PROFESSIONAL PRACTICES ALLIANCE SEMINAR REPORT

"Partner Contribution and Reward: Creating Partner Remuneration and Evaluation Processes to Drive Your Firm's Business Strategy"

A. Introduction

1. From "dog bowling" in an "eat what you kill" profit sharing structure, to how to distinguish between and handle the "gorilla" or "elephant" rain-making rogue partner in a firm's reward system, the visceral language flying around at the interactive Professional Practices Alliance breakfast seminar on Partner Contribution and Reward on 31 January 2017 was in keeping with what was a lively, topical and engaging session.

2. For audience members and the panel alike, the start of a brand new year seemed to be an appropriate time to reflect on and discuss issues relating to partner contribution and reward systems in professional service firms and strategic business goals. The panel was made up of Corinne Staves, partnership law specialist and partner at Maurice Turnor Gardner LLP, David Shufflebotham, partner remuneration specialist and founder of PEP-UP Consulting LLP, Bettina Bender, employment and partnership law specialist and partner at CM Murray LLP, and chaired by Clare Murray, employment and partnership law specialist and Managing Partner at CM Murray LLP.

3. Much ground was covered drawing on real-life experiences, including:

a. how firms could go about creating a new partner evaluation and reward structure to drive its strategic business plan and to ensure that all partners are pulling together in the same direction;

b. balancing and weighing business development, cross referral, mentoring, leadership, conduct and other key expectations, against all important financial performance;

c. the governance structures and management skills needed to get new partner evaluation and reward systems to work;

d. how to deal with partners on maternity leave, long term sick leave, or on part-time/flexible working; and

e. how to deal with rogue and even sociopathic partners in a firm's reward system.

4. This report summarises the key points of interest that came out of the seminar and also includes a summary at appendix one of the results from the PPA Partner Contribution and Reward Survey ("PCR Survey") undertaken prior to the seminar. The PCR Survey tested the respondent's views on their own partner remuneration systems and processes and included, by way of summary only, the following key findings:

    a. 81% of the respondents surveyed felt that their partner evaluation and remuneration criteria was clear, however 33% thought the system was not transparent;

    b. There was also a split between those who thought they received clear and regular messages about their own performance and the potential impact on their remuneration: 44% felt they did not receive clear and regular messages on their performance and its impact on pay from their firm, whereas 41% felt they did receive clear and regular messages;

    c. 73% thought that their partners trusted the system and criteria to produce fair results; but 23% did not trust them to produce fair results;

d. 67% considered their firm's partner evaluation and remuneration criteria were based on and drive their firm's business strategy; 26% thought they were not aligned to and driving the business strategy;

e. Only 26% indicated that their partner evaluation and remuneration are based solely on financial data, whilst 73% confirmed that their partner evaluation and remuneration are based on a range of financial and other factors.

f. On sick pay and maternity pay, the majority of firms provided for a period of continued drawings and profit share (at full or potentially other level) for 6 months (37% in respect of 6 months' sick pay, and 42% in respect of 6 months' maternity pay). However, in respect of the longer period of 12 months of continued drawings and profit share, whilst 30% of firms provided this to those suffering from extended ill health, only 23% provided the same 12-month period of benefits to those on maternity leave.

g. Finally, the three most significant factors that partners cared about in their partner remuneration system were:

    i. Perceived fairness (78%)

    ii. Supporting the firm's culture and ethos (70%)

    iii. Recognition of performance as a partner (financial or non-financial) (67%)

h. However, there was still a significant minority of partners who, rather than focussing on the wider issues of fairness and culture of their firm instead were focused primarily on their own personal position above all other factors in their firm's remuneration system:

    i. 22% prioritised absolute reward (maximising their own profit share compared to the market); and

    ii. 26% prioritised relative reward (maximising their own profit share in relation to their partners).

5. These results are encouraging in many ways as they suggest that the firms represented in the PPA survey are not only having recourse to non-financial inputs and metrics when determining partner remuneration, but that they are also, in the view of many partners, getting right the delicate balance of what to take into consideration, along with how to undertake the process to enable most partners to feel that they are being fairly rewarded in light of the firm's strategic goals.

