gray sees this new sideline as the answer to his compensation problem, even though real estate, not investments or securities, are his background. Brown thinks Gray's new client is a snake oil salesman, but doesn't feel he can say anything since it is Gray who is taking the risk and it won't affect Brown's share.

And nobody is paid for minding the store. Everybody agrees, of course, that there are administrative duties, and they divide up the chores, but the system assures they are each punished for every hour taken away from billable work, and the system pretty much guarantees that the only things that will be managed are crises.

For those who are more interested in profitability than loss prevention, the formula systems of compensation are counterproductive there as well. Pretty clearly, the formula systems put the financial interests of the individual members at odds with the profitability and welfare of the firm. Partner A

is tempted to hoard work until he can get to it, if he expects his current project to be over soon, because he fears being "under hours" next month. The firm would be better off if the work were assigned to a lawyer who is available, speeding up the generation of revenue and increasing the chances that each lawyer will be fully utilized. Partner B has a client that gives him \$200,000 in business a year, but the firm would be better off without the client because of its restrictive conflict waiver policy. B's interest is to keep the client, but the firm would be three times better off without the client. Partner C is better off if he can avoid committee assignments, recruiting interviews and other time consuming duties that benefit the firm because they do not benefit him monetarily. He can then claim he brings in more money than anybody, ignoring, as the formula does, the fact that the other duties are essential if the firm is to thrive. Partner D has figured that with his sales ability his best financial interest is served by business development, regardless of client quality, not only putting the firm at greater risk of claims, but also at greater odds of writing off fees. Since D gets a share as an originator without doing the work, the write-off falls disproportionately on those doing the work. Partner E believes that if he becomes active in one of the industry organizations that some of his clients belong to,

it will be a source of future business to the firm, but only if she can achieve recognition as an officer or chair of a committee. That will take a significant time commitment for 3 years, during which E will forego income because the effort is not compensated until it results in an origination, so she looks for activities that will produce revenue more immediately. The mid term welfare of the

Firm is ignored in favor of the individual's immediate income. In each of these examples, the decision is driven by the compensation formula, and in each the decision is at odds with the welfare of the firm as a whole.

So the worst compensation system allows at least the impression that decisions are based on greed, promotes inefficient and sloppy management, and impedes profit. Then what is the solution? How can there be a compensation system that both eliminates the perception that decisions are made primarily because of individual monetary considerations, and at the same time promotes a better running firm?

COUNTERING THE PROBLEMS OF THE FORMULA SYSTEM

There are two approaches to the problems created or exacerbated by the wrong compensation system.

First approach: Establish Rules. This approach does not touch the compensation system where such "market forces" or "informed self interest" assure that the worst loss prevention decisions will be attempted, but establishes rules to put some control on the decisions. Make a rule that Brown, the corporate lawyer, cannot dabble in litigation. Thus, Brown is theoretically forbidden from handling the litigation, but if he goes ahead and does it anyway, he is rewarded for doing so. Unworthy clients are to be avoided, but compensation is paid for originating one. Crime does in

(T)he compensation system in law firms is something to be feared.

fact pay, but one person is appointed as cop to keep him from doing it. And of course since the cop work is underpaid (it is non-billable, and not provided for in the system) there is a temptation to do it only sporadically.² It is like hoping to stop the importation of drugs from Columbia by decreasing penalties and manning law enforcement with unpaid volunteers.

Second approach: Change Motivation. The other approach is to decide what is good for the firm as an entity and model the compensation system to reward what is good for the firm and punish what is not. In that way, we may still have to deal with temptation, but the temptation will be to do what is right.

PROPOSAL

This article elaborates on the second approach. For a compensation system to work with or encourage more efficiency and contribute to compliance with loss prevention practices and overall welfare of the firm, the following are necessary:

I. DECIDE WHAT YOUR FIRM IS ABOUT

A class of officer candidates was given a timed test on following instructions, with a prize for the first to complete perfectly. The test takers were to read all before beginning, then to complete at speed. There were a couple hundred directions – from “name in upper left, serial number upper right” to such physical things as standing and saying loudly, “I am the first to reach instruction #78. I am the champion at following instructions,” and the like. Of course the last instruction was, “Now that you have read all before beginning, as instructed in the introduction, put your name on the paper and sit back and watch the fun.”

