Good Compensation Practices During a Pandemic

By James D. Cotterman

We began 2020 in bright spirits and bountiful economic conditions; by early March we knew it would be a year like no other.

In response, firms quickly adjusted operations and quite properly began salary reductions to help conserve cash for an uncertain future. Compensation expense for all (including partners) generally absorbs 78% of fees in law firms. So reducing pay was an absolutely necessary undertaking to sustain a firm. Pay reductions were often tiered by classification and/or overall salary level. The biggest reductions were at the top of the scale and the smallest reductions at the bottom of the scale.

Leaders knew they needed to retain their core capability, even if the team was largely benched for a while, so they would be able to get back to work when conditions improved. Therefore, the initial goal was to limit furloughs and terminations, at least until more was known about the future. The few furloughs and terminations that did occur were largely of individuals who were chronic underperformers pre-COVID and staff members whose jobs disappeared with remote work (i.e., receptionists, et al.).

Now we come to the traditional Labor Day end of Summer – the start of compensation season for much of the profession. Law firm leaders should use September to convene all compensation decision-makers to discuss the unique circumstances of 2020.

Start with your firm's particular internal messaging as the pandemic got underway and your approach through the late Spring and Summer. How do you build on this? How do you message for the balance of 2020? How do you craft compensation decisions that support the messaging, yet reflect the economic reality that will exist at year-end? This alignment of messaging and decisions is not just for the partners, but for the entire workforce. This cycle, more than any other, will benefit from a thoughtful and organization-wide message that carries forward with whatever theme you used this Spring.

In our conversations with law firm Managing Partners this summer, we have heard that most feel pretty good overall about where their firms are at this juncture. There is a sense that the messaging and actions have been well aligned and effective at holding firms together. Economic adjustments have worked and, overall, firms are in much better shape than their Spring worst-case projections anticipated. Some firms are even close to their original 2020 profit expectations to date – largely due to quick actions to curtail expenditures as COVID got underway in the US.

But Managing Partners also tell us that they remain cautious about the future. How will this year conclude and what will 2021 look like? They understand that patience and unity of purpose have limits, and to keep the core team together and engaged into 2021 will require healthy work flow and restoration of pay. Some have already made partial or full restoration to pre-COVID pay levels. Some have even restored pay retroactively.

As firm leaders embark on this unprecedented compensation season, they are saying:

- "I need to pay the high contributors."
- "I don't want to penalize people for shortfalls due to COVID."
- "So many of our partners are having years that are so atypical of their long-term contributions."
- "We have made select adjustments where the issues have been chronic and existed long before COIVD."

Law firm compensation is a zero-sum game. There is only so much cash to go around. The more limited the funds, the more difficult it can be to fully pay high contributors while holding others harmless. Firm leaders should work on extending the consensus they have built thus far. Part of that work requires candor about what year-end projections predict and what philosophy will guide compensation decision-makers. This year, cultural alignment may be a more significant guiding principle for compensation decisions.

In some firms the high contributors will need to leave some money on the table. That is not a new concept. When I sit with compensation committees during deliberations or debrief them afterwards, the subject of optics and very high contributors pushing money down to others for the collective best interests is frequently part of the dialogue. So, there is precedent in the act of selflessness. But in this year, it may be wise to broach and encourage this early.

To further complicate this effort, there likely have been a range of responses to this ordeal within each firm. There are individuals who maintained a solid team attitude, who pitched in, who improved their skills, who assisted others, who accepted individual sacrifices for a greater good and who stepped out of their comfort zone to add value to the firm and its clients. And, not surprisingly there were those who focused on themselves, protecting their turf (hours, fees and the like). Some reacted out of fear for the great uncertainty embedded in this crisis. Managing Partners have commented that these responses – both positive and negative – left lasting impressions which were deeply set in leaders' assessments. Adjusting pay decisions based on these views is entirely appropriate. But it should be consistent with ongoing counseling provided throughout the year and part of the feedback provided at year-end.

Another consideration is how to treat 2020 in compensation programs where performance data is averaged – thus affecting not only current year compensation, but decisions for some time into the future. There might be opposing scenarios – partners who had a really good year due to the pandemic and those who did not. The purpose of averaging data is to smooth out single year anomalies. In that regard, the averaging will accomplish its objective. However, there may be more volatile performance in 2020 then was ever anticipated when the averaging term was defined. Thus, some firms may temporarily increase the averaging term to dilute the influence of 2020. For example, a three-year average may be increased to a four-year average until 2020 drops out of the mix.

Firms where a partner's share of the profits is set at the start of the year (prospective firms) have already largely locked in the allocation for 2020. However, they still must deal with the problem by early in 2021. If a retrospective bonus is part of the compensation program in these firms, then some adjustment can be reflected in careful allocation of the bonus pool.

Firms with heavy formulaic approaches are also locked in. Those firms will have greater certainty in the outcome of their process, but also less leeway to soften the effects of 2020 activity. A great many of these firms will likely be okay with that outcome. It is part of the bargain that they signed on to. However, there may be firms where the formula results just do not feel right to the partners. Those firms may decide to adjust the formula to achieve a result that the partners can support. An objective adjustment that does not require subjectivity, is to collar compensation movement – i.e., compensation for 2020 cannot exceed some percentage plus/minus of compensation from prior year(s). Another approach is to create an absolute floor to compensation – providing a safety net.

As Fall approaches, get a head start on year-end compensation efforts. This year will require more thought, more effort and more messaging.

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Author's Note

For a quick refresher on the best practices for partner compensation: Firms establish a pay program and procedures that fit their organization in order to make consistently good compensation decisions. Those decisions are grounded to:

1. Internal consistency — Pay Proportional to Performance®
2. Strategy linkage
3. Cultural alignment
4. External competitiveness

For much more on these please download *Why Do We Have Compensation Programs?* from our website at: www.altmanweil.com/CompPrograms. We believe that the best practices will endure long-term, but in this year, we may find such an unprecedented set of circumstances that special consideration is warranted.