

Report to Legal Management

OUR 33RD YEAR

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Lockstep Compensation: Does It Still Merit Consideration?



James D. Cotterman

By James D. Cotterman

Mention lockstep compensation to law firm partners and most will roll their eyes and wonder where you have been. Historically a prominent compensation method, the lockstep approach is now the least preferred way of allocating compensation in the US. In the UK and in New York, however, some of the largest, most profitable and most prestigious law firms maintain a lockstep compensation program — some in pure form and some with various modifications.

The purpose of a compensation program is to support efforts to attract and retain the right people for an organization. A compensation program is comprised of the system that defines the methodology and the process to administer it. The right program is the one that facilitates top quality compensation decisions that are simultaneously supportive of the firm's values and culture, the business strategy and meritocracy (i.e., alignment of pay decisions with relative contributions to the organization's success). What research has shown is that top quality decisions are neither system nor process dependent. However, there are methods and processes that firms are increasingly deploying as they grow that aid them in achieving this goal. Remember that the power (good or bad) of a compensation program is that it represents the most visible, tangible expression of what leadership truly values and believes. It is, in the current vernacular, the "walk to your talk." When well executed, it

raises leadership's credibility, improves morale and fosters trust.

The conventional wisdom is that lockstep is out of step with the economic consequences of a maturing legal market. As the post-World War II lawyers approach retirement, more and more of the lawyers behind them expect to be paid for their contributions on a current basis and are much less willing to carry a partner (sometimes even for only a short period of time) whose productivity slips. "Productivity," "business generation," "performance-driven," "merit-based" are the coins of the realm. This author advocates those principles as well. This author, however, also believes that all programs are capable of achieving that end result. Lockstep merely requires special care and rigor to do so.

First, because of its generally auto-pilot approach to pay, a lockstep system requires an extraordinarily rigorous and disciplined decision at the point of entry. One must have a very high comfort level that the individual being considered for partnership (and lockstep) will

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progress sufficiently throughout his or her career to warrant the increasing pay that lockstep will bring over time. A natural consequence of such a program is a smaller ownership group. Another consequence may very well be a more cohesive group since the attributes for success are much more narrowly defined. A third may be a program that produces a flatter pay range, reaches peak more quickly than the market, and eschews the super-star lawyer syndrome.

Arguments for a Lockstep System

What do the advocates say in defense of lockstep?

1. *It is incredibly supportive of a single firm philosophy.* All partners are truly co-owners in this enterprise and rise and fall together based on their collective efforts. Truly the partnership is only as strong as its weakest contributor, since all will suffer in proportion. The largest law firms circling the globe wrestle with their ability to reinforce the notion of the firm as a single unified partnership.
2. *There is little internal competition.* The only important result is how well we *all* did. It is the firm's results that matter, and for the firm to succeed we must *all* succeed.
3. *Leadership is freed from the tedious, time consuming and increasingly difficult annual ritual of performance assessment and compensation decision making.* As law firms grow in size and geographic reach, the magnitude of time and effort seems to expand exponentially. Lockstep is a simple system to administer (or so one hopes).
4. *It is easier to ask a partner to relocate, take on a difficult assignment, accept a non-traditional role (divergent from practitioner and business generator) when leadership and the individual are freed of the worry about how this might affect his or her compensation.*

Arguments Against Lockstep

Critics of the lockstep approach have their list of failings:

1. *There is no accountability.* Once admitted, progress becomes automatic and no reduction in income share is ever experienced. Such a lack of accountability favors the least energetic, least aggressive, and least capable lawyers. It does little to reward hard work, sales ability, or expertise. In such a system, some partners "retire" at their desks long before formal retirement, and yet continue to receive a full share.
2. *This type of system can be discouraging to the most energetic partners and to those seeking higher incomes.* These partners are discouraged by the small impact their individual efforts have on the overall profit of the firm. This inability to affect their own earnings in any substantial way can eventually lead to a considerable level of frustration, and loss of some exceptional partners. This clearly has played out in the global firms, particularly when they grow by merger and acquisition.

A typical lockstep system may involve tiers, points or units to define the structure of the system. Generally the track from admission to a full share is about 5 to 15 years, with a spread of from 1.5:1 to 3:1 in compensation, from high to low.

Refining the System

A number of refinements can be made to a lockstep system to improve its acceptability and preserve its major strengths: simplicity, lack of confrontation, and lack of internal competition (scorekeeping). Let's discuss them in order of increasingly more aggressive change.

1. *Lengthen the time to full share, which will also increase the spread from top to bottom.* This change simply adjusts the lockstep to a more market-matching model.