Please don't skip this one, as it is the most important. I don't think this is an article that you can skim through and pick up a point or two, but even if it is, this one is essential. It may be hard. If it requires a culture change, fine. See *Law Firm Culture- Its Importance and How to Overcome It*.³

Law firms are not fungible. Large firms are not alike. Small firms are not alike. Boutique firms are different from general practice firms. There are firms whose main or sole goal is profit. There are public interest firms. There are firms whose goals include service to the profession, and significant *pro bono* work. There are firms with important goals involving how they work - to be diverse, to be egalitarian, to be noted for their professionalism, etc. Some firms carry no malpractice insurance, and treat malpractice suits as a cost of doing business. Others are risk averse and extremely conservative.

Some firms will adopt a something-for-everybody list of core values, but all the members do not in fact agree on those values. That is not what is needed. It is easy to adopt a list of platitudes that nobody violently disagrees with, and everybody is willing to give lip service to. Most of us have

seen the web sites of firms with statements that sound great (maybe paraphrases of three of the Ten Commandments and four of the twelve points of the Scout Law) but have no resemblance to what we know the firm stands for. Enron's published code of ethics was inspirational. That is not what we are talking about.

It is harder to make a list of values that the members of the firm agree to commit to and which, because of the members' commitment, can guide the firm's decisions. But the first step in developing a compensation system that is not inherently destructive is to decide upon core values. If the only thing important to the firm is making money, or developing a volume of work, then admit it and tell everybody concerned. The lawyer who has a personal goal of service to the profession may not fit in that firm, and both the lawyer and the firm are better off if they are honest about it and end negotiations. All parties will avoid wasted years. That firm's management and compensation system is going to be different from that of another firm with different goals. Louis Brandeis is famous for his *pro bono* work, including his *amicus curiae* Brandeis Briefs in which he put the individual case in a societal context. It is said that Brandeis reimbursed his firm for the time he spent in those *pro bono* matters. If that is true, (a) we can conclude that his firm did not share *pro bono* as a core value, and (b) we can bet its compensation system sucked.

Unworthy clients are to be avoided, but compensation is paid for originating one.

Once a firm has agreement on its core values, things can fall into place more easily, not only compensation decisions, but also decisions in other areas. Discussions about achieving intermediate goals and decisions on resolving problems are more productive if the solutions must be consistent with agreed values. This applies not only to compensation, but also to management style, approval of budgets or expenditures, decisions about expansions, hiring, and many other things. When the goal is the same, the disagreements about how to get there are less costly than those that begin with debating the goal again. Some management decisions become self-evident because one choice will detract from core values and the other choice will enhance them. A successful specialist who wants to join the firm for its reputation and support, but who wants to continue a lone wolf practice independent of the firm's policies should be an easy no, regardless of the attractiveness of more income, because it would run counter to an important firm value such as teamwork.

II. DECIDE TO REWARD WHAT ENHANCES THE FIRM'S CORE VALUES AND TO DISCOURAGE WHAT DETRACTS FROM THE FIRM'S CORE VALUES

This shouldn't be hard, because the firm has agreed on core values. If in the firm of Redd, Black & White, all agree that service to the profession is important, Redd, who does not like service on Bar committees and is happiest spending all his time on billable work, will not only not mind that Black spends substantial time on the service, he will be pleased, because of the shared core value. If Black does a good job of it, he has advanced the firm's values. If he does

a mediocre job, he shouldn't be rewarded for it, at least not much. After all, this is what the firm has decided it is about.

Some firms' core values, of course, will include things that are less susceptible to reward than penalty. For example, it is hard to pay somebody extra for good manners. But, if one of the agreed values of the firm is to provide a congenial, respectful working environment, it should not be hard to subtract from someone's compensation for acting like a jerk and thereby damaging the firm's chances of realizing that goal.

