

LOCKSTEPPING into the future

Denton Wilde Sapte's withdrawal from Asia is perhaps the most high profile example of the amount of pressure UK firms are under to improve the bottom line in recent times. **ALB** discovers what impact profitability concerns are having on the prospects of conventional lockstep systems of partner compensation across firms in Asia



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DLA is the latest UK firm to find itself in the middle of transatlantic merger rumours. Reports suggest a union with US firm Piper Rudnick could be signed, sealed and delivered by Christmas.

But for lawyers based in London or New York, they'll believe it when they see it. In recent years, the two most sophisticated legal markets have grown accustomed to speculation 'noise' only for prospective unions to peter out when it came to dotting the i's and crossing the t's.

UK firm Ashurst was responsible for much of that noise. Failing to strike a deal with Latham & Watkins, the newly rebranded firm seemed to have found a way forward with Fried Frank Harris Shriver & Jacobson. But talks stalled when Ashurst partners were unable to agree which of its high-flyers would be accorded the super-partner status [and, more importantly, remuneration package] enjoyed by select Fried Frank partners.

Alternate partner compensation systems have been at the heart of the problem for the considerable number of firms – on either side of the Atlantic – with transatlantic ambitions. How a firm's profits can be grown sustainably and how they should be divided is one of the key issues management have to consider. The question of partner remuneration is often reduced to a debate over the virtues of 'pure lockstep' versus 'eat what you kill', when the reality is far more complex, especially for international firms.

But before you divide the profits you need to make some and this has been a problem for many UK firms recently.

The bottom line

Denton Wilde Sapte's very public departure from Asia, announced in April, is part of an 18-month strategy review during which there has been an emphasis on bolstering profitability. And it is not the only UK firm with such priorities.

With profits expected to be down by some 5-10% this financial year at many of the leading UK firms, profitability is now a top priority. Measures taken include freezing newly qualified salary rates and reining in partner promotions.

In addition some firms, like Dentons, are facing the prospect of laying off partners in order to cope with tough economic conditions. Partners at Freshfields Bruckhaus Deringer have voted to close the firm's Bangkok office as part of a regional review that has already seen staff numbers quietly reduced in Singapore. And Simmons & Simmons has hit the headlines this month as it undergoes a program of de-equitising some London-based partners.

A survey last year, conducted by American Lawyer magazine, confirmed that UK firms still lagged behind the top US firms when it came to profitability. In its ranking by profits per partner only five UK firms were among the top 30 and none ranked higher than eleventh.

Fundamental to the process of making profitability a top priority – to better compete, or perhaps unite, with US firms – has been the need to address the sensitive issue of under-performing partners. A firm's partner compensation system can heavily influence this issue.

As part of its attempt to address its profits slump – and retain its top partners – Simmons & Simmons has introduced a floor in its partner compensation whereby an additional 10% of profits are added to the bonus pool in bad years. With 80% of its profits normally allocated to its modified lockstep – and the remainder to its profit pool – a 'bad year' for Simmons will see that reduced to 70%.

And reports out of London suggest that Norton Rose is set to introduce a stronger performance element into its partner compensation system. London-based chairman Paul Giles would not elaborate on reports that the firm implemented a new three-tier lockstep system on 1 May that introduced junior equity partners for the first time. "These are not matters upon which we think it appropriate to comment publicly," he told ALB. But the interesting element to the Norton Rose story is that the firm's partners were reportedly keen for the firm's new system to be as close to a strict lockstep system as possible.

The aggressive 'eat what you kill' performance-based system of partner remuneration, where each partner is assessed strictly according to his contribution to the bottom line (also described as merit-based), contrasts sharply with the more gentlemanly 'lockstep' system in many UK firms, where partners are rewarded by reference to their seniority in the firm, moving one step a year up an imaginary ladder.

The Asian Way

A generation ago, almost all the premier UK and US firms divided profits among partners on the basis of seniority but the lockstep system has largely disappeared in the US. In Asia many firms have trodden a similar path, believing that individual economic contributions have to be individually rewarded.

Miyuki Ishiguro, partner at Nagashima Ohno & Tsunematsu in Tokyo, says: "Our partner remuneration consists of the combination of lockstep portion and performance-based portion. We considered the merits and demerits of each system."

The fear of course is that if the contributions of the more productive partners are not recognised in a way more tangible than a pat on the

back – there are always other firms willing to step in. However, there are still firms in Asia that continue to believe that lockstep is the most satisfactory overall remuneration system for the global law firm.

