

Compensation Design for Law Firms

EDITED BY HELEN ROCHE



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is published by Managing Partner in association with Ark Group



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ISBN: 978-1-78358-105-4 (hard copy)

978-1-78358-106-1 (PDF)

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ARK2673

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Executive summary

THE LEGAL industry continues to undergo major change due to economic pressures, client demands, a rethinking in pricing behaviors, and technological advances (to name but a few of the myriad sources of disruption to traditional legal practice). Possibly for the first time in several decades, a comprehensive rethinking of how legal work is priced and staffed, and how lawyers and partners should be evaluated and compensated, is underway.

Even if a firm's compensation scheme has been working well for years, it is now worth taking the time to review the current system to ensure that it is best aligned with the firm's goals, business objectives, and market realities. While compensation can be a thorny issue, the success of a law firm ultimately depends on the success and satisfaction of the partners within it. Plus, it is already predicted that an upswing in the economy means that partners will be placing a greater emphasis on compensation going forward.

In addition to partner expectations, the ongoing pressure on pricing and the billable hour means that clients are paying increasing attention to all aspects of law firm management. Up until now, most clients have not paid much attention to how law firms manage themselves and compensate their lawyers, but this may change. In an age of increasing scrutiny, it is not a stretch to envision that clients may become more sensitive, not only to law firm pricing and processes, but to how a firm is managed

and to the behaviors a firm recognizes and rewards.

So what does this mean for law firms? The simple answer is that a comprehensive rethinking of how legal work is priced and managed, as well as how it is compensated, is needed. Partner compensation clearly must be brought into line with what delivers the best results for clients and the most profit for the firm, yet firms are often confused when it comes to aligning profitability with compensation. A law firm's compensation system should also be aligned with its strategic goals and should clearly express the firm's top priorities. What exactly does the firm reward? Is there a traditional emphasis on billable hours, or is the focus on new work and new clients? How is compensation allotted between these?

The need to achieve all of these goals when setting a compensation scheme may seem unattainable, and many firms may struggle to identify not only the most important but the most suitable criteria for their compensation plans.

This report therefore provides expert and candid views from industry experts concerning ways to successfully adapt compensation schemes to match firm results with their goals. The design (or redesign) of a law firm's compensation scheme is a difficult task and the aim of the report is to answer important questions such as:

- How a law firm can align a compensation system with strategic goals;

- How to align profitability and compensation plans;
- How to align compensation with client priorities; and
- How different pay for performance schemes can be used.

As a starting point in looking into compensation trends and issues within law firms, the report begins with a review of the results of the 2012 'Partner Compensation Survey' by Major, Lindsey & Africa (MLA). Jeff Lowe (global practice leader at MLA and author of the survey) summarizes the most relevant results from the survey and highlights useful information on ongoing compensation trends and sources of dissatisfaction that all firms should be aware of.

Following on from this, advice is provided on the key topics to consider when reviewing and designing a compensation system. As a very important starting point, tips are provided on sizing up a law firm's compensation acumen, with suggested tests for assessing this compensation acumen within a firm.

The process of identifying and defining the main criteria a firm needs in order to determine partner compensation and the aspects of the most successful compensation systems are also explored in the report. Advice is shared on partner compensation criteria and the responsibilities of the managing partner or members of the management and compensation committees when determining compensation.

Behavior is key when assessing any compensation scheme and one of the expert contributors warns against mixed messages when setting compensation, and underlines the need to clearly define what behaviors will be rewarded. The article takes a close look at the questions firms need to ask when

setting a compensation plan that works for the firm and the steps they need to take as a result.

Suggested approaches are shared with regards to aligning a firm's compensation system with client priorities (which, at the same time, would promote enhanced profitability, stability, and professional satisfaction), or, from a different viewpoint, aligning compensation with firm pricing and profitability.

The importance of aligning compensation with the firm's strategic plan is underlined throughout and the differences between formula-based, subjective-based, and combination systems are also explored.

The question of compensation is clearly a challenge that other professional service firms have faced also, and one of the contributors asks what law firms can learn from accounting firms and examines the ways that CPA firms are creating compensation systems that are tied to strategic initiatives. Examples of firms that have created and implemented such systems are provided (including a tiered reward system, the system in a mid-sized firm, and using the balanced scorecard).