III. ASSURE THAT ALL MEMBERS OF THE FIRM SHARE COMMITMENT TO THE CORE VALUES AND THE PRINCIPLE THAT ADVANCING THEM SHOULD BE REWARDED

This is hard, but essential. It becomes much easier once the firm has established core values, because new lawyers interested in joining the firm can be told that if they do not share the values, and do not buy into the principle that they are a significant part of compensation, they should not join. It may be harder to get commitment from 100% of existing members if sharing specific core values presents a substantial change in the status quo. But, if the existing members are unwilling to so commit, you have identified a problem, and that is important to the firm whether it adjusts its compensation systems or not. If a member cannot accept the core values of the group, that is a good thing to know. Eventually, there will be agreement if it is understood that such agreement is important. Some members will come around. Some members who do not buy in to the core values leave through attrition or a realization that their view of the world will be better accepted in another job. Outside lawyers who share the values of the firm are attracted. Lawyers whose compensation is adversely affected for detracting from the welfare of the firm will either change or decide they do not fit.

This is a very serious point, and most who have been part of law firm governance will know that it would be a lot easier, and the morale of the firm would be better, and there would be fewer personnel problems at all levels, and there would have been much less wasted time, and there would have been more profit and fun if Fred had left any of the times he threatened to over the last 10 years he was with the firm. One nonlawyer administrator of a large Florida firm was asked to write up the history of the firm over the 15 years he had served, and when finished it was 90% stories about the problem partner who joined in year five. Don't allow that. The enforcement of core values, as a matter of compensation and otherwise, probably would have corrected the problem behavior or resulted in the source of the problem departing the firm. Everybody would have been better off.

IV. COMMIT TO THE PRINCIPLE THAT THERE IS MORE THAN ONE PATH TO SUCCESS ON THE PART OF AN INDIVIDUAL MEMBER OF THE FIRM

This of course assumes that there is more than one core value that requires work to achieve. It then follows from the idea that advancing core values should be rewarded. If it is

what the firm stands for, it is worthwhile. The lawyer who is very skilled at solving legal problems but does not possess the different skills that attract clients can succeed in advancing the core value of first-rate representation of clients. The lawyer who gains a reputation for her advancement of civil rights advances the core values of service for the public good and professionalism. If this sounds like a team approach to the practice, it should. A firm will be much more efficient, more effective at achieving multiple goals and much more profitable if it approaches its goals as a team, allowing specialization and the best use of its members' abilities. Few businesses succeed without division of work and responsibilities between the sales force, designers, production, and management. Teamwork itself might be a core value.

V. MANAGEMENT

Everybody cannot just do what they want. That is not what the idea of different paths to success means. The formula system criticized above is at least simple – do the math and hope that you make enough money to clean up the problems. The system that rewards core values that produce no immediate income (e.g., pro bono work; management) requires central control. The fact that the firm has public service as a core value does not mean the firm can allow 50 people to form a nonprofit public interest group that the firm has to underwrite. Or that it can allow its Bar politicians to run amok, with half its partners spending half their time in Bar politics because the firm values service to the profession. And core values can be achieved by other means than assigning partners to projects. Management should decide that some firm functions are most efficiently performed by lay personnel or outside contractors, even though a member might enjoy doing them. Assuming that making a living is not immaterial to the members, there must be a balance that will enable the firm to earn income. Without substantial income and profit, none of the other goals of the firm can be achieved. Management of the formula-driven firm is not very hard, it is just stressful and inefficient since it will tend to be part-time and crisis driven. Management of a firm with a broad range of core values will be more difficult, more comprehensive, and more businesslike. Somebody has to see how everything can fit together and try to maintain the balance necessary to achieve agreed goals based on the core values. The accomplishment of diverse goals in areas such as service to the profession, service to the public, commitment to diversity and production of a superior legal product requires a team approach, and effective management is essential to see that all positions are being covered.

Effective management must therefore itself be one of the core values, and must be properly recognized and rewarded, not only for the full time managers, but also for service to the firm by practice group leaders, mentoring, business intake, administering such things as the pro bono program, and the like.

It is easy to adopt a list of platitudes that nobody violently disagrees with . . .

VI. INFORMATION

Some statistics such as hours recorded and billings and collections are easy to assemble. Information such as contribution to management are more subjective, and harder to collect. Some system or systems must be devised to collect the latter. Lawyers may be asked to describe their activities toward the firm's goals, as would be their department heads or practice group leaders, and they would be graded on projects undertaken by the firm, such as management assignments. The same questions should be asked of the lawyer's department head or practice group leader, and information, both positive and negative, should be requested from administration, human resources, and management. If it is important to value a lawyer's overall contribution to the organization, it is worth the extra effort to collect the information. Beware the argument that a management procedure is easy to administer if it does not also promote accuracy and fairness.