6. However, it was also clear from the results that firms need to do more to address the views and concerns of significantly sized minorities of dissatisfied partners, by:

   a. Ensuring as far as possible that all partners in the firm have confidence in the clarity and fairness of the system and that it will produce fair results for all;

   b. Introducing greater transparency into their partner remuneration system;

   c. Revisiting their partner evaluation and remuneration systems to ensure that they are more closely aligned to and driving their firm's overall business strategy;

   d. Ensuring that their firm's remuneration system adequately and fairly rewards important non-financial contributions rather than focusing solely or predominantly on financial contribution of partners;

   e. Dramatically improving communications with partners individually regarding their own performance and its likely impact on their pay under the firm's remuneration system; and

   f. Identifying and carefully managing those partners who are more likely to place their own interests, particularly in respect of pay, above the wider interests of the firm and other partners.

B. The Options

Lockstep

7. The seminar began with a brief overview from Corinne Staves of the main remuneration models used by professional service firms to determine a partner's level of reward. The first is the pure lockstep model: whereby a partner moves up the profit sharing ladder in accordance with their increasing seniority. The approach aims to encourage a collective focus on the firm's performance, foster collegiality and reward loyalty, but of course there is no scope to reward exceptional performance and robust performance management of partners and the firm is vital to avoid carrying passengers and the inevitable tensions and dissatisfaction that result.

8. This system was described as being like a long multi-storey escalator: a partner would automatically progress up it steadily over time, with the only alternative being an exit from the firm (i.e. being tipped off the side of the escalator). A variant is the modified lockstep, with gates or hurdles at intervals on the lockstep where partners must meet certain criteria in order to progress up to the next level (or stay at the top). So, to get on the escalator you first have to get past the bouncer (or partnership board as the case might be) guarding the entrance at the foot of each storey.

Eat what you kill

9. At the opposite end of the scale is the pure merit model, often known as "eat what you kill". Under this model a partner's profit share is based on individual performance, often very closely linked to the revenue they as an individual partner generate. This was said to be more like a flight of stairs than an escalator, where the partner who is able to run to the top of the stairs the fastest would reap the largest financial reward. The "eat what you kill" model can encourage individual entrepreneurial flair and success, but can also lead to undesirable behaviours such as "dog bowling", that is keeping work and clients to oneself and not delegating or sharing work that other partners may be better placed to undertake. It also encourages internal competition which may or may not be the best way to help the firm's long-term success.

Hybrids

10. There are many hybrid models reflecting elements of both lockstep and "eat what you kill". There are many possible versions of the hybrid model, but this usually includes the division of profits into two (or more) pools; one pool would be allocated to the (possibly gated) lockstep and a partner will participate in these profits in proportion to

their position on the lockstep as usual and the second pool would be the merit pool, which would be divided up according to the determination of each partner's contribution to the firm in accordance with whatever assessment criteria that firm uses (often decided by some form of remuneration committee).

Black box system

11. An audience member highlighted a further partner remuneration model called the black box system, whereby the managing partner or a small committee in the firm sets remuneration levels for the other partners in their or its absolute discretion (and often only they know what each of the other partners are awarded in profit share or on what basis). The KPIs are often a mystery, but typically this has a simple merit based system at its heart. It was observed however that although the black box system may work in some firms and it has been used in the hedge fund and financial services industry, a challenge with it is that it may be difficult to sustain long-term. For example, if the system relies on a high level of trust in certain individuals, how can the firm plan succession effectively?

12. Further a black box system could present a high risk of potential discrimination issues, particularly where you have a group of partners who are not a homogenous demographic, and have different ages groups and genders etc. The lack of transparency in this system may be more likely to result in individuals succeeding in arguing that lower reward was based on inappropriate criteria (such as protected characteristics) rather than on performance. And that, on this basis, even within black-box systems it was highly advisable to maintain an audit trail of the reasoning behind each reward decision so that the firm is in a stronger position to justify its remuneration decisions as being on clear objective and non-discriminatory grounds.

Trends

13. Corinne Staves noted that in 2015 an Association of Partnership Practitioners (APP) survey of 47 professional service firms, including UK, international and specialist firms, regarding their firm's remuneration models found that 53% of firms operated a lockstep, of which only ¼ of these were pure lockstep and ¾ were modified lockstep. This indicates a trend of movement away from pure lockstep because in a similar

earlier survey by the APP in 2011 almost 10% more firms operated a lockstep and half were pure lockstep.

14. 56% of the respondents used performance gates, suggesting that 20% use some other form of modification of their lockstep. The 2015 survey also found that 57% of firms had a 5 – 8 year lockstep, but only 29% had an 8 – 10 year lockstep.

