

Merit-Based Compensation as an Alternative to Lockstep: Firms Test the Waters

By Stephanie B. Goldberg

Some see the recession as an opportunity to usher in much-needed modifications of the law firm business model so that billing 50 hours a week is no longer the measure of success and a prerequisite to advancement. As Patricia K. Gillette, a partner in the San Francisco office of Orrick, Herrington & Sutcliffe LLP, wrote in *Am Law Daily* in April 2009, “[T]he economic crisis provides law firms with opportunities they never before had [including] stepping away from the salary and bonus programs . . . making structural and organizational changes long overdue, killing the billable hour once and for all, and getting ahead of the sea change that is coming to the legal profession.”

While the most visible impact of the recession has been a demoralizing wave of layoffs, deferred associate start dates, and lower salaries, the downturn also has accelerated one particular trend—the decline in lockstep promotions for associates and the emergence of merit-based compensation systems. According to a survey conducted in July 2009 by Citi Private Bank’s Law Firm Group, approximately half of the top 50 firms in the Am Law 100 were planning to switch to performance-based compensation.

Goalposts to Partnership

For some firms, the change in compensation systems is relatively straightforward: Reduce or freeze base salaries and make bonuses a larger part of compensation. But for other firms, the new compensation system is ushering in profound changes—not simply in how they determine associate salaries but in how they train associates, assign them work, and evaluate them as well. This includes grading associate performance in areas such as public service, client development, teamwork, initiative, efficiency, and leadership.

What’s more, firms are reclassifying associates by their level of competence and disbanding lockstep

compensation and promotion, which group associates in classes according to the year they graduated law school. Under traditional lockstep systems, all members of a class are guaranteed the same base salary, which notches upward each year, culminating in consideration for partnership in years five through eight, depending on the firm.

Under the new schema, lawyers are only considered for partnership when they've advanced through a series of goalposts associated with ever-increasing levels of skill. Some may get there after four years; others, not at all either because their performance doesn't measure up or the firm has taken them off the partner track by mutual consent.

Some of the firms that are pioneering this movement include Husch Blackwell Sanders LLP, whose predecessor firm adopted a levels approach in 2000; McKenna Long & Aldridge LLP, which moved to merit-based promotions for associates in 2007; McGuireWoods LLP, which introduced merit-based compensation for senior and mid-level associates in the same year; and Howrey LLP, which phased in merit-based compensation for all but starting associates in 2008 and introduced an apprenticeship program for new associates in 2009. Howrey rolled out the new competencies in 2003–2004, thereafter introducing academies and then integrating evaluations with competencies, before shifting off lockstep.

Howrey was joined by a wave of firms—including Reed Smith LLP; Orrick, Herrington & Sutcliffe; Sonnenschein Nath & Rosenthal LLP; DLA Piper LLP; WilmerHale; and Fulbright & Jaworski L.L.P.—that announced they either had begun the process of adopting a multi-tiered competency system or would be shifting over in years to come.

A second group of firms—among them, Baker Botts L.L.P. and Bingham McCutchen LLP—adopted “hybrid” systems that retain certain

features of the lockstep system while embracing aspects of the new model. At Bingham McCutchen, for example, base salary is still tied to class year, but a greater percentage is merit based, and the evaluation process has been broadened to include factors such as commitment, teamwork, and what it calls “firm citizenship.”

Merit-based systems are more flexible than lockstep in determining advancement, development, and compensation.

The differences in implementation boil down to how rapidly firms are transitioning to merit-based compensation, the percentage of salary that's tied to performance, the number of levels that define the associate track, the type of competencies and specific behaviors or “benchmarks” associated with each level, and the extent to which firms assume the responsibility for training associates in skills critical to advancement. But, under all of these systems, the evaluation process becomes increasingly important as the yardstick that measures whether an associate is qualified to progress to the new level. The assignment process has to be rethought as well so that it affords associates the opportunity to become well-rounded lawyers.

Impact on Women

How does this shake out for women lawyers? At this point, it's not clear, although many of the architects

and administrators of these plans are women. “I'm a working mother who's married to a stay-at-home father,” points out Natalie Spears, a partner in Sonnenschein's Chicago office who helped roll out the firm's new system of merit-based promotions in December 2009. “Diversity concerns are extremely important to me. I firmly believe this gives us the flexibility to reward performance and won't change our really deep commitment to women and minorities.”

It also allows women with family responsibilities to take the slow track to partnership without being penalized, notes Theresa M. Gillis, managing partner of Howrey's New York office. They can take an extended maternity leave and pick up where they left off. “The hope is that expectations will be more individualized,” she says.