VII. LEVELING

Since much of the information must be evaluated subjectively, there must be some consistency imposed on valuation of the subjective contributions. Department head Williams is an enthusiastic cheerleader for all his lawyers and evaluates them all as superior, no matter what. Department head Jackson will only give praise or credit if a lawyer has taken charge of a project and invented something extraordinary. In some firms, the managing partner or president interviews every member of the firm at least yearly, so that the differences in the evaluators can be leveled. The evaluation of all members by a single person will help address the universal issue of the "easy grader/tough grader" that burdens all subjective valuation elements.

VIII. ADMINISTRATION

Consideration has to be given to the various problems of administration of the compensation system, and to refinements that will make it work. Setting income and ownership in advance, for example, will encourage the lawyers to maximize the opportunities of their partners. If Jones knows in advance that he will receive 1% of the profits of the firm for the year, then he should do as much as he can to maximize the income of the firm as a whole. If in the formula firm he would be tempted to hoard work for an anticipated down time, in a system where he gets a percentage, he will be encouraged to pass the work to one who has the time – the firm will do better, and so will he.⁴ Similarly, it might be wise to have a bonus pool to reward exceptional service, and provide a means of penalizing anyone who detracted from the goals of the firm by inappropriate conduct.

IX. ELIMINATE THE FORMULA

This may be hard, but it may be easier than you think. Origination credits, at least as they are treated in some firms are easily the most destructive aspect of law firm compensation. Origination of business is vital. The formulaic reward

for it is harmful. Unworthy clients are a major loss prevention problem. Origination credits reward the intake of an unworthy client, at least until the roof falls in. The firm is more profitable if the unworthy client is screened out. There are different sorts of origination. Some clients are attracted by the reputation of the firm, or a contact with a retired partner. The lawyer whom the switchboard finds gets origination credit in some firms. Business development should be rewarded, but origination credits do not distinguish between the business development efforts of the trial lawyer who happened to be working late when the inventor of the antigravity machine knocked on the window because he had heard of the firm's patent department (none of whom were present), and the lawyer who has spent years at the firm's request positioning herself in an organization that will enhance the firm's exposure to clients in a desirable industry. The origination credit system of some firms will reward the wrong lawyer. Business built on the firm's reputation should belong to the firm. Effort at the firm's direction should be rewarded separately from rewarding the result. Luck should belong to the firm. A choice between clients in a conflict situation should

not depend on the personality of the lawyers involved but on the long-term benefit to the firm.

[I]t is hard to pay somebody extra for good manners.

Similarly, the person who logs the most billable hours, all genuine, all high quality and paid at the expected rate is an asset. But spending all her time on billable work

means that other lawyers must handle the mentoring responsibilities, the recruiting, the work for the profession, the running of the firm. All these functions are essential, and singling one out for a formulaic reward is neither fair nor good business. On any team, all positions must be filled and paid.

The recurring reference to the firm as a team is not just a motivational or morale thing. The formula firm, particularly because of the origination credits, encourages competition internal to the firm, a rivalry as to who can earn or manipulate the greater share of the firm's revenues. The firm in that system can be no greater than the sum of its parts. But if the firm organizes, manages itself and operates as a team, identifying and pursuing specific goals on a team basis, with the firm bearing the expense of a long term project but the firm getting the reward, the firm as a whole will be more successful, more profitable. The firm will have evolved from a group of individual practitioners to a businesslike organization, with the advantages that brings.

X. EDUCATION AND THE PROBLEMS OF PERCEPTION

Education is extremely important. The firm will have records of hours worked, and maybe of clients and matters produced. The fact that the numbers exist allows them to take on an importance that might be excessive in the firm that intends to reward all contributions to the firm. Education can prevent that. This is an important management function. It will take repetition to explain to the chronic hoarder of work that his income will increase if instead he

assigns to others. He will eventually get it, but he has already proved to be short-sighted, and it will take effort.

XI. DOES THIS WORK IN REAL LIFE

I am sure it does. Everybody can see how this works at the small group level. Angus is extraordinary at developing business and loves it. Hereford is the lawyer's lawyer who adds value to every case he advises on and he is able to supervise more than most. Santa Gatrudis has been asked to serve on the Bar's board of governors, and the judicial nominating committee, and the firm believes he should accept both. Each is successful at what he does, and these represent three of the shared core values. They will have no problem agreeing on compensation. Each recognizes that without the others, they would get nothing done, instead of the worthwhile work that they do as a team serving a variety of agreed values.

