Inventing the Future

Practical Strategies for Law Firm Innovation

I first encountered Bruce MacEwen's website "adamsmithesq.com" back when I was Chief Administrative Officer at LeBoeuf Lamb. I cannot now recall which article I first read, but I was hooked and printed out his entire archive for travel reading. I was struck that what he was saying needed to be said, and that while some of it I had thought about (not too precisely), most of it I realized I should be thinking about. This past fall, like so many, I read and re-read "Growth Is Dead: Now What?" and am inspired to respond.

MacEwen maps the critical challenges confronting law firms in the post-recession era, and along the way manages to deconstruct long-held assumptions about the practice of law. A sense of urgency follows from his premise that we are on the brink of an extraordinary transformation in the delivery of legal services, yet those who have grown up in BigLaw, and presumably know it best, may have the hardest time embracing the change.

Clients are seizing on the new economic realities as an opportunity to lower costs. In the early months of the recession, a popular conference topic was whether a paradigm shift was underway. Today, the question is not whether, but how, to react. The case for urgency is in a landscape of declining revenue, reduced leverage, and increased competition from traditional peers, LPOs, contract/temp lawyers, and onshore and offshore operations.

The implications of MacEwen's analysis are for deep change in the delivery of legal services, yet he says that, at this critical juncture, what is needed is not a Grand Strategy as much as a commitment to continuous experimentation. The business environment is evolving so rapidly that no one knows for certain where it will go. Each firm must find its own way. The question for many managing partners, though, even those who understand the urgency, will be where to begin. A lot of firms made a lot of money in the boom years, but cash is king now, especially for those struggling to manage the fallout from declining revenue. Reluctance to invest in what could turn out to be costly errors is foreseeable. The answer may be "keep it small," yet some of the more intractable problems – such as hourly rates and compensation – touch on so many aspects of a firm's revenue model they can be hard to approach incrementally. Caution may undermine the will to innovate.

"Growth Is Dead" concludes with an invitation to step into the process of creation. As a response, however partial, I have set down my thoughts on three practical strategies for innovation.

- Tie hourly rates more directly to experience.
- Rely on market-based compensation for low producing partners.
- Abandon the 8 to 10 year equity partner track.

While none of these is a solution in and of itself, each promises to reduce the friction costs of innovation and so enable the creative process. I would emphasize that they are examples only.

There are other ways to re-think hourly rates, compensation, administrative costs, and every other variety of law firm financial metric. Lock a few people in a room for a week (and take away e-mail, internet, and phones), and they'll bring back more. Their double barrel assignment: to introduce more objective standards of measure and bring costs and value into closer alignment.

1. Experience-Based Rates

Approaching rates as a function of a lawyer's experience and skill sets is a departure from past practices, which are rooted in seniority and a host of other considerations. It introduces objective criteria for measuring "value add" and positions a firm to defend against what can sometimes feel like unilateral discounting.

Stubbornly resilient despite decades of criticism, the billable hour continues to loom large in conversations about legal costs. A great deal of commentary has been written about the negative, and sometimes absurd, billing incentives that take hold in a system predicated on it, yet it remains the default billing path and a key driver of firm revenue.

In talking about the billable hour, we need also talk about the hourly rate. They are two sides of a single coin. Together, they are revenue. While it is true that the mechanics of billing time, the incentives lawyers have to reach annual billing targets, and the degree to which firms exercise oversight of billable hours all impact costs, I suspect much of the frustration with the billable hour would ease if clients thought firms had managed to get rates right. As it is, clients think rates are high and want a better deal, whether through straight discounting or alternative fee arrangements, and law firms try hard to hold the line on rates in an effort to maintain realization. To the extent they are successful, this tug of war over pricing may give clients a sense of getting more for their money. Ultimately, however, it is less about the value of the legal work than about finding a mutually agreeable bottom line.

Anyone who has spent time in a law firm has seen rate setting at work. It is hardly new territory. But looking more closely at the dynamics that drive rate setting highlights a resistance to reducing fees that is as much organizational as it is financial. Because rate setting is rooted in a firm's organizational structure, the hourly rate can be as resistant to change as the billable hour.

There are other ways to approach the elephant, of course, including through alternative fee strategies, leverage, overhead, outsourcing, onshoring. All can help drive down costs; all can have an impact on the economic terms of the client-firm relationship. There is no single magic wand. That said, in rate setting we are confronting a particularly tough obstacle to change.

