

# LOCKSTEP LOCKSTEP UNLOCKING KSTEP LOCKSTEP STEP LOCKSTEP

*A U.S. law firm has shaken the industry by doing away with lockstep compensation for associates, replacing it with individual performance- and experience-based evaluation.*

*What does this mean for how lawyers' services are valued? And will your firm be next?*

**By Bruce MacEwen**

**T**raditionally, associates' pay and billing rates have been tied to their class year. Notoriously, first-years at big firms in the United States now start at \$160,000 per year, second-years at around \$175,000, and so on — and billing rates have hewn to the same lockstep.

So deeply embedded is this practice in the core assumptions of law firm management that it's only now that firms — prodded by clients asking common-sense questions — are trying to envision alternatives. Questions such as: “Why does the exact same associate who cost me \$325/hour last month suddenly show up on this month's bill at \$350/hour? He's still the same guy.”

If the best answer the client relationship partner can give is, “Well, uh, you see, he had an anniversary and he's now a third-year,” firms begin to cast around for more compelling comebacks. They might even go so far as to experiment with alternatives to lockstep compensation and billing rates.

We're about to have the opportunity to watch at least one such experiment unfold.



### A new scheme

Washington-based Howrey LLP (630 lawyers) recently announced that it is ditching lockstep compensation for associates effective January 2008. The key elements of the initiative are:

- First-year lawyers start at the “market rate” (presently, \$160,000 at Howrey’s)
- After first year, associates advance through a series of “levels” based not on seniority, but on personal evaluations of performance and experience. Subjective? Sounds like. (I prefer to think of it as exercising judgment.) A better approximation of reality than lockstep? Without a doubt.
- Each level contains a salary range approximately centered on “market,” but with some associates paid more and others less.

According to Henry Bunsow, Howrey’s managing partner for northern California, “the goal is not to have associates make

less than their counterparts at other firms.” He adds, showing a fine appreciation of marketplace dynamics: “If poor performers can get a better deal somewhere else, that may be a marketplace reality — we would hope that this system wouldn’t promote that.”

And the firm appears committed to the initiative. For example, one express result of the “performance/experience” evaluative criteria is that partnership tracks could well become shorter for some and longer for others.

Also, each associate will be assigned to partners responsible for his or her development, exposure to appropriate new responsibilities in areas such as writing, discovery, trial preparation, and client presentation skills, and of course, evaluations. One full-time staff person will be responsible for monitoring the program and keeping tabs on associates’ perceptions.

Finally, billing rates for each associate will reflect his or her performance/experience ratings, with higher performers billed out at higher rates.

All in all, this reaction probably sums up the reception the non-lockstep plan is getting: “To say it’s a bold move would be an understatement,” said William Nason, a recruiter with San Diego-based Watanabe Nason Schwartz & Lippman. Matthew Larrabee, chair of Heller Ehrman, is also quoted as taking a cautious approach, allowing as how even though firms might begin to get more creative with associate compensation, “it can be difficult to buck the market trend of lockstep.”

But how difficult might it really be? For every perverse situation where an underperformer can arbitrage the system and get a raise by going to a market/lockstep firm, one can hope there will be more situations where high performers could reverse-arbitrage the system and get a raise by going to Howrey.

And if you add in the expected half-life of those two hypothetical lateral associates at each of their new firms, it’s perfectly reasonable to expect the dud will be out long before the ace. Over time, associates might begin to sort themselves out by a performance yardstick. Could this be the start of — imagine! — compensation actually having at least some marginal relation to competence?

**How new is it?**

Actually, at Latham & Watkins — widely regarded as a paragon of enlightened law firm management — associate compensation has long had a significant merit component, expressed through bonuses. A Latham partner in the New York office reports: “A top performer in a given class can make better than the compensation paid to average or below-average performers in the class or two ahead of them.

“Our philosophy,” the partner says, “is that a top performer will make more than market (sometimes substantially more) and someone who is less than average will make less than market.

“As to the general rule of increasing pay every year, there is clearly a heavy experience component to salaries,” notes the partner. “I think you can never get away from that. A lawyer who has worked on more cases or deals is generally able to give better advice and do better work than someone who has less experience.