The problem is in fair administration over hundreds of partner-level lawyers. It will be hard work. But so is it hard living with a formula and its fallout.

I cannot name a large firm that follows exactly all the principles here, but I know of some that follow several, many or most. And with each principle implemented, there is an improvement in satisfaction with the compensation system *and* a safer and more secure organization.⁵

At least two major firms pledge to keep individual compensation secret, and compensation is set by one or two persons, who set compensation based on overall contribution. By and large, the partners are quite satisfied with the system. Since the compensation is secret, I have no clue whether a formula does or does not play any part in the setting of compensation, but, since it is secret, it doesn't matter. If firm members don't know the process, they can't try to manipulate it. If they think they are fairly paid, they will not be tempted to hoard work or dabble in the wrong field despite firm policy. The same effect is achieved as if the compensation were totally subjective but fair.

Some firms keep track of "the numbers" and inform the partners of them, but also inform them that there is a major element of subjective adjustment, including negative adjustment for things that do not reflect well on the firm, failure to follow firm policies, etc. Convincing members that the numbers are not given undue weight remains an education function. Some members refuse to believe that subjective factors prevail, but they do prevail in those firms. Satisfaction increases as the education effort emphasizing the subjective element of compensation has increased.

Several firms have the managing partner or another firm leader interview all partners at least once a year on matters of concern, including compensation issues, one purpose being to insure an opportunity to have fair consideration of all things that are believed to be relevant to overall contribution to the firm, and another to provide the leveling function.

Several firms specifically reward management efforts.

Some with "billable credit," which is good, but merely adjusts a formula rather than eliminating it; some subjectively, but significantly, as good businesses do.

Some firms assign certain persons to tasks such as client development, with the idea that they will be compensated on their success, but not with the same tests that others are. This is a very good example of identifying and separately valuing contributions deemed to be in the best interest of the firm. A team is made up of different persons performing in their areas of strength.

One firm adopts as an "article of faith" that no records are kept of "originations." This is a big deal by itself, as "client origination credit" is one of the most pervasive and disruptive compensation elements. I know of at least two firms with formulas in which the fact that individual partners "origination" numbers entitled them to very large incomes, when they were doing little or no work, caused the breakup of the firm.

Several firms now have full time management positions, where the lawyers holding them have no billable budget and are compensated for management contributions alone. This may be a managing partner or CEO and it may be a general counsel or another function. Others provide a reduced expectation of billable work in view of assigned management or other tasks. Valuations for

these full time jobs vary from negotiated, to being dependent upon what compensation was before the management job was undertaken, to subjective valuation of the quality of the performance. Every firm that I have encountered that has employed a full time manager believes that it has benefited substantially from having one.

Anecdotal information is all I have to offer in this piece. I am aware of no polls or surveys in this area. It is easy to imagine some that would not be useful. "Q. Does your firm's compensation system have a substantial subjective element?" could be truthfully answered yes in a wide variety of situations – for example, a complaint about the inventiveness of a partner on the client origination form; or the situation where the controlling partner fixes compensation because he can. It would be interesting, however, to more systematically ask major firms how they deal in compensation matters with partners who create problems of morale, with historic originators who tend to "rest on their laurels," and with powerful income producers who are poor managers. But then, all you would have would be more anecdotes. I doubt they would differ much from these.

CONCLUSION

Some reading this will have reacted, "What about my origination credits?" Others will have thought, "Well, maybe we can have origination credits decrease over a certain number of years." I know this is difficult, but you don't abandon a formula approach by changing the formula. The argument that "we have never done it this way before" is not

Teamwork itself might be a core value.

an argument but a statistic. This is not intended as a list of pointers, but as a different approach to the management of a firm, of which compensation is an extremely important part. Yes, it requires a great deal of trust, but for a group with common goals and shared core values (see above) trust can be more confidently expected.