The Inverted Compensation Pyramid
In "Growth Is Dead," the need for heightened levels of client service is a key theme. (See Part 10.) Of course, "Client Service" is a well-worn tag, often preceded by "superior" or "exemplary," but MacEwen's point is that where client service "matters most" is "in terms of transparent value for transparent money." Clear pricing is integral to great client service. You aren't delivering superior client service if your clients don't understand your basic fees.

Law firm pricing generally falls well short of the mark. Firms have been persistently internal facing when setting hourly rates. Clients often have little basis for understanding why lawyers are billed out at their assigned rates (beyond a rough notion of seniority), and invoices can be tough to parse as a result. Put another way, if an hourly rate is understood as a proxy for value, than any subjectivity in pricing is an obstacle to transparency.

Once rates are set, firms try to hang onto them, even in the face of declining realization. It is easy to see why. Revenue targets are predicated on rate schedules. Top rainmakers still command, and are paid, scheduled rates. Firms are concerned that, even if rates are lowered, realization will continue to fall, the worst of all worlds. More problematic, though, is that putting rates in play invites difficult conversations.

During the boom years, hourly rates typically rose in one of two ways: either a firm announced a firm-wide increase or a lawyer moved up to the next higher billing bracket by reason of seniority ("step increases"). Once in effect, rate increases generated a new revenue trajectory, but the eventual increase in cash flow was quickly absorbed by relentlessly rising overhead. A significant portion of the rising overhead was new compensation, as firms not only charged for but also compensated for seniority. The longer a lawyer was with a firm, the more she could expect to make. There may have been a lag in timing, but increases in compensation routinely followed increases in rates.

Firms raised rates over many years and did so with relative ease. While other paths to revenue growth (say, increasing average annual billable hours) could be tough sledding, increasing rates often required little more than release of an artfully written memo, with perhaps a few calls to clients. Over time, firms became addicted to rate hikes, and they arrived like clockwork, often twice annually, once in January for the official annual increase and again in the summer with step increases. Moreover, the increases were premised not on individualized assessment of each lawyer's value but, instead, on a rising tide of fee earners. The cost of legal services became a byproduct of the cost of a firm's hierarchical structure.

Cumulatively, rate increases stoked record profits and enabled historic rises in compensation. In the same way that a partnership structure is pyramidal, law firm compensation grew in an inverse pyramid. It had a certain coherence in a world of rising demand, revenue growth, and bulging partnerships. The formula worked. But with revenue falling, demand slowing, and leverage narrowing, the inverted compensation pyramid jumps out as glaringly asymmetric.

All Lawyers Are Not Created Equal

Law firms tend to price lawyers, including partners, in generalized bands, by seniority. There will always be exceptions, but, as a rule, rates move steadily higher as a lawyer matures. Moreover, increases early in a lawyer's career tend to be accelerated, reflecting internal assumptions of rapidly increasing value. As a result, rates can be top heavy in a partnership, at $700 to $900 an hour and higher. In justifying high rates, firms point to uniformly deep experience, consistently superior lawyering, and investment in training and mentoring.

But all lawyers are not created equal. Within rising bands, they may be priced as though they are, but anyone who has spent even a few days with a group of partners – sometimes a few minutes – knows some are more equal than others. While not even remotely scientific, here is a handy rule of thumb. In a group setting of any size, you can expect 5% to be stellar performers (with true stars a tiny few), 10% to be very good, 15% good, 40% adequate to the purpose, 15% underperforming in ways not routinely visible, 10% problematic, and 5% a source of chronic headaches. The point is not the math. It is that quality is *always* relative. Pricing lawyers as though it isn't, as though certain bands of lawyers are uniformly valuable to clients, says more about a firm's organizing principles than it does the value of legal services.

The extent to which hourly rates are internal facing and subjective, reflecting a firm's internal dynamics more than market value, is the extent to which they lose transparency. In conversations about "value added," clients are being asked to share in assumptions about professional value that are, without more, objectively unquantifiable.

The Cost of Doing Nothing

Clients will find a way to reduce costs where firms cannot. In a world of increasingly aggressive discounting, with clients driving the conversation and every year savvier about available pricing tools, new market pricing of legal services will emerge. Firms that choose to be merely reactive, giving up discounts matter-by-matter while stubbornly resisting larger conversations about value, in effect surrender price-setting to clients, who have no reason to let up until they have legal costs they can live with.