“I have never seen a star first-year do better work than an average five-year, for example, but generally, I believe that an associate can be ahead of his or her class average by a year or two. The key here is that someone who is below average has to be moved out of the firm and firms have to be tough on that score.

“Finally, as to why a client should pay more because another year has rolled by — well first, as I said before, the more experienced someone is, the more efficient they are, and the work product should be better. As to the client who asked why the associate’s billing rate went up, I would answer that the client is paying for that higher experience level and the greater efficiency.”

That appears to be precisely what some reacting to the news seem to be afraid of. Consider this comment on the story, from an anonymous reader at the *Wall Street Journal’s* Law Blog (<http://blogs.wsj.com/law/>):

“Firms paying associates based on merit is all fine and well. The question gets more complicated, however, from a client’s perspective. Presumably, the associate who is paid less will have a lower billable rate than one who is paid more. If this is the case, although the nickel-and-dime client might be pleased, the more serious client will naturally ask: Why am I getting the bottom-feeder associate? Thus, staffing cases will become an issue down the road.”

Wait just a minute: since when should clients pay the same for the dud as for the ace? Yet that’s just what this interlocutor seems to recommend.

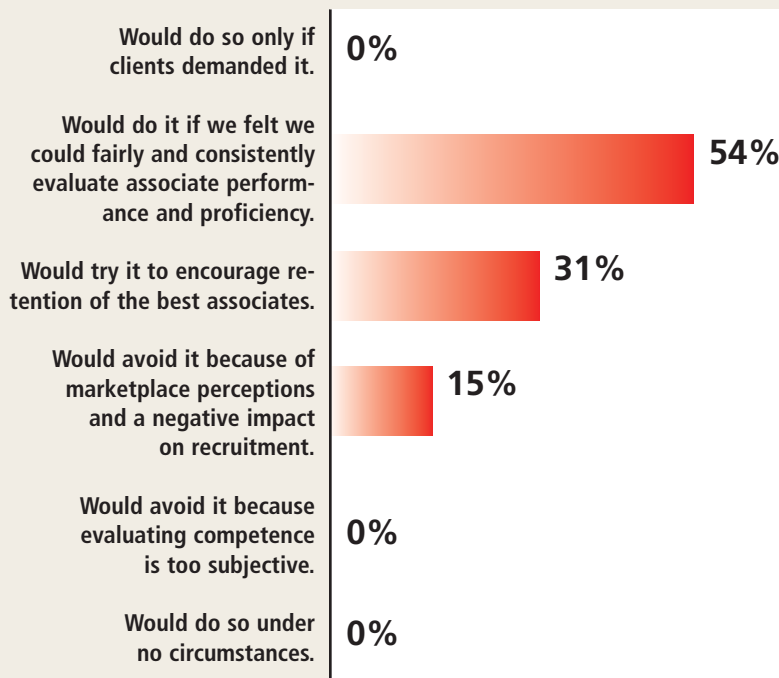
Furthermore, there’s a hairball of confusion in pitting “the nickel-and-dime client” against “the more serious client.” Putting aside the implication that clients who want to squeeze their law firms don’t have ample opportunity to do so under the current system, why should one assume the “more serious” client would tolerate “the bottom-feeder?” Presumably, this client is “more serious” because there’s more at stake.

Unless the law firm seriously misapprehends how the client perceives the gravity of its matter (which is, of course, another topic entirely), the last thing the firm would want to do would be to staff the matter with sub-par performers.

There’s not going to be a wave of adoption of this, is there? Actually, resistance may be weaker than one would assume. I conducted a thoroughly unscientific poll through my online publication, “Adam Smith, Esq.,” posing this question to readers: “In terms of moving to merit-based associate compensation, my firm would...” The results can be found in the chart at lower-left.

Perhaps surprisingly, 85% of respondents indicated they might follow Howrey’s lead if it would encourage the best associates to stay, or if they felt they could fairly evaluate performance. Interestingly, not a single respondent said they would do it “only if clients demanded it,” or “under no circumstances.”

**In terms of moving to merit-based associate compensation, my firm would...**



Results from reader survey at the online publication “Adam Smith, Esq.”