Actually, there is exaggeration in the preceding paragraph. The firm will in fact profit enormously from identifying and adopting the core values sincerely held by all, and by making decisions based on whether they are in accord with those core values. Even that step will almost necessarily affect the formula compensation for the better because almost necessarily the element of subjective valuation will intrude. If service to the community is a value, the firm will make an exception to the formula for the lawyer who the firm encouraged to take the time to be president of the Chamber of Commerce. Or if the firm recognizes the need for a full time managing lawyer, it will have to negotiate value for management. The system can evolve. But eventually, as each of the points above is covered, the system will be fairer, the firm's practice will be safer and more productive, and all systems will operate in aid of the firm's aspirations.

ADDENDUM

Give me an illustration. How would it work?

This addendum reflects the reaction of those I asked to review the draft. How would it work?

The foregoing is theoretical. Practical application need not be precise, and will depend on what the core values are. So this is a suggestion, a hypothetical application, not tested, and in need of refinement. It assumes a hypothetical firm with 100 owners because that is an even number, and assumes that the following core values, however stated, and in no particular order, have been adopted and are sincerely held by the firm:

- Reputation for and dedication to the highest standards of ethics and professionalism
- Reputation for and dedication to a first class legal product
- Reputation for and being a congenial place to work for both owners and employees
- Reputation for and being a leading firm in service to the profession
- Reputation for and being a leading firm in service to the public
- Reputation for and dedication to principles of diversity
- Dedication to good and active management
- Operation as a team; as one firm; with the firm's interest more important than individual interest
- To operate profitably, to operate in a businesslike manner, to provide a good income for members, to compen-

sate fairly and well

- To provide legal services and related services, rather than to engage in entrepreneurial activities

A. WITH THOSE CORE VALUES IN MIND, ADOPT THE FOLLOWING MANAGEMENT POLICIES AS BEARING ON THE COMPENSATION OF THE LAWYERS:

1. Every lawyer is expected to devote full time to the business of the firm, full time being X hours. Assume X is fixed at 2400.

This assures that everybody agrees that everybody has to work. You may get extra for performance, but there is no resting on laurels. Note that this is not a *billable* budget, but a definition of full time on firm business. It should also achieve the bonus of encouraging better timekeeping on things that the firm needs to keep track of. Pro bono time records are needed for various bar reporting and also for tracking information about a core value. Time spent on conflict resolution might suggest that the firm would be more efficient with additional staff in the conflicts department.

A choice between clients in a conflict situation should not depend on the personality of the lawyers involved . . .

2. All non-billable activities for the benefit of the firm, to be recognized as firm business, must have the approval of the firm. The convention of the Harry Potter Hobbyists Association or the Mountain Man Experience won't count

just because, who knows, you might run into a potential client; non-billable work for the firm must be approved by a designated decision maker [practice group leader, president, management committee, business development committee] or must be within a pre-authorized list.

3. The amount of time spent on non-billable activities must be authorized by the firm through a similar decision maker. It may be brilliant management to have one lawyer take advantage of an opportunity to serve as president of a prestigious national charity - consistent with the public service value and bringing prestige to the firm - even though it will take three quarters of his time for a year. It may be extremely wise to assign the most suited person to spend virtually full time identifying and investigating the potential new business from existing business contacts. It may also be foolish to let everybody in the practice area do that and leave nobody to do the legal work for six months. Using talent for what needs to be done is good management. But the vital legal work has to be done, and striking the balance requires management.

4. Client development is the business of the firm. When there is a reason to choose between one client and another and one class of clients and another, those are firm decisions, made by a designated decision maker. Hopefully, this will eliminate the problem of the good client for one partner - who gives him half his business, but who conflicts out twice the business from others in the firm - and similar problems that attach to client origination credits. Likewise,

it might be recognized that a leadership position in a particular industry group will both develop desirable business and be a service to the public, but that it will take a minimum of three years of a significant expenditure of time for an individual to achieve such a position. The *firm* having approved the endeavor, the *firm* should pay the lawyer for the effort, and the *firm* takes the risk of the project failing, *but* also the rewards belong to the firm.

5. There is more than one way to achieve success at this firm. The successful trial lawyer, the successful transaction lawyer, and the successful developer of business may be paid the same. One does not need to “touch all the bases”, but may achieve success by filling a variety of the needs of the *firm*.

