



2015 Global Partner Compensation System Survey

Triennial Survey into Worldwide Compensation Trends in Law Firms

EDGE INTERNATIONAL

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Authored by: Ed Wesemann and Nick Jarrett Kerr

2015 Global Partner Compensation System Survey

As the practice of law becomes an increasingly global enterprise, the cultures of the law firms involved in international practice are becoming more homogeneous. Nowhere is that more apparent than in the processes that law firm partnerships use to determine partner compensation. In 2006, 2009, 2012 and again this year, we surveyed a significant sample of law firms throughout the world on the subject of partner compensation. Our objective was to gain an understanding of differences in firms' approaches to compensation by nationality over time.

The result of this year's survey was precisely what we anticipated. The basis and process used to compensate partners is continuing to follow the trend we saw from 2006 to 2012 in that they are becoming increasingly harmonised among law firms around the world. However, there continues to be some interesting cultural differences. Among those differences:

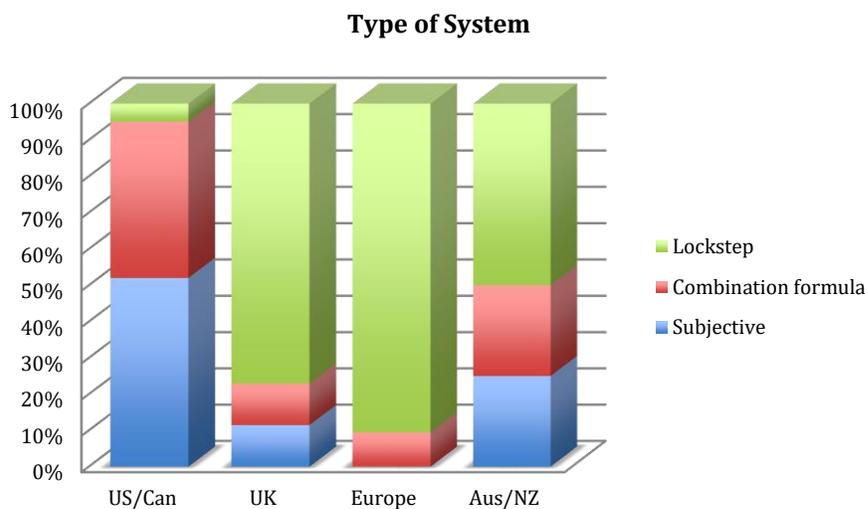
- US and Canadian law firms lean much more to subjective compensation systems than firms in other countries.
- The use of non-equity partners is increasing in every country and the use of these partnerships is also anticipated to increase.
- "Lockstep" as a base method of compensation is the preferred system among law firms around the world with the unique exception of North America. Since 2006, the use of pure Lockstep has declined in the UK and Europe to less than 18% of firms, but the use of Lockstep as a base for performance related elements remains stubbornly high. In the 2009 and 2012 surveys, the use of Lockstep appeared to be on the decline, particularly in the U.K. and Australia, presumably as a reaction to the profitability concerns brought to law firms by the world-wide recession. But in 2015, Lockstep appears to be returning to prominence everywhere except the United States and Canada as firms continue to find some elements of fixed remuneration to be attractive.

These are the primary findings in the Edge International survey of law firm partner compensation systems around the world. The survey included 134 large law firms in the United States, the United Kingdom, Europe, Australia, New Zealand and Canada which represents a sample of approximately 11 percent of eligible law firms. The response by country and by size of firm is highly proportionate to the universe of law firms. In some prior surveys we had included Asia and South Africa. However, the limited number of large firms and tight competitive situations, made the gathering of reliable data difficult. Further, we concluded that, at least in Asia, the ownership structure of firms and their compensation schemes reflected cultures that were sufficiently different from the participants in other countries as to be of reduced value. The purpose of this survey was to ascertain compensation trends, and therefore, some known consistencies from prior surveys were not resurveyed this year to shorten the survey and increase participation.