There are countless ways to share the compensation pie and what works in one firm may not work in another. However, with expert contributions from August Aquila (Aquila Global Advisors, LLC), Thomas Berman (BERMAN & ASSOCIATES), Toby Brown (Akin Gump), James D. Cotterman (Altman Weil), Arthur Greene (Boyer Greene, LLC), Joel A. Rose (Joel A. Rose & Associates Inc.), Michael Roster (co-chair for the Association of Corporate Counsel's Value Challenge and formerly managing partner of Morrison & Foerster's Los Angeles office), and Julious P. Smith Jr (Williams Mullen),

this report provides different options on the best approaches a firm may use. The advice and opinions shared will help firm leaders in identifying the most important factors for their compensation system, and will help towards the design of a system that is aligned with current and future business realities and the goals and objectives of the firm.

About the authors

August Aquila

August is the CEO of AQUILA Global Advisors, LLC which specializes in succession planning, mergers and acquisitions, compensation plans, and strategic planning for professional service firms. August has more than 25 years of experience. He was a partner in a top 50 CPA firm (Friedman, Eisenstein, Raemer & Schwartz – FERS) and vice president, field management and mergers & acquisitions, for American Express tax and business services.

In 2004, 2007 and from 2009–13 he has been selected as one of the Top 100 Most Influential People in The Accounting Profession by *Accounting Today*. August has consulted in the United States, India, Canada, and the United Kingdom and has been a frequent speaker at national and international conferences and partner retreats. He has written numerous articles and has authored and co-authored seven books. For more information, contact August at aquila@aquilaadvisors.com.

Thomas Berman

Before starting the firm of BERMAN & ASSOCIATES in 1991, Thomas had managed a large multi-faceted and international law firm as well as 200 lawyers in a corporate law department. He managed the law firm consultancy department of a California accountancy firm and worked across the US with the Legal Services Corporation. In 1980 he began a computer and management consulting firm which grew into the present entity.

BERMAN & ASSOCIATES has, for a quarter century, worked with almost 2,000 law firms of every kind: from a single lawyer to several hundred lawyers; covering intellectual property to plaintiffs personal injury law; and in the US, UK, Canada, and Eastern Europe. The firm is hired directly by lawyers and law firms, through independent insurance brokers and/or insurance underwriters, and by Bar Associations and Bar Groups. BERMAN & ASSOCIATES is involved in all phases of law firm practice management including mergers and acquisitions, systems and structure, partnership/shareholders agreements, planning, succession, compensation and, of course, risk management.

Toby Brown

Toby Brown is the director of strategic pricing & analytics for Akin Gump. In this role Toby works with firm partners and clients in developing pricing arrangements and service delivery models that drive successful relationships. Prior to this, Toby served in similar roles for both Vinson & Elkins and Fulbright & Jaworski, where he also drove knowledge management initiatives and various marketing efforts. Before joining Fulbright, Toby served as the communications director for the Utah State Bar. In his tenure with the Bar, he also served as the CLE, access to justice and programs director.

Toby presents nationally on legal pricing, marketing, technology, and law firm management for associations, law firms, legal departments, law schools, and paralegal programs. He has

published numerous articles on these topics, as well as a recent report on *Law Firm Pricing: Strategies, Roles, and Responsibilities* (Ark Group, 2013). He has served on a number of legal services boards, bar association task forces, and legal market organizations. He received the Peer Excellence Award, the President's Award, and the Anne Charles Award from the National Association of Bar Executives.

Toby maintains the ABA award winning *3 Geeks and a Law Blog* with two colleagues at: www.geeklawblog.com.

James D. Cotterman

Jim is a principal with Altman Weil, Inc. He advises law firms on compensation, capital structure (and other economic issues), governance, management, and law firm merger assessments. Before joining Altman Weil in 1988, Jim was manager of acquisitions for a public company in the health care industry where he developed, evaluated, negotiated, and integrated merger opportunities.

Jim is the author of 'Cotterman on Compensation', a blog on lawyer compensation and law firm finance. He is the lead author of the ABA's *Compensation Plans for Law Firms* and is a member of the Board of Editors of *Accounting and Financial Planning for Law Firms*. He has also been the supervising author for Matthew Bender's looseleaf text, *How to Manage Your Law Office*. His writings have appeared in *The American Lawyer*, *The National Law Journal*, *ABA's Law Practice*, *International Law Firm Management* and many other publications.

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Arthur is a long standing member of the ABA and has served as chair of its Law Practice Management Section. He is also a Fellow of the College of Law Practice Management. Arthur can be reached at agg@boyergreene.com.