B. COLLECT DATA WITH REGARD TO CONTRIBUTIONS OR PROBLEMS OF EACH OWNER REGARDING EACH CORE VALUE.

Some data is easy to collect. Hours are recorded anyway, and are easy to track. Everybody knows who is serving as a practice group leader and department head. Other stuff is not secret, but probably the most efficient way to collect it is to provide a form and have each lawyer put the information together for the reviewers. “What efforts toward business development on behalf of the firm are you involved in, how is your plan progressing, and what successes or milestones have you achieved?”

Similarly, data must be collected on negative contributions. Has sloppy lawyering endangered the firm? Note that what should be considered is exposure, not necessarily bad results. If the firm has not suffered a loss because of Jackson’s frequent missed deadlines, but that is because of luck or good corrective work, the exposure must be considered and not forgiven because the bullets were dodged. Some core values have few positions for positive contributions, but plenty for negative contributions. If the person assigned as head of the diversity committee has performed admirably, a firm value has been enhanced. But the person whose attitude and behavior has made working on the 6th floor uncomfortable for women has subtracted from core values and the negative contribution must have a consequence.

C. WITH THOSE MANAGEMENT POLICIES IN MIND, COMPENSATION WILL BE DETERMINED, [IN ADVANCE, AS PERCENTAGE POINTS AND APPLIED TO 90% OF ASSUMED PROFIT FOR NEXT YEAR] WITHIN THE FOLLOWING GUIDELINES, EVALUATED ON A ROLLING [3? 5?] YEAR BASIS.

Profit, in this context means revenues less expenses other than owner’s compensation.

50% as base - base salary or draw - assuming full time employment at budget. [50% is not magic. 60% would work.]

25% quality of performance at assigned duties / advancing the interests of the firm. [To provide negative affect, you could start at an assumed adequate performance of 12.5%, and evaluate up or down.]

25% extraordinary performance – This provides for the superstar contributor. [Here again, this amount could be

reduced and added to the previous category]

Assume 100 partners, 1000 points.

- 500 points will be assigned among those 100 partners based on historic matters, recognized positions in the firm, experience, etc. The 500 points to be so divided may range from 2 points to the most junior partner to 7 points or more for the largest historical contributor. [An alternative for getting the program started - take last year’s compensation, assume it is fair, determine how much was extraordinary, arrive at a base, and translate into points.]
- 250 points are now assigned for extraordinary performance in the assigned tasks. If the head of the mentoring program has turned it into a model for the profession and has thus advanced the firm’s core values relating to congenial work environment, fairness, diversity, and the firm as an entity, his total points should increase. If he has merely filled the position of chair of the committee, but done nothing more, he gets little or nothing from this group. That has been paid for by paying for his hours in the first 500 points. Similarly, the chair of business development, who has achieved a significant improvement to the quality of the client base, is rewarded for that performance by additional points from this level. The same is done with the lawyer whose quality of legal work has enhanced the firm’s reputation for excellence or who has achieved notable success. There is room here as well for the full time manager of the firm - managing partner or president - who has not only filled the position but has excelled at it and has achieved a smoother running, more profitable operation. There is also room here to detract from the problem partner’s compensation.
- 250 points are now assigned for special successes - these may not be repeated, so cannot be compensated for ad infinitum, but deserve recognition. The three years Partner A has been working to advance in the construction industry organization he joined with firm approval is something he has been paid for as part of his assignments by the firm under the first two categories for the last three years. But this year the effort has paid off. Under this system, he did not take his own time to develop the relationships and the business over the last three years, he was assigned to it, and the firm paid him for the effort, and the firm as a whole is entitled to the reward. But the firm might specially reward the successful effort as well. Repeated successes will reward Partner A under the first two categories in the future.

The value of the point is determined by dividing 90% of next year’s estimated profit by 1000. The other 10% (assuming it materializes) will either increase the value of the point, or could be used for special purposes, including special bonuses, not in advance, but for extraordinary results or performance in the year. Or, it might not materialize, or might be better used to prepay expenses, etc., at the discretion of the governing board.

If firm members don't know the process, they can't try to manipulate it.