C. A Firm or Flexible Choice: How to decide on the Best Remuneration Structure for your Firm

15. Once the potential remuneration model options had been identified, next the panel turned to consider how a firm might decide what remuneration structure is likely to work best for it, its partners and its long-term strategy. David Shufflebotham introduced some principles that firms can use to help identify an optimum profit sharing model for their firm's particular style of partner performance and market conditions.

Optimum Paradigm: Pure lockstep

16. A firm with a combination of high poaching/flight risk (that is where other firms in the relevant market are willing and able to offer higher levels of reward to high performing partners) and a high degree of performance variation between partners would tend towards that firm adopting more of pure merit or eat what you kill profit share model. Whereas in a firm that has a low flight risk, because partners are highly paid in comparison to the market and there is a fairly low performance variation between partners the most likely optimum model would be a pure or lightly modified lockstep. A very well-known and successful example of these principles in action would be a firm like Slaughter & May, which has retained its lockstep model and where partners are known to be highly paid and partner attrition levels are low.

17. Though, of course, it is also important to recognise that there are many other factors at play in determining a partner's long-term commitment to their firm.

18. In a pure lockstep system, a partner's contribution is expected to increase as they move up the lockstep. It was therefore acknowledged that for such a system to work a partner's development would need to be supported accordingly by constructive

feedback, training and coaching. This requires open and honest conversation between partners, which was acknowledged to be something that ironically most lawyers were not particularly good at doing. It was said that this is because lawyers were trained to see feedback as a criticism, whereas in a pure lockstep model (and all other models for that matter) it is really important that partners see feedback as constructive and as paving the way to improvements for the long-term stability and sustained success of the firm. The risk of failing to have these conversations is that partners who are not pulling their weight; not being utilized where their optimum skills, experience, and capabilities lie or perhaps lacking in motivation may coast along just below the radar and may become a drag on the firm's ability to achieve its overall strategic goals.

19. David Shufflebotham stated that the partnership model remains a fantastically efficient structure for producing high quality and profitable output in a professional services context. He noted, however, that, for partnerships to be able to work successfully, significant time and energy needs to be expended in creating and maintaining the partnership in terms of both its culture and strategy and including the way that that both feed into its partner evaluation and remuneration systems. In this context, it is critical that we draw a distinction between the partnership business model itself and the style of management used within that overall business model. As firms grow in size increasingly corporate styles of management become necessary, however, those leadership teams that manage their firms with a view to maintaining a spirit of partnership and a spirited partnership will tend to be the firms that get the greatest and most engaged output from their most valuable asset – their partners. On the other hand, a leadership approach whereby a select few partners in management hand down edicts to rank and file partners and expect compliance (with partners feeling like they are just very highly paid employees) is unlikely to engender the same level of partner commitment and engagement.

Optimum Paradigm: The Push and Pull between Eat What You Kill and Merit Based Systems

20. In a competitive market, the bigger the differential between the performance of the top performing partners and the lowest performing partners the more likely it is that a partner who is performing very well will be able to get better paid at another firm. Where a high degree of performance variation exists, pure lockstep models are

unlikely to be the most appropriate remuneration structure. In such circumstances a firm is usually faced with a choice of either reducing the range of variation in partner performance (typically by reducing the number of partners) or developing a more merit based remuneration system, so as to prevent partners leaving to join a better paying rival and potentially taking their revenue generation with them.

21. Having said that, it was also stated that in such a fluctuating scenario the relevant firm would have to think on one hand about the extent of the performance variation and any resulting competing tensions that could be created between someone who was a comparatively lower revenue generator (for example bringing in around £500k) and someone who was a relatively high revenue generator bringing in millions. On the other hand, the firm may also have to consider their overall business needs and whether to retain the lower revenue/profit generating partner who nonetheless is working on a business-critical area for clients who also use the firm for their big ticket high profit work undertaken by another "top performing" partner. In this situation, firms are likely to have to adopt a more differentiated merit based model to enable it to retain both sets of partner. This might be achieved in a number of ways, for example, by rewarding them with super points in any given successful year or accelerating their progress up the lockstep.

22. It was also noted that firms could of course both seek to "manage the equity" and introduce a more merit based partner remuneration system. This, however, also needs careful management as unless a firm places an explicit value on the efforts of partners to invest in the fabric of the firm (through contribution to management, knowledge sharing, training, relationship building) they can create a perfect storm whereby individualistic, profit seeking behaviours become over rewarded and partners with lesser financial output, who nonetheless contribute to the sustainability of the business, are removed from the partnership leaving a business with very little binding it together in the event of any major market or internal shock.