Yet lockstep is undoubtedly popular with many associates because of its transparency and automatic advancement, noted NALP Foundation CEO and President Tammy Patterson at an ALI-ABA panel in July 2009. “It has a perception of equality because everyone is treated the same. It's also an easy system to manage and budget for,” she said, noting that its chief disadvantage is lack of accountability. (The program, “Leaving Lockstep: Moving Toward Competency-Based Compensation,” is available online for CLE credit. Go to www.ali-aba.org/index.cfm?fuseaction=online.ondemand and click on “Law Practice.”)

By contrast, merit-based systems are more flexible in determining advancement, development, and compensation, which makes them fairer in practice, Patterson said. They reward high-performing associates by allowing them to make partner sooner, thereby increasing the likelihood of retention. But administering the system is unending because “they're a work in progress,” she pointed out.

Lockstep, on the other hand, is “autopilot or cruise control,” noted another panelist, Peter Sloan of

Husch Blackwell Sanders, author of *From Classes to Competencies, Lockstep to Levels: How One Law Firm Discarded Lockstep Associate Advancement and Replaced It with an Associate Level System* (Blackwell Sanders Peper Martin, 2002).

“The legal profession’s reverence for lockstep is something of an anomaly,” says Dr. Larry R. Richard, head of the leadership and organization development practice group of Hildebrandt International. (The firm’s main U.S. office is in Somerset, New Jersey.) He points out that other professional service firms don’t use it, and it seems almost nonsensical to corporate clients. “The attitude is, ‘why should I pay more just because the associate has had a birthday?’”

Richard says another problem is that the skill level of two associates in the same class might vary dramatically although their hourly rates are the same.

ACC Value Challenge

Some firms admit privately to being influenced by the Association of Corporate Counsel’s (ACC) Value Challenge initiative, described by the organization as an attempt “to reconnect value to the cost of legal services.” The Challenge’s literature advocates a wide range of cost-containment measures, including “matching the law firm and lawyers to the requirements of each case.” A bulletin dated November 2008 praised Howrey’s in-house training program, which is keyed to a set of four core competencies: building the case for the client, advocating for the client, working with others, and positioning self and firm for success.

“We think of the move to training and the emphasis on value as a very positive step,” notes ACC President Frederick J. Krebs, who believes the ACC Value Challenge “has had a significant impact on this movement. Our chapter and literally hundreds of members are meeting with their firms and pushing for change.”

As for the shift away from lockstep, the reaction of ACC members has been “generally positive,” Krebs says, noting that “it is important that a firm’s process encourages teamwork and commitment to the firm, not just a star mentality.”

After areas of competence are established, benchmarks are created to specify the degree of accomplishment expected at each level.

But beyond pleasing clients, there’s another reason to shift to competency-based levels: It’s a much more strategic management tool, Sloan noted in his ALI-ABA presentation. “Successful companies manage their assets, which consist of key client relationships, the law firm’s brand, what differentiates it from other firms, and client service. Behind all those things are people. It’s hard to find a system that’s worse than lockstep in managing people and seeing that they become more valuable.”

Some firms are making the change for the wrong reason—to justify cutbacks of associate salaries during lean times. The better reason to switch to a competency-based system is to deliver a predictable level of service to the client, Richard says. He also sees firms plunging into a merit-based system without having a transition plan or realistic timetable or clear goals. “They’re finding out that implementing [the change] is complex and disruptive.”

Competency Levels

The first question for firms to decide is how many levels—or rungs in the partnership ladder—their system will have. Many firms, including Sonnenschein and Reed Smith, have chosen three, which correspond to junior associate, mid-level associate, and senior associate. Drinker Biddle & Reath LLP contemplates a four-level system, while Howrey has opted for five. The danger in having too many levels, consultants say, is that it’s really lockstep under a different name.

“Developing eight or more distinct sets of criteria quickly reveals insignificant differences among levels that result in contradictions and conflicts in the evaluation process. Experience has shown that three to four levels work far better, as firms can establish specific and clearly differentiated criteria for each level,” Richard stated in a September 2009 Hildebrandt practice memo he coauthored with Michael D. Short and Blane R. Prescott, the consulting firm’s vice president and senior vice president, respectively.

The next step is designating skill sets or competency areas that associates must master. Howrey subdivides its four main categories into 15 areas: legal research and analysis, factual development and investigation, mastery of substantive and procedural law, creative problem solving, written and oral advocacy, negotiation skills, trial and courtroom skills, project management, leadership, cooperativeness, internal communication, client service, self-development, business development, and the drive for excellence.