Basis of Compensation

Nothing demonstrates the cultural differences among firms more than the compensation system they utilize. While there are literally hundreds of variations a firm could select, most compensation systems fall into seven permeations:

1. **Lockstep**, which sets fixed levels of percentage participation in a firm's profits according to a predetermined set of progressively increasing steps, usually based on seniority.
2. **Equal Distribution**, which is a form of lockstep in which all partners are paid equally.
3. **Modified Lockstep**, involves a Lockstep schedule for part or all of a partner's compensation; this can be accelerated, decelerated or managed based upon individual performance.
4. **Formula**, where compensation is determined by a quantitative formula based on each individual partner's statistical performance.
5. **Combination**, where compensation is based on statistical performance but the application of the statistics may be subjectively modified.
6. **Subjective**, a system where compensation is determined based on the subjective decisions made by a person or committee, although inputs to the decision may include statistical information.
7. **Corporate**, which is a normal business model where partners receive a salary and bonus based on performance and then are paid dividends based on the profitability of the firm.

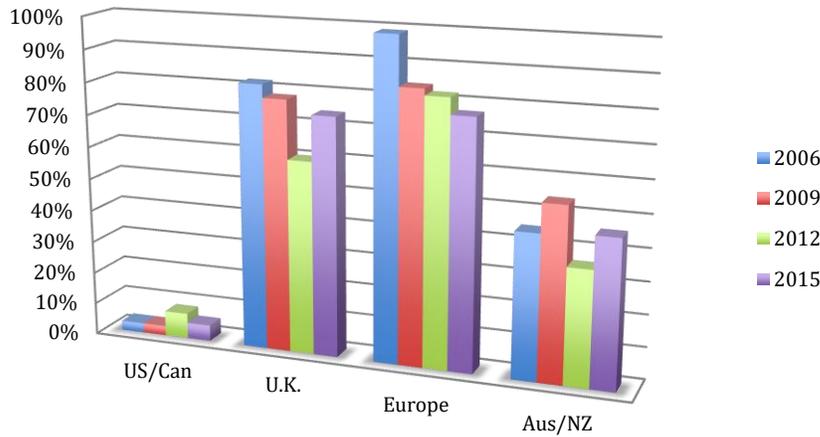


Because there are so many variations, we classified the responses of the participants into three categories: Lockstep, which included Modified Lockstep and equal distribution; Combination Formula which, as the name implies, includes the Formula and the Combination systems; and Subjective. Outside of a few responses in the UK and Australia (less than 3% of respondents), we found virtually no law firm users of the Corporate model.

Lockstep - In the UK, 72% of responding firms utilize some means of Lockstep compensation. That is an 11% increase from the 2012 survey but still below the 82% of Lockstep users in 2006. Of those using some form of Lockstep, 18% were pure Lockstep (i.e., compensation is based exclusively on a series of compensation steps achieved solely through seniority) and 54% used some form of Modified Lockstep.

In Europe, Lockstep is used by 79% of firms with 23% being pure Lockstep. That compares to the 2012 data where 86% of firms used Lockstep with 41% being pure Lockstep. Less than 4% of U.S. and Canadian responding firms employ Lockstep and all use a modified version.

Use of Lockstep Compensation



As a general statement, the use of pure Lockstep appears to be on the decline. In our 2006 survey, 30% of responding firms were pure Lockstep or equal distribution. In this year’s survey, the use of Lockstep was reduced by more than half to only 14%. Interestingly, the impact of the 2008-2009 recession clearly caused firms throughout the world to make at least temporary modifications to their compensation systems.

It has been speculated that Lockstep remains as popular as ever in UK and European firms. We have observed previously that it is difficult for firms to transform their compensation model completely and will prefer to modify and incrementally change their current model. Hence, it is no surprise to have it confirmed that firms have added some performance factors to adjust the automatic progression under Lockstep.

Formula – At one time, the concept of compensation based on a formula that took into consideration individual partner performance as a working and originating lawyer was viewed as the means of achieving a truly meritocratic compensation system. In fact, when law firms discuss merit compensation especially outside of the US they often focus on an “eat what you kill,” formula system. But, with the exception of very small firms, the use of strict formulas is essentially only present in the US, and represents less than 5% of law firms. Its popularity remains unchanged in the past nine years.