Brian Salter, banking and financial services partner at Clayton Utz in Sydney, says: “When lockstep works, it works extremely well. It has a number of advantages. It removes any internal debate and competition among partners and creates internal harmony. It also creates an outward-looking culture and encourages team approaches internally. Whereas in a merit-based system, partners are effectively often competing against each other and a lot of management time is spent sorting out all of the competing claims and assessing them in order to be able to treat people fairly.”

In Australia – with the exception of Freehills – firms have inherited the UK lockstep system. Mallesons Stephen Jacques operates a conventional seven-year lockstep system. Hong Kong-based Robert Milliner, the firm’s international managing partner, says: “We have been using the same system for some time now and the partners are comfortable with it. We believe it is consistent with and reinforcing of the underlying values and philosophies of our firm.”

But some Australian firms have recently been thinking about moving to a performance-based system of partner remuneration as a means to be able to retain their best people.

However, according to lawyers those that have recently introduced – either wholly or partially – a performance-based system are generally the firms experiencing a bit of stress.

Salter says: “Any remuneration system has to be transparent and fair. And when you build into the lockstep inefficiencies – in other words there are people who are not carrying their own weight or making the contribution that justifies their receipts under the lockstep – that starts to undermine the success of the lockstep system.”

A lockstep system of remuneration requires enormous financial discipline says Kevin Wong, national managing partner of Linklaters Allen & Gledhill in Singapore.

“Lockstep is a self-regulating mechanism, but it has to be administered. The basis of a lockstep is that everyone is pulling his or her weight and in volatile markets like those found in Asia, this is even more acute. For us, the performance of the firm outweighs the performance of the individual,” says Wong.

The recent moves by some UK firms are recognition of the fact that the global law firms of tomorrow will have to include some element

How firms piece the pie

Asian firms

Firm	Country	Profit Sharing System
Nagashima Ohno & Tsunematsu	Japan	Combination of lockstep and performance-based
Hwang Mok Park	Korea	Combination of lockstep and performance-based. Clear distinction between junior and senior partners although bulk of equity held by managing partner
Jun He Law Offices	China	Combination of lockstep and performance-based. Pooling system whereby profits partly distributed on seniority and partly on performance
Llinks Law Office	China	Lockstep
Pu Dong Law Office	China	Combination of lockstep and performance-based
Mallesons Stephen Jacques	Australia	Conventional seven-year lockstep
Minter Ellison	Australia	6-year lockstep: no bonus pool
Freehills	Australia	Performance-based: units awarded from 30 to 120, increase in units based on performance not locked. Plus bonus for five to 10 partners
Allens Arthur Robinson	Australia	Lockstep
Clayton Utz	Australia	Lockstep
Blake Dawson Waldron	Australia	Modified lockstep: lockstep plus additional units or cash bonus for performance

Sources: ALB research; American Lawyer; The Lawyer; Legal Week; BRW

How firms piece the pie

UK firms

Firm	Profit Sharing System
Allen & Overy	15-year lockstep
Clifford Chance	10-year lockstep
Denton Wilde Sapte	10-year lockstep (75% + 25% performance-based): Partners begin on 45 points, climbing five points a year to 90 points. Super lockstep at 100, 110 and 120 points. Appointment to super lockstep for two years only
Freshfields Bruckhaus Deringer	12-year lockstep: UK partners start on 20 points increasing 2.5 points a year. German partners start on 15 points, increasing 3.5 points a year. Two streams merge after 7 years
Herbert Smith	7-year lockstep: ‘A’ (advanced) equity partners promoted from ‘b’ basic equity partners after two to four years
Linklaters	10-year lockstep
Lovells	12-year lockstep
Norton Rose	10-year lockstep: Partners begin on 100 points and climb 12.5 points a year. Fixed share partners enter lockstep at 80 points, for first two years
Simmons & Simmons	6-year lockstep (80% + 20% performance-based): To climb from steps 2-3, and 5-6 partners must pass gateway. Partners can move maximum of two steps a year
Slaughter and May	10-year lockstep

Sources: ALB research; American Lawyer; The Lawyer; Legal Week; BRW

of the US ‘merit’ approach.