That is the outline. Of course there must be refinement. For example, there is nothing inconsistent with using the above criteria instead to classify lawyers into “categories” or “pay grades” for firms who use such systems. But please note the following:

- This is *not* an effort to decrease the share of the rain-makers or other outstanding performers of the firm. The antipathy for origination credit as part of a formula is not a refusal to recognize client origination as a vital part of the success of the firm, but recognition that over time it precludes fair administration and creates discord. Partner B, who is extremely talented in developing business, will be recognized for doing so and will make no less than under the prior system assuming the firm continues to be as successful.
- What a system such as this *should* do is reduce friction in the firm and make it more efficient, more profitable, and safer. “I brought Acme Industries to the firm when they were doing nothing but manufacturing instant holes and jet powered shoes for sale to the coyote market. Now they have the corner on high tech businesses I don’t even understand” will not carry with it the origination credit, subtracting from funds the firm needs to pay the lawyers who do understand the business, and who are vital if the work is to expand and the client is to stay with the firm. Additional business development, or continued development of Acme work is of more value and is concurrently recognized.
- This is very subjective, *but* subjective within the limits of contribution to core values, and divided between levels of success. Formulas look like math, but they are not really exact because people tend to “play the formula” by manipulating the input. “I approved this undesirable client because Joe needed to develop some business” is the charitable reason a bad decision is made, while, “I originated this client, but I am giving him to senior associate to develop and handle” is the uncharitable way that difficult clients are foisted on the unsuspecting. There is no bonus under the system proposed for taking an undesirable client, and in fact the subjective allocation of points also allows for subtracting them for such negative contributions as these. That is the point. There should be disincentives for bad and unwise decisions. A reward should last no longer than it is deserved. The firm should be managed as a firm, and not be allowed to develop, consolidate and divide as a result of random decisions of self-interest.
- A system such as this is flexible, in that it provides a method of rewarding lawyers for service to the firm other than performing legal work and developing business. Management of a large law firm is essential, not simply in the form of a full time CEO, but also at the practice group level and certain other functions. But this system does *not* give a practice group leader a “free ride” by allowing him to meet his budget by logging management hours. It credits hours neces-

sary to do the job, and thus recognizes that the job is necessary, but that is only 50% of compensation. The rest is determined qualitatively by evaluating how well he has done that job as well as others. The practice group leader who has developed and executed a plan to bring the practice group into the forefront as a recognized “go to” source for sophisticated clients gets high marks, while one who goes through the motions does not. The leader of the 100-person practice group has a harder job than the one with 15 members, and that will affect the consideration. But the person saddled with the management job he dislikes is not stuck. There are different paths to success and he and the firm may well decide that his contribution is greater handling client business and leaving the management duties to another. Similarly, the head of the diversity committee may elect, with firm approval, to spend more time for a couple of years creating, implementing and educating the firm about systems and procedures to assure the integration of minority members into the firm and to provide early alerts for possible diversity problems. It is not simply holding the position that she is paid for, it is doing a good job at it.

***“[W]e have never done it this way before”
is not an argument but a statistic.***

No compensation system is perfect. But some are awful. A system based on the foregoing principles should (a) remove impediments to good management, (b) remove impediments to increasing the quality of the firm’s client base, (c) remove impediments

to fairness and long term firm planning, (d) remove impediments to good loss prevention practices, (e) assure cohesiveness because of the agreed core values, and (f) be flexible enough to address the needs of firms with different values. It will take good management to run it.

Endnotes

1. Peter J. Winders, *Unintended Consequences (The Essence of Law Firm Management)*, Vol. 14, No. 3 THE PROFESSIONAL LAWYER (2003).
2. To be fair, there are systems that can be imposed to enforce policy, particularly where there is a gatekeeping opportunity. A new business intake system requiring approval of uninvolved persons is an example. It is still better if this is in addition to aligning the interests of the individuals with good loss prevention, rather than instead of doing so.
3. Peter J. Winders, *Law Firm Culture- Its Importance and How to Overcome It*, 2004 SYMPOSIUM ISSUE OF THE PROFESSIONAL LAWYER (2004).
4. The 1% has been derived by a process that may or may not involve a formula but since compensation is set as a share of available distribution, the self interest of the individual tends to be co-extensive with the welfare of the firm.
5. I do not have permission to name the firms whose General Counsel or Loss Prevention Partners I have spoken with, and some of the information came from sources who did not want a particular firm identified publicly. Besides, with most of these conversations I did not know I was going to try to later synthesize the information about experience with various approaches to compensation into an article like this, and neither did those I talked with. ☞