23. There will usually come a time when the significance of the differential in levels of performance within a firm will lead to some kind of split. This may occur through top performing partners or relatively poorer performing partners or business units deciding for themselves to leave their current firm on the basis that the firm's profit and reward parameters no longer fit their practices and their clients' needs.

24. An increasingly common impact of significant differentials in partner profitability was noted from the fact that partners in the largest firms will split off into smaller groups of homogenous practice groups or club together on the basis of other shared interests and instead revert back to a tighter range of performance and a pure lockstep model, re-focused on the sense of mutuality, sharing, support and shared vision that is the hallmark of a successful partnership. Some of the most difficult tasks for law firm leaders are identifying when a partner of entire business area should no longer be part of the firm – either through material under or over performance.

D. Navigating the Metrics Matrix

Commonly used metrics

25. Discussion then moved on to the commonly adopted metrics used by firms to assess partner contribution and allocate profits and how those systems usually work in practice. It was highlighted that there was typically a lot of focus on financial data, which people tend to assume is an objective measure. However, it was noted that financial data is actually a proxy for performance, not a pure performance indicator in itself.

26. For example, financial data on origination (which partner introduced each client to the firm) may have a limited shelf life, with usefulness as an indicator of performance in the one to three years after the relevant partner has brought in that work, but thereafter tapering off. Other indicators may then become more important, for example who is actually doing the day in and day out work to keep that client satisfied with the service they are receiving?

27. Equally client partner data, which may show that a partner was responsible for a certain level of day to day interaction or business development with the client, may not be the whole picture if there were other partners or colleagues who were also doing the work and/or providing background support to that partner to enable the work to be undertaken. Indeed, it may be important to identify in these situations which partners or other colleagues are involved in the background, so if the main client partner in leaves, the firm could seek to minimise the risk of the client also leaving by reassuring them that the resources will still be available to provide a high level of service to them.

28. Even seemingly straightforward metrics such as Supervising Partner (i.e. the partner that is supervising more junior colleagues to do the work required on a particular matter) or partner chargeable hours data may require further interpretation in line with the firm's strategic goals. For example, it could be that a partner had put in a lot of supervising partner time and comparatively had low actual chargeable time for themselves. A firm may then want to look at the reasons behind this. It could be that there is not enough partner level work for the individual to carry out – a major issue. Or alternatively, if for example the firm has encouraged the partner to take on a more supervisory role and develop other lawyers as part of its long-term strategy, those metrics may instead show that the partner has been successful in what is expected of them.

Mirroring the corporate world

29. An audience member highlighted that the corporate world's approach to performance metrics and reward may be worthwhile considering in the professional practice partnership context. The example given of such a successful model was a three-fold equally weighted performance criteria based on: personal targets, which were agreed with the individual's line manager and personnel; how well the business performed overall; and how others perceived that individual's behaviour. This model is in fact used in many law firms too. The benefit of this corporate metrics model, it was argued, was that in a scenario where an individual was doing a role in an area of the business that for some reason, unrelated to their personal performance, during that year was not particularly profitable (for example maybe because of external market conditions) they would not necessarily be disproportionately penalised for that. In such a system, it was said that employees throughout the organisation therefore have an expectation of fair treatment as they would have their performance measured as against the targets which had been agreed with them and their perceived behaviour, not pure financial metrics. Some of the panel members agreed that such a system may have been beneficial for star performers who were affected by market changes after the credit crunch, but who had been performing very well prior to that.

Discrimination and other Challenges to the Metric System

30. The panel moved on to discuss the challenges that metric based systems of assessment for partner remuneration may encounter. Bettina Bender set the scene by

first highlighting that a key risk for firms in any remuneration system was the potential discrimination claims that may be bought by partners who felt unfairly treated. Such partners could seek to argue that they believe their treatment in respect of pay did not reflect their performance but instead was based on unlawful discrimination based on one of the protected characteristics of age, sex, disability, religion and belief, race, pregnancy and maternity, gender reassignment or marriage and civil partnership. It was noted however that the most commonly raised protected characteristics in this context tended to be sex, age, disability and race. The key recommendation identified was that even where the criteria were written down, remuneration structures still needed to be objectively justified by reference to non-discriminatory grounds, to avoid a firm finding itself in a situation where it was being challenged for the way it had decided to award the profit share. Additionally, firms would need to have a paper trail in place to explain in relation to each individual partner why they had come to the decision that they had on profit share, by reference to their own criteria and firm objectives. Overall the key message was that if a firm was arbitrarily making decisions without documented reasoning, then it would be likely to come back to bite them. If the firm on the other hand had a reasoned and documented objective justification for why they have allocated the profit share for each partner, then it would be much easier to fend off any challenges that may be presented.