As the concept of the pan-Asian firm is yet to eventuate, firms have developed hybrid remuneration systems appropriately reflecting the performance of their respective individual markets. In the less developed jurisdictions, where many small firms are effectively run as barristers’ chambers, equity is very tightly held at the top. This is certainly the case in Singapore where firms are generally not lockstep beyond the first few years post-qualified. This has caused some resentment with younger lawyers, many of whom are now choosing to leave the profession.

As one lawyer put it: “There have been some examples of high profile domestic firms in Singapore that have found it difficult to regenerate themselves.”

In Korea, the remuneration of lawyers at major firms is kept almost as secret as in Singapore. Salaries are not published and it is the intention of the firms’ management that compensation not be discussed among members.

“One of the key reasons for the silence is that the system is far less uniform than one might find in the US or UK, particularly for lateral hires,” says one lawyer.

Associates joining Korean firms fresh out of school (or the Judicial Research and Training Institute, in the case of Korean-licensed lawyers) receive a set salary. But very often they do not know how much they will be paid until after they have joined the firm. As associates move up the ladder, their pay generally increases in step according to class year. However, bonuses are often based on performance (generally measured by billable hours) and there can be individual adjustments in an associate’s base salary

– which may also involve an associate getting bumped up a class year or two.

But many firms in Korea do not operate a true partnership system. While there are people named ‘partner’, they are often economically the equivalent of senior associates without any actual equity stake in the firm or genuine profit sharing. And for firms that do have more true partnership-like systems, the approach is often a combination of both the lockstep and eat-what-you-kill approaches..

Another interesting aspect of Korean firms is that the founding partners of most major Korean firms tend still to be the managing partners of the firms and often make all major decisions by themselves instead of delegating the matters to committees or administrative personnel.

Senior partners come not only from within the firm’s own ranks, but also from the ranks of retiring judges, prosecutors, and government officials. They all get individual deals. In addition to regular compensation, they also generally get a larger office that will include a private reception area (some very senior partners get separate conference rooms attached to their offices) with sofas and coffee table, as well as a car and driver.

“The problem with those types of partners is that they become less and less useful over time as their connections go stale and the market shifts towards a demand for more substantive knowledge of the law and the business that it supports,” says one lawyer. “This is definitely creating discontent among lots of lawyers who grew up in the firm and now question the value that the ex-bureaucrats add relative to their compensation packages.”

So the problem of firms regenerating themselves is not confined to Singapore. As

“I think there is a shift, particularly among younger attorneys, towards more of a meritocracy. People see less of a need to sacrifice for someone else’s benefit”

How firms piece the pie

US firms	
Firm	Profit Sharing System
Cravath Swaine & Moore	Lockstep
Davis Polk & Wardwell	Lockstep
Jones Day	Secretive profit-sharing system – details of equity shares are not even circulated among partnership
Latham & Watkins	Modified lockstep, with performance-based element
Morrison & Foerster	Performance-based
Shearman & Sterling	Performance-based
Sidley Austin Brown & Wood	Largely performance-based system, with an element of lockstep
Skadden Arps Slate Meagher & Flom	Renowned for being highly meritocratic
Sullivan & Cromwell	Performance-based
White & Case	Principally performance-based, with an element of lockstep

Sources: ALB research; American Lawyer; The Lawyer; Legal Week; BRW

our source in Seoul puts it: “Kim & Chang, in particular, has a reputation for being something of a finishing school for attorneys who later move on to boutiques or become solo practitioners.”

Pure lockstep systems are also uncommon in China. Llinks Law Office is known to offer a combination of lockstep and performance-related elements. It was because of this, says Llinks partner David Yu, the firm recently lost its managing partner.

At the beginning of February, David Liu quit Llinks to rejoin his former firm Shanghai rival Pu Dong Law Office. Yu told ALB: “The partners in this firm are very young and they look for a future. So we’re looking to build up our profile as a first tier national firm. To achieve this, you have to input a lot of money and effort. It also needs contributions from all the partners, which means our profit ratio will be lower than other law firms.”

He added: “David Liu was the eldest partner in this firm and had worked for many years. At this stage in his career, he feels he needs the money not the future and that’s why he’s rejoined Pu Dong. But at Llinks, we’ve adopted a profit sharing system. We emphasise cooperation and teamwork between the partners. And we also emphasise the development of the firm. David Liu strongly rejected the new partners because it would decrease our profit ratio.”

Liu vehemently rejected the charge that he was simply following the money by returning to Pu Dong. He said: “If I just pursue the money, then why did I leave Pu Dong five years ago to help start up Llinks?”