# À bas le statu quo!

**La rémunération des avocats salariés s'appuyant sur l'ancienneté a été abolie par un cabinet américain qui l'a remplacée par les critères de performance individuelle et une évaluation fondée sur l'expérience. Une véritable révolution dans l'univers du droit!**

**S**elon la tradition, les salaires et les taux de facturation des avocats salariés sont étroitement liés à leur ancienneté. Dans les grands cabinets américains, les salaires débutent à 160 000 \$ par an la première année; aux environs de 175 000 \$ la seconde année, et ainsi de suite. Les taux de facturation suivent le même principe.

Cette pratique fait tellement partie intégrante des principes centraux de gestion des cabinets que ces derniers commencent à peine à y envisager des alternatives, poussées par certains clients qui se demandent : « Pourquoi le même avocat salarié qui me coûtait 325 \$/heure le mois dernier me coûte désormais 350 \$/heure? ».

Il n'est pas toujours évident de répondre au client qu'il s'agit simplement d'une augmentation annuelle.

## **Le nouveau programme de rémunération**

Le cabinet Howrey LLP de Washington a récemment annoncé son intention de se débarrasser dès janvier 2008 du mode de rémunération classique à l'attention des avocats salariés. Voici les points saillants sur lesquels repose cette initiative :

- Les avocats de première année seront payés en fonction d'un « taux du marché » (actuellement 160 000 \$ chez Howrey)
- Après la première année, les avocats salariés passeront par une série de « niveaux » fondés non pas sur l'ancienneté, mais plutôt sur des évaluations personnelles de leur performance et de leur expérience.

• Chaque niveau reposera sur une échelle salariale axée sur le « marché », certains avocats salariés pouvant néanmoins être plus ou moins rémunérés.

Pour ce faire, Henry Bunsow, associé-directeur du bureau de Howrey en Californie du Nord s'en remet à la dynamique du marché. « Le but est de faire en sorte que les avocats salariés ne gagnent pas moins que leurs homologues d'autres cabinets ».

Ultimement, les avocats les plus performants pourront facturer à un taux supérieur basé sur leur réussite et leur expérience.

Chaque avocat salarié sera supervisé par des associés responsables de son développement, de son exposition à la rédaction, à la découverte et à la préparation d'un procès, ainsi que des évaluations. Il incombera à un employé à temps plein de surveiller le programme et de garder l'oeil ouvert sur les perceptions des avocats salariés en la matière.

Les réactions à ce programme révolutionnaire ne tardent pas à se manifester. « Affirmer qu'il s'agit d'une manœuvre audacieuse est un euphémisme », affirme William Nason, recruteur chez Watanabe Nason Schwartz & Lippman à San Diego.

Peu importe la résistance, elle ne semble pas si puissante, à en juger par un sondage en ligne mené par l'intermédiaire de la publication Adam Smith, Esq. Les résultats indiquent que 85 % des répondants suivraient les traces de Howrey si le cabinet encourageait ses

meilleurs avocats salariés à rester, ou s'ils estimaient qu'il pourrait évaluer leur performance avec justesse.

## **Une révolution latente**

Les justifications de ce nouveau système de pensée ne sont pas nées de la dernière pluie. Chez Latham & Watkins — largement considéré comme un modèle éclairé en gestion du droit — cela fait longtemps que la rémunération des avocats salariés a été affublée d'une composante fondée sur le mérite et matérialisée sous la forme de boni. « Notre philosophie est que quelqu'un qui performe très bien gagnera plus que [le prix du] marché (parfois de manière significative) et qu'une personne en dessous de la moyenne gagnera moins que ce prix », rapporte un associé du bureau de Latham à New-York.

« Concernant la règle générale qui consiste à augmenter le salaire chaque année, fait-il remarquer, je pense qu'on ne peut pas s'en départir. Un avocat qui a travaillé sur plus de causes ou de transactions peut généralement donner de meilleurs conseils et effectuer un meilleur travail que quelqu'un dont l'expérience est moindre ». Selon lui, il suffit de répondre au client qui se demande pourquoi le taux horaire d'un avocat salarié a été majoré, qu'il est justifié par « un niveau d'expérience plus élevé et une plus grande efficacité ».