Lawyers' compensation typically rises until around the 29th to 31st year of practice, and then tends to plateau or slightly decrease until lawyers begin to retire.¹ This partially addresses the concerns some raise about the divergence in contribution from high to low being more than 1.5:1 to 3:1. However, it also indicates that the admission criteria are not as strict as required by a lockstep program, and possibly more strict than many firms feel they can be to retain seasoned lawyers.

2. *Modify the track to advance lawyers more quickly in the early years, then more slowly as they age.* This change further aligns the program with how the market behaves. It also attempts to address the concern that younger lawyers have about being able to move more quickly up the compensation ladder.
3. *Insert gates or plateaus into the lockstep.* Essentially these changes permit the lockstep to be divided into mini-locksteps. To pass through a gate one must be requalified. Some firms see this as a partner decision administered just like the initial admission process. Others view the gates as a system element to be administered by leadership. There are varying degrees of rigor and standards required for an affirmative vote in either situation.
4. *Allow the lockstep to have a career-end reduction that mirrors the market and provides for an orderly winding down of a partner's career late in life.* There are many approaches to this. Some are more rigid, with mandatory cycles to begin and end. Others are more flexible in start and end dates.
5. *Allow leadership to alter a partner's movement in the lockstep at any time. Now we are getting into the more actively managed versions of lockstep.* This is a bit easier because leadership really only addresses outliers — individuals

who are not performing adequately for their position in the lockstep or progressing at the same pace as the lockstep assumes. Some may need to be progressed faster, some slower (or even stopped) and some may even need a downward movement well before retirement. This gets the program in line to recognize greater individuality within the firm. Often the criteria for outliers is crafted to only affect 5% or less of the partners. Statistically it means greater than plus or minus two standard deviations from the mean. In other words, acceptable performance and pace of progression are wide avenues designed to handle most of the partners.

6. Introduction of a bonus pool to recognize individuals whose performance in a single year may be materially beyond his or her "class" in the lockstep. Again a wide band of performance is established so the bonus is likely to only affect the 2.5% of the partners who are truly exceptional. Bonuses should be few in number and large in amount. If the bonus you feel is warranted is less than 10% of a person's pay, then the person is probably not performing at an exceptional level and no bonus should be paid (i.e., no distinction made).

7. Overlay a merit program on top of the lockstep. Here the lockstep represents some portion of total compensation. Generally the merit portion is applied in greater proportion to the total as one climbs the lockstep. For example, the merit

portion may be 10% to 15% of total compensation in the first third to half of the locksteps, rising to 15% to 20% over the remaining steps and plateauing at 20% to 40% of total potential compensation once a full share is reached in lockstep.

8. Finally, all of the above changes can be done in various combinations. Obviously this is limited only by one's imagination and how complicated one wants to make the design. Generally, the more simple the approach the easier it will be to implement.

Making it Work

Let's return for a moment to how to make a lockstep system work. First, the firm must adopt standards of performance (a "comfort zone" concept developed by Altman Weil is an appropriate approach). Second, the firm must apply the standards and have zero tolerance for chronic underperformance. In this way, the system's weaknesses are mitigated.

Firm standards should include a specific budget for "firm" time for those partners with managerial or committee assignments. Authorized management time may be credited, wholly or in part, toward time budgets. When an individual accepts a leadership position in a community enterprise, such as a bar presidency or the head of a fund drive, and when the firm approved the activity in advance, a time budget could be established and made part of the quota. Individual partners who consistently fail to achieve the budgeted

hours might have their units of participation reduced, until their effort and shares of profit come into balance. Only disability or the expressed advance action of the firm might excuse a partner from meeting budgeted hours. Remember however, that effort, while an important consideration, is less important than results in a compensation decision.

Design the lockstep with a 10% differential between levels. Consider increasing that to 15% or even 20% at upper levels of the ladder. This reinforces the idea that level changes are for easily identifiable differences in contribution. It also puts faster movement at the bottom of the ladder where it is needed. Finally, it helps orient partners towards improving overall profitability as the prime means to raise income.

In conclusion, lockstep can work in a modern law firm. There are some attractive features that align nicely with many values and aspirations law firms have. With it, however, comes the requirement for rigor in deciding who you let into the system. Quite possibly, it is the most important decision law firm partners make — who is and who is not part of the team. ♦

¹*Productivity and Profitability Over a Career in Law*, James D. Cotterman, Altman Weil Publications, Inc. 2004, Page 3.

James D. Cotterman is a principal of Altman Weil, Inc., working out of the firm's office in Florida. He can be reached at (407) 381-2426 or jdcotterman@altmanweil.com.