Subjective – The antithesis of a formula is a pure subjective system. In such systems, the compensation authority (usually a compensation or management committee) decides compensation on a subjective basis, often involving interviews with other partners. Typically the committee has access to statistical performance information. There is also a modified subjective compensation that utilizes a formula but the actual decisions can be heavily modified through subjective decisions. The subjective and combined systems appear to be almost uniquely Canadian, American and Australian. 52% of US and Canadian law firms, and 23% of Australian firms use a purely subjective system. Conversely, only 11% of UK firms and virtually no European firms reported that they purely use a subjective system, although subjective decisions are made in those firms where the Modified Lockstep calls for performance factors to be assessed as part of the compensation mix

Combination - The unifying system appears to be the modified subjective or combination system. It is experiencing some marginal growth outside North America, notably in Europe where it has grown from zero in 2006 to 8% in 2015. In the US, it remained relatively static in the 37-38% range.

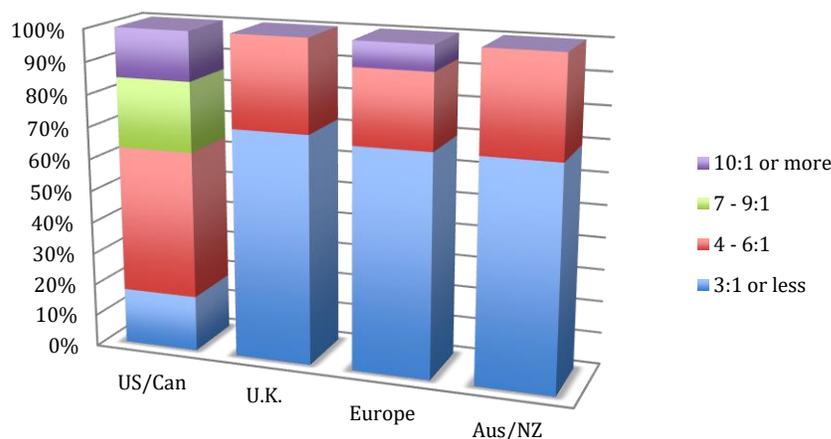
Corporate – Another growing system, reaching 15%, is the corporate style compensation which pays a fixed base salary plus a bonus based on individual performance plus a dividend based on the financial success of the firm. Such systems are rarely seen in the US or Canada. We predict further growth in the corporate style system in jurisdictions such as (notably) Australia and the UK, where external investment in firms plays a part in firm operations.

The different forms of compensation systems also arguably reflect what appears to be a fundamental difference in partnership culture in which US and Canadian partners seem to be more willing to place their compensation in the judgment of others while UK, European and Australian law firm partners prefer a more predictable and pre-established set of criteria for at least part of the compensation package.

Compensation Spread

An interesting difference between North America and the rest of the countries surveyed is the size of the spread between firms' lowest and highest compensated partners. In the U.S. and Canada, compensation spreads have a significant range, with only 18% of firms having a spread of 3 to 1 or lower, while in all of the other countries surveyed two thirds or more of firms have a spread of 3 to 1 or less. By the same token, spreads of 7 to 1 or more are virtually non-existent anywhere but in North America.

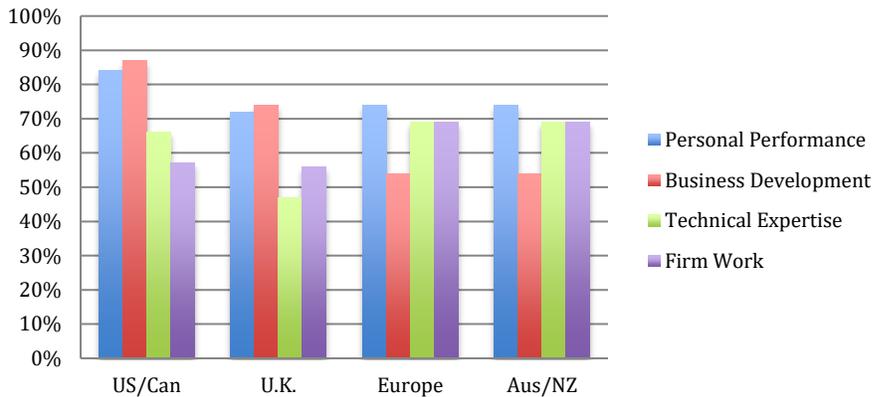
Compensation Spread (High:Low)