Pour l'heure, une tendance connexe aux nouveaux modes de rémunération indique que les avocats oeuvrant dans des pratiques spécialisées très prisées gagneraient davantage que leurs homologues au sein d'un même cabinet. Dechert LLP a justement annoncé l'hiver dernier que ses avocats salariés appartenant au groupe des services financiers percevaient des salaires supérieurs de 5000 \$ au cours de la troisième année jusqu'à concurrence de 30 000 \$ la huitième année.

Une chose est sûre : les cabinets juridiques échappent de moins en moins à la logique purement économique. ■

— Yasmina El Jamaï

Again, this is far closer to the anecdotal than to the data end of the spectrum, but I believe its results are suggestive, and hopeful.

## **What's really going on here?**

I must confess that the most surprising aspect of this story to me is that others find the departure from lockstep surprising — as in the remark, “to say it's bold would be an understatement.” Where is the revolution? Enlightened management has always sought to reward superior performance, and clients

will ungrudgingly pay more for superior quality and service. This should not be viewed as new.

But there is another dimension to what clients value and what they'll pay a premium to get. The dimension we've been discussing is simply that of professional excellence and impeccable legal skills. The second dimension I want to introduce is that of legal advice that's intrinsically more valuable because it's provided in a high-margin practice area.

As Prof. Bill Henderson of Indiana University Law School/Bloomington has pointed out, the market sets a different

price on, say, a fifth-year employment law defence associate versus a fifth-year private equity or hedge fund associate. Might it not be that the “internal” market within the law firm is, under the Howrey model, merely reflecting the external market value differentiation?

After all, in a very real economic sense, it costs a law firm more to lose a productive and proficient associate in a high-value practice area than it does to lose one from a commodity practice. Law firms would only be acting in their rational self-interest to

*It costs a law firm more to lose a productive and proficient associate in a high-value practice area than it does to lose one from a commodity practice.*

reflect that value in the associate’s total compensation.

Furthermore, to the extent partners practising in high-value specialties have more internal clout than their colleagues in commodity practices, presumably they would be in a position to urge the firm to reward their associates more highly.

Indeed, Dechert LLP announced last winter that associates in its Financial Services Group would receive higher salaries across the board than associates elsewhere in the firm — from an additional \$5,000/year starting in third year to an additional \$30,000 by eighth year. The internal memo quite candidly

describes the differential pay scale as “unusual.” That it surely is — but perhaps only in its candour and clarity.

Associate X can be more valuable than associate Y because she is just plain a better lawyer. But she can also be more valuable because her expertise is in an area clients will pay a premium for. No inconsistency here.

#### Summing it up

Here’s what it boils down to, for my money:

- Howrey’s initiative is one of the first serious stabs to get away from the transparent fiction that all X-year associates are alike. As Bunsow puts it, “no business in this country would run itself that way.” (Surely he cannot be implying that law firms are not run in a businesslike fashion?)
- This is one of the more meaningful attempts to tie cost of service with value to client: the more skilled the associate (at level X), the more you pay — and the more the associate is actually capable of doing.
- Bunsow sums it up best: “Our goal is to (a) attract and keep the best people, (b) compensate them for what they’re worth, and (c) justify their cost to the clients, because we think clients are willing to pay for high-quality legal services.”

Point (a) is all about winning the war for talent, by putting your firm’s money where its mouth is. Point (b) means you understand your associates are not fungible — an extraordinary leap of faith for some, no doubt — and, again, that your firm is prepared to act on that reality.

Finally, (c) means you are unapologetic about what it costs to deliver impeccable quality.

The only thing that shocks me about this thunderbolt is how immediate, and visceral, was the resistance. Are we truly such slaves to a century-old system, the “Cravath system,” showing greater signs of superannuation with each passing year? If the intrinsic economic value of different practice groups diverges as much as this analysis suggests it does, why do commodity and premium practice groups continue to co-exist under the same roof and law firm brand name?

My answer — I’d be interested in yours — is through a combination of tradition, sheer inertia, and personal and emotional preferences by all concerned for conflict avoidance. In today’s world of hyper-informed and cost-conscious clients, I doubt it can still be ascribed to the comfort of a one-stop shopping relationship.

And I leave you with a prediction: were there ever to be an active public market in law firms, you would see a sudden and transforming series of spin-offs, regroupings, and recapitalizations, as firms sorted themselves into premium, median, and commodity practice specialties. What would this do to your firm? ■

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