He added: “At Llinks, I tried a Western style mixture of a lockstep and profit sharing platform, which proved to be a failure. I believe at Pu Dong we can find a middle way.”

Yu said that during his stewardship of Llinks, the firm had grown from the four original partners to the 12 it has today.

“Every year I generate almost US\$2m in revenue. Under a US-style meritorious system I can earn much more than in a lockstep profit sharing system. You will not believe what I have sacrificed economically to Llinks in the past five years. We have a big gap between the partners in terms of the revenue. If it was for money, I would never have left Pu Dong Law Office.”

Over at Jun He Law Offices, a hybrid remuneration system among the partners has been adopted, combining the features of pure lockstep and performance-based. The firm adopts a pooling system where all the income goes to the firm first. The partnership then shares all the major costs of the firm, including the lease and the payrolls to all the employees.

Part of the profit of the firm is distributed among the partners on a lockstep basis, primarily measured by their seniorities. The rest of the profit is distributed among partners, according to performance by each partner relative to other partners. This is evaluated from a number of perspectives, including client generation, billing and case management.

The partners’ contribution to the general management of the firm is also recognised with a small portion set aside to remunerate for their time in firm management. Partners’ accumulated contribution is recognised with a seniority system, whose portion has been intentionally maintained at a level not to discourage new partners while being fair to the old partners.

New York-based Jun He partner Qi Adam Li told ALB: “While the firm recognises the necessity to give sufficient incentive to partners to get clients, it is also clearly aware of the institutional need to maintain a balanced partnership while quality maintenance and collaboration are becoming more important. The partners of the firm have been striving to strike the right balance through these years.”

For international firms, the evaluation of the respective merits of each remuneration system is even more complex than it is for smaller, local firms. Additional issues they must contend with include the fact

that lawyers in different countries almost certainly will have different approaches to money; there will be alternative tax regimes in place at these jurisdictions and there will likely be different approaches to retirement dates.

While a single worldwide system offers simplicity, it may also prove to be too rigid. The use of local or salaried partnership status or even a so-called ‘super lockstep’ system may fudge many of these issues, but this can have profound implications for the culture of the firm worldwide.

While there is much debate over the respective merits of lockstep or a merit-based approach, there is consensus among lawyers over what issues need to be addressed by a firm’s remuneration system. Any system, they say, needs to answer the following: does it motivate your best performers to perform; does it encourage partners to develop existing clients and to locate new ones; does it encourage partners to involve other partners outside their group or office; does it encourage the right behaviour in the firm to partners and all staff; does it enable you to keep partners in areas of significance to the firm which may be inherently less profitable than the rest of the firm; does it facilitate lateral hires; do partners think it fair; and, how much management time does it take to run?

For many firms in Asia, the biggest problem is the lack of transparency. Firms risk alienating their partners of tomorrow unless more money trickle downs to those who are actually earning it.

One lawyer in Seoul says: “It used to be in Korea, as in Japan, that one simply put in one’s time with the firm with the understanding that they would be rewarded at some point. However, I think there is a shift, particularly among younger attorneys, towards more of a meritocracy. People see less of a need to sacrifice for someone else’s benefit with the hope of receiving some sort of payoff some day are more interested in being compensated now for the value they actually add.” **ALB**

Lockstep explained

Full lockstep

In a full lockstep structure profits are distributed strictly according to seniority. Partners receive a points allocation based on year of entry into partnership. Partners move up a ladder (lockstep) over a period of between five and 15 years. Once partners reach the top of the lockstep – the plateau – their share of profits is static.

Even full lockstep structures have mechanisms to halt partners advancing up the lockstep if partners are considered not to be performing at full potential. Some full locksteps also allow for extra distribution of points to a small pool of top performers.

Flexible lockstep

In flexible or modified lockstep structures there is no automatic presumption of advancement up lockstep. Management retains significant discretion to stop, accelerate or demote partners on lockstep. These systems typically have ‘gateways’ along the lockstep through which partners can only climb with approval of partnership.

Partial lockstep (lockstep and performance-based)

This is a hybrid of a lockstep and a merit/performance-based system. Part of the partnership profit is allocated according to seniority and part at the discretion of management and remuneration committees. The balance between the two can vary enormously. Criteria for discretionary compensation can be broad but will principally be based on billings.

Performance (merit)-based

In these systems profit shares are divided among partners at discretion of management and/or remuneration committees.

Source: In Brief