31. The lockstep system can create indirect age discrimination risks for a firm as it essentially involves providing a different benefit to partners based on their length of service, which may indirectly discriminate against younger partners. However, it was explained that lockstep progression models which are based on five years' service as a partner or less in order to reach plateau are automatically exempt from unlawful age discrimination under the Equality Act 2010. Those systems which require more than five years' service as a partner to reach plateau may still be lawful from an age discrimination perspective if the firm can establish that it 'reasonably believes' this fulfils a 'business need', which may include rewarding loyalty amongst other factors.

32. Age discrimination claims can be brought by both junior partners and senior partners. In terms of the possible justification open to a firm, case law in relation to partner retirement ages has established that succession planning and collegiality are amongst the legitimate aims which can potentially justify a difference in treatment.

33. It was noted that some firms have started to look at allowing flexible working more generally and to allow flexible working or part time working for more senior partners to allow them to transition out of the firm over time whilst at the same time allowing more junior partners to move up the ranks, thus supporting succession planning across the generations.

Maternity and Sick Leave

34. Additionally, how should firms deal with assessing the performance of partners who go on maternity leave or sick leave? How should their profit share be determined during leave and when they return?

35. The first point to make in relation to maternity leave is that, except for the statutory protected period lasting until two weeks after the birth, female partners do not have a statutory right to maternity leave. Nonetheless it was noted that most firms offer some level of maternity leave, where the partner would be allowed to take a certain level of drawings for a certain period, typically 3 or 6 months. It was normally lawful to pro-rate remuneration to a partner on maternity leave for the period worked. However, it was also highlighted that even with such provisions there are questions around how a firm should ensure that a female partner's contribution prior to them going on maternity leave - for example in bringing in a particular client (which may not manifest until when they are actually on maternity leave), should be recorded and reflected in that year's equity allocation. On return from maternity leave, it was noted that some firms focus on trying to retain and accommodate the relevant partner by allowing them to undertake flexible or part time working for example.

36. It was suggested that when considering how to assess a partner on maternity leave firms may want to look at how they comparatively treat partners that are on long term sick leave; there remains a potential risk of unlawful sex discrimination claims by female partners on maternity leave who are treated less favourably than comparable male partners on similar extended sick leave. Although such a comparison is not an exact science, looking at the provisions for these two categories of partners in the relevant partnership agreement could be a starting point to reduce the risk of discrimination complaints as far as possible. In this regard the PCR Survey found a slight disparity between the apparent provisions made for partners on maternity leave compared to that made for partners on sick leave. On one hand the PCR Survey

found that only 37% of the firms of those surveyed had a partner remuneration structure which allowed for a 6-month period of continued drawings / profit share at some level during extended ill health, which is less than the 42.31% of those respondents whose firm's partner remuneration structure allowed for a 6-month period of continued drawings / profit share (at some level) during maternity leave. On the other hand, the PCR Survey found that 29.63% of the firms surveyed provided for a period of 12 months continued drawings / profit share during extended ill health, which is a slightly higher percentage than those firms which provided the equivalent 12-month period of continued drawings / profit share for partners during maternity leave, (23.08%).

37. It was highlighted briefly that other issues to consider in relation to those partners who are on sick leave, may be whether or not the partner may qualify as disabled under equality legislation and therefore whether reasonable adjustments should be made to assist them to return to work or should otherwise be made to the firm's remuneration assessment process and allocation – this will depend on the particular circumstances of the case.

E. Changing Remuneration Structure: The Framework, Mechanisms and Challenges

Actual Power verses the Mandate

38. Moving on to the scenario where a firm has decided to change its remuneration structure, the next question posed to the panel was what legal and organisational framework the firm's management would need to put in place to implement it. The first step identified would be to look at what the firm's constitutional documents provide in relation to changes to partner evaluation and/or profit sharing arrangements. The firm would also be well advised to have sensible majority decision making: a high enough majority to make sure that there is the need to achieve high levels of buy-in, but not unanimity. Secondly management would also need power to design the new model, and then ensure they have won the partners' support before putting the changes to a formal vote. Getting to this point will often also involve consultation with the whole partnership body or focus groups on key issues.