Compensation Factors

There is a significant difference among countries as to what factors law firms take into consideration in setting compensation. In the US and elsewhere in the world, personal performance of the partner, in terms of the value of the legal work he or she personally performs, is a consistently important factor in determining compensation. In both the U.S. and the UK, new client

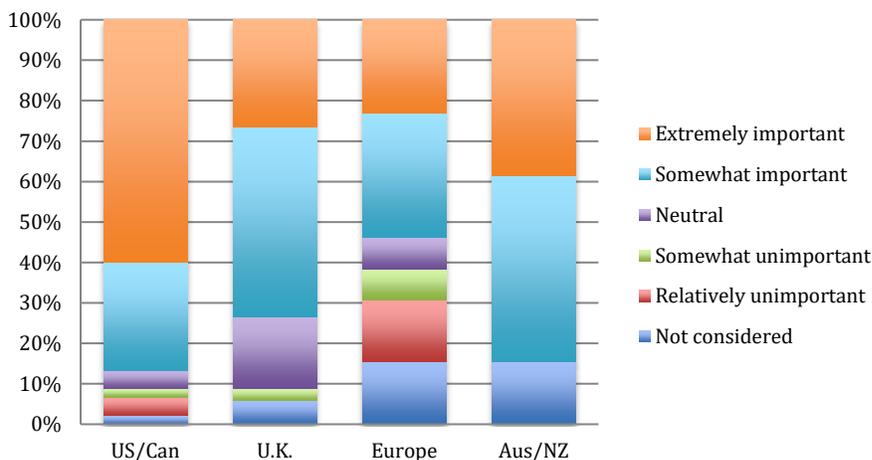
Factors in Determining Compensation Percentage Rating Factor as Most Important



origination now is the most important factor followed closely by personal performance. Although the two are considered similarly important in those countries, this is a shift from previous years when personal performance was the key factor. The comparatively low percentages in the responses from the UK, Europe and Australia/New Zealand reflects those countries preference for Lockstep compensation in which evaluation factors other than seniority are less of an issue.

This shift in emphasis to origination related performance in compensating partners is further reflected in the level of importance respondents placed on business development. Although important in other countries, the intensity of importance in the U.S. and Canada demonstrates the growth of its consideration in setting compensation.

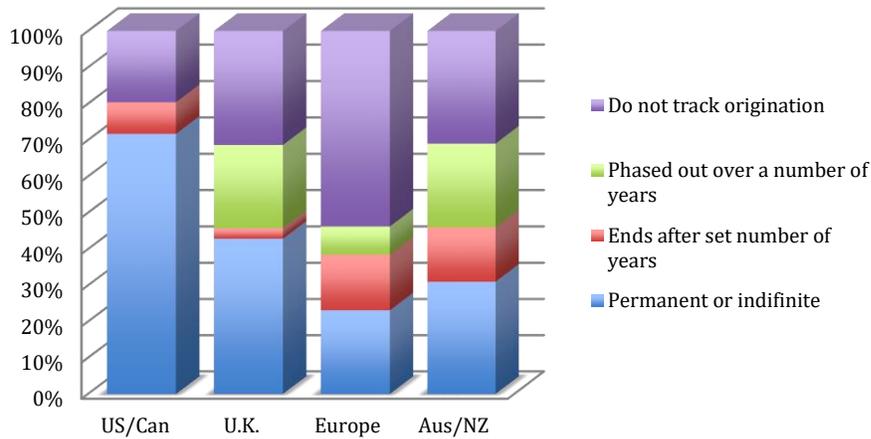
Importance of Origination



time for which origination credit is awarded.