At that point the pendulum will have swung. *But discounting and alternative fees do not necessarily get at true value any more than BigLaw's historic billing practices do*. Once the pendulum has swung, though, law firm grousing that legal services are now *undervalued* will be white noise. The cost of doing nothing is in missing an opportunity to define what is truly and uniquely valuable about a firm's work product.

No mistake about it: law firms deliver value, often exceptionally high value. Pricing models may be skewed. Too many law firms may be doing too much of the same thing. Maybe too many firms have too many lawyers. But a checklist of defects is not an argument against the essential viability of BigLaw. Put another way, it is one thing to retain low cost providers to process documents or turn around routine contracts. It is quite another to entrust someone with a significant financing, a risky litigation, a cutting edge tax problem, or a sensitive senior staffing issue. Not to say that one kind of work is more important than another. The point is that price matters a whole lot more with some kinds of work than with others. Sophisticated legal representation is a highly desirable service, and clients are willing to pay for it.

The challenge for a law firm is to demonstrate value, not collectively across seniority bands, but lawyer by lawyer. There may be good reasons for ducking the challenge (revenue might fall, good people may suffer, organizational implications could be significant) but, assuming that change is already underway, with or without law firm engagement, ducking the challenge only delays – it does not avoid – the reckoning. Firms that wait may find themselves on the sidelines as the game moves downfield.

Right Valuing Rates

No one said it would be easy. Setting rates that measure value to clients invites tough conversations. Every partner has well-grooved compensation expectations. Every firm has revenue goals built on the earning power of those partners. On the other hand, tying value directly to experience has an inherent logic, both externally for clients and internally for lawyers and firm management.

Law firms conduct annual performance reviews of lawyers, usually as a lead up to a conversation about compensation. Hours billed, total client billings, administrative workload, and occasional personnel issues all inform the process. There is a separate way to evaluate lawyers, though, and it involves stepping into the client's shoes. What is a lawyer's specific experience? What are his skill sets? What is he actually able to *do* for a client?

Law firms can document each lawyer's experience and skill sets with detailed lists of matters worked on and the specific role(s) played on each. The more detail the better, including information about differentiating value and client feedback. In an experience-based review, relevant questions could include:

- He's a good M&A lawyer? On how many cases was he the lead? For what size companies? And which industries? What specific areas of expertise are reflected in hours billed on past matters?
- Is her practice area highly specialized? Even so, does she offer sophisticated analysis or perform routine and repetitive assignments? Does every firm have someone just like her? What do *clients* say about her work product? Is she a recognized expert, with speaking and writing credits?
- A trusted case manager? Is he a highly competent generalist, and maybe a good writer to boot, but indistinguishable from hundreds of other lawyers at other firms?

Relevant questions do not include:

- What are we paying him?
- How many years with the firm?
- What do we charge for other partners at his level of seniority?
- What kind of job did she do managing her practice group?
- History of new client development?
- Leverage? Total billings? Hours worked? Wasn't he a good soldier spending four months in the Singapore office?

Clients don't care about any of this latter set, nor do you want to suggest that they should, for it invites them to care about purely internal management issues. Yet that is exactly what the current rate-setting system would seem to do.

The good news? In taking on the challenge of demonstrating value, many firms will find that, in the experience and skill sets of one lawyer after another, they have an incredible story to tell.

2. Approaching Compensation

In terms of practical impact, the area of greatest change for law firms is in pricing, as clients push back on legal fees, and law firms try to hold the line against declining revenue. The challenge can be finding a line to hold. For some, it may derive from a strategic vision. For others, it will follow the dictates of a few indispensable clients. In every case, it requires identifying price thresholds below which the firm cannot go. The pressure is on to understand the costs of delivering legal services.

Clients Don't Care What It Costs . . . You

In a relatively new phenomenon, law firms are devoting significant resources to pricing initiatives. The goal is to find common ground where the client and the firm can accept projected financial exposure. A key internal benefit to the firm is identifying gaps in cost data, which it can then work to remedy. Over time, as the quality of data improves, so should a firm's ability to negotiate fees.

These initiatives promise to improve law firm pricing, but it does not follow that clients will care about a firm's cost basis. Clients care what a representation costs them. If a client is happy with pricing, the firm's costs don't matter. If a client is unhappy with pricing, the firm's costs don't matter. Put another way, if your costs are low, more power to you. If your costs are high, you need to figure out how to bring them down, but don't look to clients to pay you higher fees while you do.