39. It is important to recognise this key difference between power and mandate to maximise the chance of the implementing process for a new remuneration system to be successful. Whereas mandate comes from the relevant majority of partners expressed via the means set down in the constitutional documents, power is built by garnering the views of all of the partners to get them on side.

40. David Shufflebotham commented that these requirements may be known as the need for "WIMPS". The W and I in this acronym stands for the will for the partners to make the change and see it through; the M stands for mandate, which was is the technical power from the relevant partner majority via the constitutional documents to make the change; P is for power, that is the actual power to persuade partners as to the strategic benefits of the new model and win over a supportive partner body including any powerful individual partners who may have a minority view and who can make it difficult to effectively implement the changes sought; and the S is for the skills, needed to gain buy-in and support and to at least neutralise any unhelpful and potentially belligerent opposition. If it is not possible for a firm to harness all of the WIMPS requirements, then management may then need to consider whether they should attempt to force the issue by taking whatever action lying within their powers or reconsider whether the specific roadblock is something that generally requires them to go back to the drawing board and reconsider potential alternative options or, if serious enough, even triggering a managing partner election.

41. It was also highlighted that it would be important if a firm's remuneration structure would be changing to ensure that the partners first decided in isolation on the model and criteria that they want to apply, before considering how those criteria will be applied to individual partners. If it is done the other way around, there is a potential significant risk that the firm would find that individual partners would be thinking more about their own personal interests and trying to work out how to achieve the best outcome for themselves within the system, rather than thinking about whether the system would be objectively beneficial for the firm. Although it was acknowledged that this would be a difficult ask, as the individuals who were being asked to consider and vote on a new remuneration structure would of course thereafter have the system applied to them.

The Naysayers

42. But what if a firm has a sensible majority, but also has a few problem (usually vocal) naysayer partners who may fear and be heavily critical of a change in remuneration, and may want to block any such change. If it is possible to do so a firm's management should seek to win 'problem' partners over and get them to see the potential benefit of adopting a remuneration system that aligns with the firm's long-term strategy and which focusses on stability and serving clients.

43. And what to do with the naysayers once the new system has been voted through? Could those partners refuse to participate and insist on the old system being applied to them? Could the firm expel those partners as a result of refusal to comply? The panel were of the view that if the requisite (even simple) majority had agreed to the new system, then the dissenting minority partners could be compelled to follow the new system. However, firms will want to avoid a situation where a vote on the remuneration system could turn into a vote of confidence in management. It was commented that if a firm encounters a situation where even after any pre-and post-implementation PR exercise they still have some "naysayer" partners who are just not prepared to agree to the new system and are doing all they can to upset progress, those partners no longer fit with the general culture and freshly established strategic direction of the firm anymore. Does such a partner have a long-term future with the firm?

F. Best Practice: do what you say and say what you do

44. Finally, the panel turned to address best practice for partner evaluation and remuneration assessments. The key theme that emerged from both the panel and audience was that there is no one size fits all model when it comes to professional practice partnerships; what was important was that firms ensured that their remuneration structure and process were consistent with their values, culture, and strategic business objectives. Indeed, a similar view was also reflected in the PCR Survey undertaken prior to the seminar, in which respondents were asked to rate the top three factors they considered most important in their own firm's remuneration system. The top three factors identified were: perceived fairness (identified by 78% of respondents); the remuneration system supporting the firm's culture and ethos (identified by 70% of respondents); and recognition of financial and non-financial performance as a partner (identified by 67% of respondents). Please see the attached appendix.

Beware of the remuneration policy trap

45. It was observed that some firms fall into the trap of failing to reflect in their written partner remuneration policies the criteria and partner contribution that they truly use to assess and value partner contribution in practice. For example, it was suggested that some firms may state that that they value and reward a “good citizen” partner (that is, someone who also embodies and enhances firm culture and expected partner behaviour and contributes to the fabric of the business) and not partners who solely focus on generating revenue and profit by doing direct client service work and who may actually demonstrate non-collegiate and individualistic behaviours to enable them do so. However, when it comes to the actual assessment, it become apparent that those partners with a high levels of fee generation are typically the ones that the firm ends up rewarding most highly. Examples were cited of partners who have been good citizens, at the request of their firm, by transferring some of their client credit to support the business case for a new potential partner, only to then find themselves harshly judged based on their own depleted figures, with no account taken of their having been a good citizen.