In response to requests regarding the measurement of client origination, we found that a majority of firms in the U.S. and fewer firms in other countries have a mechanism for tracking business development. But, unlike firms in the UK, Europe and Australia/New Zealand, most firms in the U.S. and Canada have no expiration on the length of

Duration of Origination Credit

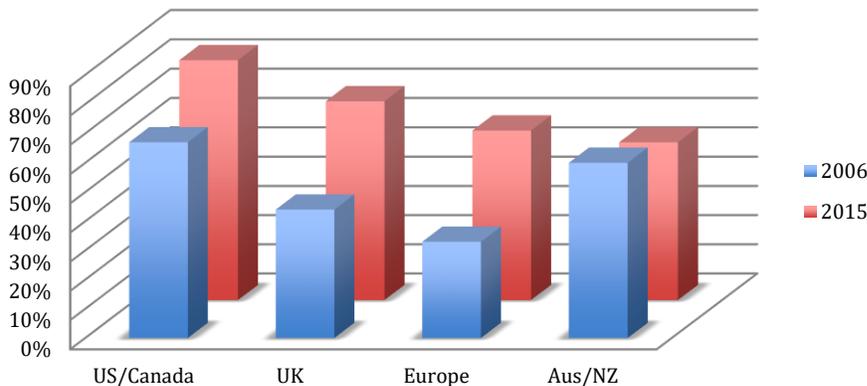


Our experience shows that compensation-setting in multi-jurisdictional firms can cause issues. While global firms often use alternative partnership structures such as the Swiss Verein to create separate profit pools between different jurisdictions, we found the overwhelming preference was for all partners to share in a single firm-wide profit pool - in the US and Canada (99%), the UK (97%) and Australia/New Zealand (90%). The lowest was in Europe at 69%, which is a dramatic reduction from previous years when it was in the range of 80%. This is most likely the result of the use of Vereins in the globalization of Continental firms.

Bonuses

One of the most significant changes since the 2006 survey is the importance of bonuses to the typical partner compensation scheme used by larger firms.

Use of Bonuses

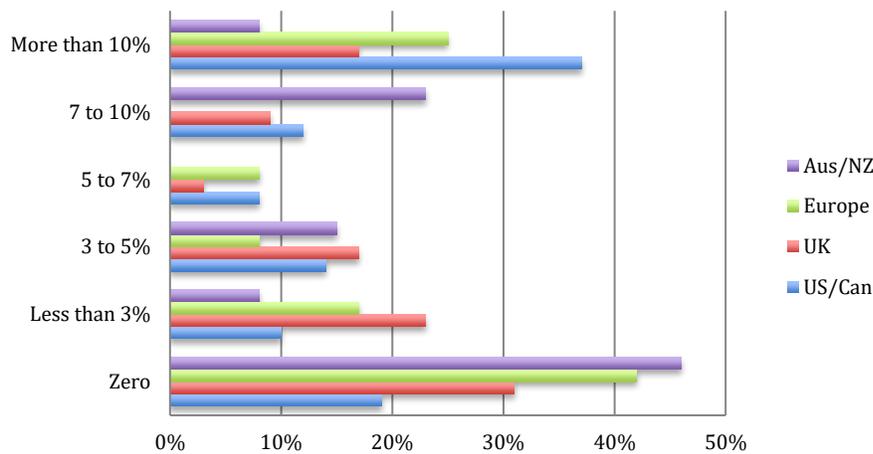


In every country surveyed, except for minor decrease in Australia/New Zealand, the use of partner bonuses has increased significantly over the past nine years. The single greatest jump is in the UK and Europe where the popularity of bonuses has increased by an average of roughly 70%. This tends to bear out our own experience that UK and European firms have

tended to increase the importance and size of performance related bonuses to temper and balance the retention of Lockstep as a base system.

The value of bonuses as a percentage of compensation has also gone up, particularly in the U.S. and Canada. In more than a third of U.S. and Canadian firms bonuses make up more than a third of partner compensation.