There is a right way and a wrong way to define competencies, Richard cautions. The wrong way is via committee or what Richard calls “the focus group approach.” The problem is that it’s unscientific and yields only what he terms “opinion data.”

A much more painstaking and ultimately more accurate approach is the behavioral science method. It entails bringing in an interviewer who will talk to 20 to 30 lawyers for

hours at a time to map patterns of behavior that define the firm's best lawyers. Richard estimates that perhaps 5 percent of the firms shifting to merit-based levels are doing this.

The technique is explained in *Constructing Core Competencies* by Robert Ruyak, Howrey's managing partner and CEO, and Heather Bock, the firm's chief professional development officer (American Bar Association, 2007). A typical task might be: "Describe a time in which you provided extraordinarily good service, above the call of duty, to a customer or client." Or: "Give me an example of a time when you went out of your way to meet an agreement."

Benchmarks for Associates

Once the areas of competence are established, benchmarks have to be created to specify the degree of accomplishment expected at each level. In the area of business development skills, for example, McKenna expects level one associates "to provide support for business development initiatives and . . . begin to cultivate a personal business network."

Level two associates are expected to maintain a network of colleagues and contacts; level three associates are expected to engage in business development activity, while level four associates participate actively in business development, conduct training, and have direct contact with clients.

Similarly, Gardere Wynne Sewell LLP specifies four levels of competency for written communication, beginning with the ability to write clear memoranda, pleadings, and correspondence and culminating in supervising and signing off on written work. Some firms go further and require the ability to perform particular types of tasks, such as authoring a motion for summary judgment or delivering a speech at a bar association.

The challenge is to define traits that pertain to associates across the board, although the emphasis on particular skills is likely to vary across practice groups. Consider that Husch

Blackwell Sanders created departmental guidelines to address this question, Sloan told the ALI-ABA gathering.

Richard sees a danger in overwhelming associates with too many directives, noting that one firm compiled a 60-page memo to define competencies. "There can be too much of a good thing," he emphasizes.

Joan Williams, however, fears that "hidden bias in the assignment and evaluation process has the potential to bleach women and minorities out of the system." Williams, co-director of the Project for Attorney Retention, an initiative of the Center for WorkLife Law at the University of California Hastings College of the Law, wrote the second edition of *Fair Measure: Toward Effective Attorney Evaluations*, the ABA Commission on Women in the Profession's manual on bias-free evaluation processes (American Bar Association, 2nd ed. 2008).

The antidote, she says, is to train everyone involved to spot and self-correct for patterns of gender bias, such as faulting untraditionally feminine women for having personality problems or expecting a more conventional woman to play a female support role with no expectations of skills development. It's the classic double bind in which a woman can be either liked or respected but not both. Likewise, the evaluation form itself has to be combed for bias and what Williams calls the standard "hey, you" system of doling out assignments has to be rethought so that everyone has access to career-enhancing assignments.

"If firms use this as an opportunity to shift to behavior-based evaluation systems . . . and move toward truly sophisticated human resource management in the professional service industry, this can be good for everyone," Williams says. 🍷

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THE DEVIL IS IN THE DETAILS

The following tips can help firms manage a transition from lockstep to merit-based levels:

- (1) Take your time—even if it takes several years.** Many firms choose to roll out their programs in stages, either changing one process (such as evaluation or training) at a time or reclassifying more senior lawyers while leaving new associates for last. At Howrey, for example, it took "two years to figure out our competencies and levels," says Theresa M. Gillis, managing partner in that firm's New York office.
- (2) Keep associates informed.** "A lot of firms focus on technique and have very little interest in how to get buy-in and keep people from freaking out," notes Larry Richard of Hildebrandt. Expect associates to be worried about the mastery of nontraditional skills and the fairness of the evaluation process. "Acknowledge that while the transition is under way, there's likely to be less transparency," he says.
- (3) Tailor your firm's training programs.** Reed Smith's careers training program, which is designed to assist lawyers in developing nine core competencies, is among the most ambitious. It reportedly took years of planning before its introduction in October 2009 and augments the firm's already extensive training program of 140 courses with three academies—one for each level of associates. Howrey has created a two-year apprenticeship for its newest arrivals that carries reduced expectations of billing and the opportunity to spend a third of their time on pro bono.
- (4) Share your competency models with clients.** After all, they're less likely to balk at bills if they know why the special talents of a level two associate were necessary for a particular job.