46. Equally when firms fail to adhere to their written partner remuneration policies this can cause confusion for those partners who use it to guide their conduct and performance goals. For example, if a firm states that it values internally-focused activities such as mentoring, sponsorship, talent-development and succession-planning then a senior equity partner may take the view at a particular stage in their career that if they start focusing on handing over their clients or practice to a junior partner, the firm will regard that as an indication of good performance even though this may result in lower personal billings. However, if the firm does not actually reward such behaviours in its partner assessments in reality then such partners may instead find that they are disadvantaged by relying on the firm’s policy even if what they are doing can be shown to be for the greater benefit of the firm.

Consistency, Consistency, Consistency

47. To avoid the above issues firms should aim to “do what they say” on partner remuneration assessments and “say what they do”. The firm should ensure that its strategic aims, business plans and KPIs for assessing partners are aligned with and flow right through to its remuneration structure and how the firm assesses partners. It was suggested that one way to do this may be to first create a relative scale of what the business actually needs and values from its partners in terms of immediate business imperatives and longer term strategic goals. Is it building the next generation of lawyers, diversifying the practice, contributing to the technical knowledge, capital or pure profit generation? Where each of these values would go on the scale will vary from business to business and, ideally, from time to time. The firm may then wish to create and operate a transparent matrix based on these values, where there are clear criteria weighted to the firm’s particular needs, and against which each partner is measured and given a specific individual score, the aggregate of which is then compared to that of other partners as the basis for the partner’s profit allocation.

48. Additionally, it was noted that there should be a place in this matrix for regularly reviewed personal partner goals that are specific to the partner and resonate with some or all of the overall firm’s values. So, if an objective for that particular partner in a particular year was transitioning clients, and that accorded with the firm’s strategy of developing a succession plan, then it may be that the very fact of the partner getting rid of those clients by passing them over to a more junior partner is a highly-valued part of the partner’s contribution. It was commented that, anecdotally, a member of the panel had heard of firms where partners were more highly rewarded in the last few years of their practice if they were able to transition a higher number of their matters to other partners as it was seen as a reflection of good succession planning and implementation.

49. It was also recognised that a matrix based system may not ultimately be the ideal way for every firm to determine their partner remuneration. For example, if a firm has a very clear strategy with clear aims and milestones partners can get behind, then a matrix based performance evaluation system can work well. However, if it was an early stage or more entrepreneurial and culturally led business where each partner was required to adopt a flexible and wide ranging outlook in order to unearth the "next big thing", then they may need a more fluid system. Ultimately to facilitate high levels of business performance the partner evaluation and remuneration system will need to match the business imperatives and strategic aims of the business.

Handling the rain-making rogue partner: is s/he a gorilla or an elephant?

50. The panel then considered how a rogue rain-making partner should be dealt with in a firm that operates a remuneration policy which they publicise as being consistent with their values and strategic goals. Various examples were highlighted of rogue partners in professional practice firms who frequently exhibit bad behaviours seen by other colleagues in the partnership, but which was usually ignored because the partner is perceived as generating large revenues and profits that the firm cannot do without. The panel considered whether firms could and should penalise such a partner in terms of profit share in these circumstances. It appeared that the answer may come down to whether that partner was a "gorilla or an elephant" in the terminology of one audience member.

51. All rogue partners will likely exhibit unacceptable behaviours, for example being openly discriminatory or bullying. They may lack social empathy or simply manners, but may also be quite clever or charming in nature (at least when and where it suits them), good with clients and revenue generating which could make it harder for management to take the initiative to confront their conduct. Everyone inside the firm knows who they are. However, a gorilla rogue partner is one who is an undeniable villain, badly behaved and knows it but does not care to change. Whereas an elephant rogue partner is a slow learner, one who although badly behaved does not do so out of malice but because perhaps they are less self-aware and stuck in their ways. They may be for example unaware of how they come across to other colleagues, may not understand why their approach is being perceived negatively, or may be going through non-work related issues that impact their behaviours.

52. It was proposed that when a firm is confronted with a rogue rain-making partner it should first try to differentiate between whether the partner is a gorilla or elephant. This might be done for example, by utilising a corporate style "perceived behaviour" evaluation system mentioned above based on peer to peer feedback as well as feedback from more junior colleagues. Of course, the paper trail created in such scenarios may create additional data protection issues and best practice would probably also require the firm to allow the relevant individual to comment on such assessments before any action is taken based on it. These are issues that will need to be carefully considered by the firm.