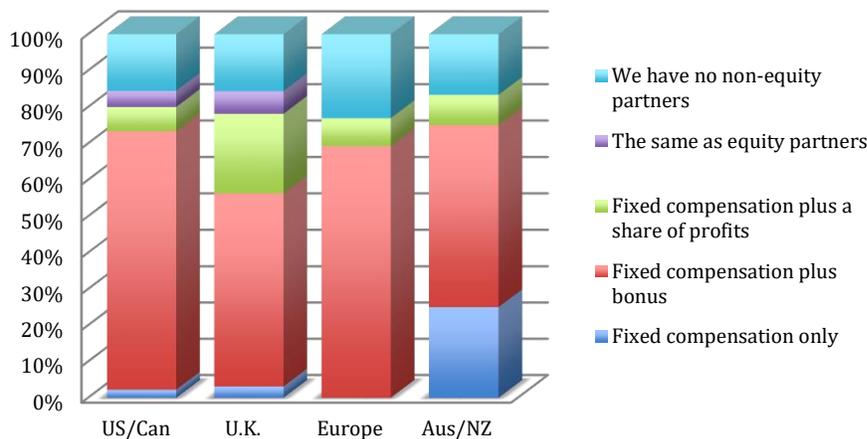
Bonuses



Non-equity Partners

As anticipated in our previous surveys, the use of non-equity partnerships has continued to increase. In the US, 96% of firms have more than one tier of partner - an increase from 77% in 2006. The vast majority of those partners are paid a fixed compensation plus a bonus. In the UK, 86% of firms have

Non-equity Partner Compensation

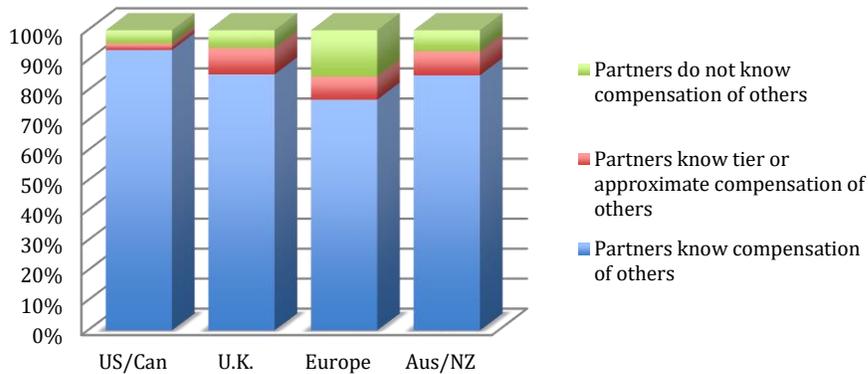


non-equity partners, which is a decrease from 94% in 2008. Roughly half of UK non-equities are paid a fixed compensation plus a bonus. In Europe, 77% of firms have non-equity partners and 70% of those partners are paid a fixed compensation plus bonus. There was a split in Australia and New Zealand with non-equity partnerships being present in all of the Australian firms surveyed but only in roughly half of the New Zealand firms. Both countries primarily compensate their non-equity partners with a fixed compensation and bonus.

Open and Closed Compensation Systems

A common topic of conversation among law firm leaders is the movement of firms away from open compensation systems, i.e., where all partners know the

Open Compensation Knowledge



compensation of all other partners. We found that the use of open systems is continuing to grow. Interestingly, the US has the largest percentage of firms reporting an open system at 92%. However, we found a wide-variety of restrictions on what constitutes “open” including some “need to know” provisions, i.e., practice group leaders and partners involved in assembling client service teams, and “availability upon request”. A common restriction is that partners may view the information in the managing partner’s office but may not copy or remove it from the office.

Conclusions

The Lockstep method continues to be the standard base for law firm partner compensation throughout the world, with the very major exception of North America where the practice is virtually non-existent. That difference continues to grow as firms in the UK, Continental Europe, Australia and New Zealand have reverted from a brief decline in the use of Lockstep during the aftermaths of the world-wide recession to an actual increase in its usage – particularly with the ability to make some performance modifications. We did not ask firms questions about the extent of system changes, but it is tempting to conclude that some firms may have returned to Lockstep (as a base system) after finding that wholesale changes in their compensation systems met with resistance or failure; as we have previously pointed out, incremental changes are easier to implement than radical change.

The other issue of significance in North America and the UK is the growth in of business development as a significant factor in the determination of compensation. This, perhaps more than anything else has led to the increasing spreads from the lowest to the highest paid partners.