Compensating the Unique Practice Partner

By James D. Cotterman

Since I first wrote about compensating the unique practice partner fifteen years ago, the prevalence of these practitioners in law firms has increased, driven, I believe, largely by the merger activity of the past two decades. Today, more law firms find themselves with a growing collection of practices that are not quite core, yet not conflicted out or necessarily destined for release. It has been and continues to be culturally challenging to really tighten the strategic focus at many law firms.

So, let's examine how to compensate the unique practice partner. First you must determine when a unique practice exists. The situation arises when a partner develops a practice that is outside of the firm's core services and/or clients. A 'unique' practice is likely to be:

- **Self-supporting**: of sufficient scale to be a stand-alone operation,
- **Independent**: it is not dependent on the rest of the firm for its clients and work, although resources of the firm may support it to some extent,
- **Interesting**: at least for the partner who developed it, and,
- **Sustainable**: economically viable over many years and in varying economic conditions.

The unique practice partner should be fairly uncommon. Every different practice group (litigation vs. corporate or insurance defense vs. contingent fee to name two of the more common and notable specialized practices) should not consider itself unique and deserving of a separate economic arrangement, unless that is the nature of the relationships among all of the partners. Such might occur in a law firm operated as a confederation – multiple independent practices sharing a common name, but economically separate. Specialization does not equal uniqueness.

How do you compensate the partner who has a unique practice within a law firm? The answer to the question "How?" – as any lawyer is fond of saying – is "It depends." There are two significant variables that affect how to compensate the unique practice partner. They are the method of remunerating partners at the firm and the nature of the relationships among all of the partners.

If the firm is a confederation of space sharers the issue may be relatively simple. This type of firm is likely to make independent decisions regarding many issues and joint decisions only on a few issues, such as space and other common services allocated by specific utilization. It is likely that this type of law firm (actually a firm of many “mini-firms”) will allocate receipts and expenses directly to each of the various “profit centers.” The profit centers may be individual partners or small groups of partners who have agreed to band together for a common purpose. The compensation systems in such firms tend towards the “eat what you kill” variety.

The question becomes more difficult in a firm that operates with a team-orientation. This firm type is characterized by client sharing, pooled resources, common philosophies and the like. Within this type of firm, the partner with a unique practice will quite likely operate within the firm’s environment for all but the clients sought and/or services offered. A separate, and possibly more important, discussion is the rationale of having such a unique practice within a firm of this kind.

A team-oriented firm that pays its partners using objective metrics such as business generation, business management, personal productivity and the like will find that compensating the partner with a unique practice area is a bit easier as the metrics apply equally to the unique practice partner as to the general partner population.

However, as the firm adds subjective elements such as management, training, mentoring, leadership, or firm marketing, the job begins to get a bit more difficult. Some of these activities may not be applicable to the unique practice partner. The extent to which the compensation decision-makers have latitude in applying criteria will affect the difficulty they have in fairly addressing pay concerns for this individual.

Team oriented firms that use tiered, lock-step and equal share systems clearly focus on a shared risk / reward philosophy. In these situations, the unique practice partner’s pay determination is most problematic.

The best course to pursue for the unique practice partner is to first identify what the firm wants out of the relationship with this individual. If the intent is that this is a unique practice but still part of the firm, then it would seem logical that the risks and rewards are shared to some extent. If the intent is to associate yet segregate the practice, then a separately negotiated compensation arrangement makes the most sense. This is often the case with lawyers designated “special counsel” and “of counsel” in a law firm.

When the relationship calls for a special compensation arrangement, each party must understand how risks and rewards are to be shared. There are many variations from the elegantly simple to the technically complex.

At the simple end of the spectrum are arrangements that split the fees paid. Three scenarios apply:

- The unique practice partner originates some work that the firm services. Here the unique practice partner is generally entitled to a range from 10% to one-third of the fee.

- The unique practice partner originates and services the work. Here the unique practice partner is generally entitled to a range from 40% to two-thirds of the fee. In this and the prior scenario, the remainder of the fee goes to the firm to cover overhead and the value of the firm's time if it services the work.

- The unique practice partner may also have an agreed upon rate that he/she is paid for servicing firm clients. This is probably the more typical compensation approach for a unique practitioner servicing firm clients. Alternatively, the arrangement can be a percentage of the fees paid by those clients (like the two scenarios described above). This happens less with a unique practice partner than it does generally with senior counsel. As a rule, the more often the practitioner is called upon to serve firm clients, the less likely it is that his/her practice meets the definition of unique.

A more complex arrangement occurs when a firm adopts the profit center approach, allocating the direct expenses of malpractice insurance, occupancy, shared office services and secretary and other staff who, while employees of the firm, are dedicated to the unique practice partner. Some firms add a mark-up to the directly allocated expenses to cover management of those services. Directly allocated employee expenses include fringe benefits, mandatory employer contributions and taxes. Fees belong to the unique practice partner and he/she is charged back for the direct overhead and the agreed upon rate of any firm timekeepers who work on his/her matters.

Some firms take another approach in which they split the unique practice partner's fee income so that the partner takes the first "x" of fees, then the firm takes the next "y" of fees and then they split anything above "x plus y." This scenario provides cash flow to each party and is agreed to as a simple means to recognize the elements of origination, servicing and overhead without the bother of tracking and accounting specifically for each.

This very brief sample of what has been done shows that the methods used can be quite diverse. One is limited only by one's creativity.

James D. Cotterman is a principal with management consultancy Altman Weil, Inc. He advises law firms on compensation, capital structure and other economic issues, governance, management and law firm merger assessments. Contact Mr. Cotterman at jdcotterman@altmanweil.com.