53. The cycle length of a partner assessment process may also important in identifying and distinguishing between a gorilla or elephant rogue partner. If a firm undertakes their partner assessments for the purposes of allocating remuneration every two years instead of annually for example, there was some concern expressed that this longer assessment cycle could hide or delay the ability of the firm to deal with bad behaviours by certain rogue partners (which may stay just below any official misconduct process radar) and may not fully be confronted until a year or two after the bad behaviour becomes evident or continues. On the other hand, a firm may want to use a longer reference period when determining partner performance, for example taking into account performance over the last three years to assist in building accurate and balanced picture of a partner's performance in line with the firm's values and objectives and then rewarding consistently good behaviours.

54. Once the rogue partner has been identified as a gorilla, the firm may then want to consider penalising the partner in the remuneration allocation process, as an acknowledgement that the partner is not reflecting the firm's values. It was stated by one audience member that their firm had a partner performance management system that allowed them to drop down partners by four bands in the managed lockstep, and suggested that this flexibility could potentially be used in such cases. In extreme cases, it was agreed by a few members of the audience and panel that gorillas may have to be exited to safeguard the long-term sustainability of the firm even if they are a high revenue generator, as otherwise all the other strategic value-based goals that a firm may be pursing will be undermined by their behaviours. One audience member commented that in their firm they had had two such gorilla rogue partners who had to exited and the firm as a whole was now better for it.

55. On the other hand, when an elephant rogue partner is identified it was suggested that the firm may consider dealing with such individuals more lightly within whatever evaluation and remuneration system they use whereby they might hold the partner at a gateway and state that maintaining their position or having the potential to increase their profit share is conditional upon improvement in their behaviour. This could be supplemented by use of a well-developed "perceived behaviour" evaluation process, using constructive verbal communication to feed into the overall development of the partner in the firm.

G. Conclusion

56. This seminar captured the interest of those present, because ultimately it explored how long established partner contribution evaluation and reward systems might be developed within the partnership model to ensure continued business success against the backdrop of a much changed and increasingly dynamic business environment. As one panel member put it, it comes down to this – partnerships have a permanency about them which has endured the passage of time because they can be flexible and embody a very natural and preferred way for humans to work together with a common culture and shared ethos of fair dealing and excellence. So, although a variety of different remuneration models and approaches were suggested, each firm is unique and will need to evaluate their own business imperatives and strategic goals and ensure their chosen partner remuneration system is aligned with them.

57. Encouragingly the PCR Survey results seem to suggest that at least those firms represented in the survey are getting on the right track in the never-ending business of evolving their partner remuneration systems and processes to suit a contemporary environment.

Reporters:
Wonu Sanda and Zeinab Harb,
Trainees at CM Murray LLP

With thanks to the panel:

Corinne Staves

Partner – Maurice Turnor Gardner LLP

Corinne specialises in advising on partnerships, limited partnerships, LLPs for professional firms and fund managers and as wealth planning vehicles. In the professional services sector, she advises both firms and individual partners on the full range of matters, including partner and team moves, regulation, start-ups, LLP conversions, international structuring, governance, mergers and demergers.

Corinne.Staves@mtgllp.com
+44 (0)20 7786 8724
www.mtgllp.com

David Shufflebotham

Founder - PEP-UP Consulting

David is the founder of PEP-UP Consulting and he focuses on advising partnership businesses on partner evaluation and reward. As the name of his business suggest, David is interested in helping businesses improve the performance of their most valuable asset – their partners – and in doing so driving PEP up.

David has 25 years of legal industry experience as a lawyer, HR Director and lecturer. He has a practical hands-on approach to implementing effective change in partnership businesses. David has also conducted academic research into lawyer career structures and the partnership model – of which he is a strong advocate.

david.shufflebotham@pepup.consulting
+44 (0) 7410 560756

Bettina Bender

Partner - CM Murray LLP

Bettina is a partner specialising in employment and partnership law. Bettina provides contentious partnership law advice and has particular expertise in providing advice on partner discrimination, including maternity, issues. She has extensive experience in managing partner exits, providing strategic and commercial advice, including in the financial services and legal sectors. Bettina also advises in the context of cross-border partnership exits and disputes.

bettina.bender@cm-murray.com
+44 207 933 9133
www.cm-murray.com

Clare Murray

Founder and Managing Partner - CM Murray LLP

Clare is an employment and partnership law specialist who acts for multinational employers, senior executives, professional service firms and their equity partners on a wide range of issues. She has been named as a 'Leading Individual' by Legal 500 2016 for both employment and partnership law.

clare.murray@cm-murray.com
+44 207 933 9133
www.cm-murray.com