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Jeff is the global practice leader of Major, Lindsey & Africa's Law Firm Practice and the managing partner of the firm's Washington, DC office. He is the author of the 2010 and 2012 Major, Lindsey & Africa 'Partner Compensation Surveys', the most comprehensive efforts ever undertaken to identify ranges of partner compensation, and the co-author of the 2013 Major, Lindsey & Africa 'Lateral Partner Satisfaction Survey'.

Jeff is regularly quoted by leading legal newspapers and periodicals, such as *The American Lawyer*, *Law 360* and *The Wall Street Journal*, and his articles have been published in the *DC Legal Times*, *The New York Law Journal*, *The National Law Journal*, the *Law Firm Partnership & Benefits Report*, and *The Texas Lawyer*.

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Joel is a certified management consultant and president of Joel A. Rose & Associates Inc., management consultants to law firms based in Cherry Hill, New Jersey. He has extensive experience consulting with private law firms, and performs and directs consulting assignments in law firm management and organization, strategic and financial planning, lawyer compensation, the feasibility of mergers and acquisitions, and the marketing of legal services.

Joel's articles on law firm management appear in the *Philadelphia Legal Intelligencer*, *The New Jersey Law Journal*, *The Texas Lawyer*, publications of the Association of Legal Administrators, and other state and local bar association journals. He is the principle contributor to 'Thrive', the blog of the Law Practice Management Committee of the New York State Bar Association. He is also a contributing author of *Model Partnership Agreements for New York Law Firms*, published by the New York State Bar Association.

Joel is on the Board for the 'Editors of Accounting and Financial Planning for Law Firms' and 'Law Firm Partnership and Benefits Report' journals. He speaks at national, state, and city bar association meetings and at the Association of Legal Administrators chapter meetings. He is a member of the Law Practice Management Committee of the New York State Bar Association, a member of the Section of Law Practice Management of the American Bar Association, and a Fellow in the College of Law Practice Management.

Michael Roster

For the past five years Mike has been the steering committee co-chair for the Association of Corporate Counsel's Value Challenge, a project that is looking at ways to reconnect the cost of legal services with value. He was formerly managing partner of Morrison & Foerster's Los Angeles office as well as co-chair of the firm's Financial Services Practice Group worldwide, resident in both Los Angeles and Washington, DC.

Mike subsequently was general counsel of Stanford University, Stanford Medical Center, and Stanford Management Company and then an executive vice president and general counsel of Golden West Financial Corporation. Mike has also served as an outside director and vice chair of Silicon Valley Bank, chair of the Stanford Alumni Association, and chair of two start-up companies (Insert Therapeutics and Encira). He is a former director of the California Bankers Association and the Federal Home Loan Bank of San Francisco.

Mike is currently an adjunct faculty member at USC Gould School of Law where he teaches advanced contracts. He also is a director of MDRC, a nonprofit corporation based in New York that evaluates the effectiveness of government and other nonprofit programs, and he recently chaired a project funded by two foundations that developed a private sector approach to eliminate abuses in consumer credit cards in the US.

Julious P. Smith, Jr

Joey is the chairman emeritus of Williams Mullen. He served as CEO of the firm from February 1984 through January 2010. Under his leadership, Williams Mullen grew from 25 lawyers in Richmond, Virginia to over 300 in 12 offices in Virginia, North Carolina, Washington, DC, and London. Gross revenues increased from approximately \$4.5 million to \$150 million. During his tenure as CEO, he initiated six mergers with law firms ranging in size from 20 to 55 lawyers.

Joey's practice includes representing and advising business clients in corporate and business matters, including succession planning and mergers and acquisitions. He has specific experience in closely-held businesses, insurance brokers, and family businesses. His merger and acquisition experience ranges from small family businesses to major transactions involving publicly-traded companies. He also consults with law firms on business-related issues.

He is listed in *The Best Lawyers in America* and in *Virginia Business* magazine's list of 'Legal Elite'. Joey has been recognized as a leading corporate attorney by *Chamber's USA: America's Leading Lawyers for Business*. In addition, he has been named a 'Super Lawyer' for business/corporate by *Virginia Super Lawyers* magazine. He is a past president of the Richmond, Virginia, Bar Association. He graduated from Hampden-Sydney College in 1965 and served as a trustee of that institution and as vice-chairman of its board of trustees.