Clients purchase legal services, not your business model. If they push back on pricing, you can counter by highlighting the experience your lawyers bring (and why that experience is germane), but not with an argument that your fees are actually, truly, really justified by your cost of delivery. Unless you have no serious competition whatsoever – but you do – your cost basis results from a world of decisions only you can control or care about.

What clients value and what firms value will never be perfectly aligned, but clients write the checks. To the extent a client thinks you are overcharging, you have to be able to defend your costs. Not to the client, who doesn't care about your costs, but internally. In making an intelligent commitment to pricing, you need to know what you spend money on, and why.

The acid test for any expense is whether it contributes to client value. Not every expense will. You may pay for things that do not translate into client value in any appreciable way whatsoever. But you do so understanding the value is to you and not the client.

Digging into Hourly Rates

For the sake of argument, assume a client is prepared to retain a firm but thinks the proposed fees are excessive. Ensuing negotiations allocate exposure to upside legal costs, as the client nails down as many contingencies as possible, and the firm tries not to commit to providing services, for little or no payment, never contemplated at the time of retention. Negotiations also settle pricing. For the firm, the critical pricing point is typically hourly rates.

An hourly rate is a firm's formal statement of a lawyer's value. Whether official rates obtain in a matter is beside the point. If rates are heavily discounted, a client can see the official rate as the point from which to measure the discount. Even if an arrangement is for fixed or capped fees – and as far as the client is concerned rates aren't even under discussion – they are singularly important to the firm in deciding whether to take the matter on. It has to calculate back to *effective* hourly rates in order to understand whether the work will result in a profit or a loss.

In deciding where to hold a line on rates, a firm has to look at costs, but also partner profits. Costs are: (*i*) compensation for everyone who is not an equity partner (lawyers and staff) *and* (*ii*) all other overhead (real estate, technology, fresh coffee). In theory, partner profits are whatever is left over at year end after costs, and actual profits are not guaranteed. In practice, firms do a very good job of projecting year-end partner distributions, such that for years on end partners lived securely with lifestyle expectations predicated on recurring profit shares. Firms set precise revenue targets for covering costs and profits both.

Two-Tiered Valuation

To a large extent, managing non-compensation costs at a law firm is much like managing such costs at any organization. It involves sophisticated recordkeeping and analysis, yet the math is pretty straightforward. Budgets provide for and track spend. Firms negotiate with vendors, choose to spend on some things and not others, ship whole departments off to low cost centers, but it is an essentially manageable process with objectively quantifiable data. Much of the work is handled by administrative staff working at salaries comparable to what they would make elsewhere in the job market. Lawyers also handle a significant amount of administrative work, however, and therein lies a two-tiered valuation.

Whether recruiting, training, monitoring associate assignments, drafting pitches, researching potential clients, or coordinating with the billing department on invoices, big firm lawyers do a lot more than practice law. They generally record time for these activities, and legal and non-legal billings are tracked separately. But in cost-management terms, firms effectively value administrative work twice, once for staff and once for lawyers. The higher a lawyer's compensation, the more pronounced the gap.

Firms can, and do, manage the high cost of administrative work handled by lawyers by capping the number of non-billable hours (separate and apart from pro bono) that count toward annual billing targets. For that matter, if a lawyer meets his billing target, a firm might conclude that the administrative work isn't overvalued at all but *free*. On the other hand, in a no-growth environment, if a significant number of lawyers are not meeting targets, but instead fill timesheets with increasing percentages of non-billable work, it represents an extraordinary outlay on administrative services.

What is the right way to value this work? Actually, firms have already answered that with staff salaries. Even if it is administrative work a firm wants only a lawyer to handle, it doesn't move the dial on *client* value. When the recession hit, and law firms scrambled to cut costs, they laid off staff in waves. In doing so, they were arguably cutting into some of their more cost-effective resources.

Great Expectations

Lawyer compensation generally, and partner compensation in particular, accounts for an enormous slice of law firm revenue. In any conversation about pricing, it is the 800-pound gorilla. I earlier sketched a history of hourly rates and lawyer compensation rising significantly over many years for reasons that had little to do with client value but, instead, followed a firm's organizational imperatives. This history is well understood by clients. Clients also read the news. They know profits per partner, they know associate salaries, and many of them have worked in law firms and have a clear idea of compensation for everyone else. And they know that, as clients, they are paying for it all.

Here's a hypothetical: The venerable New York law firm Alpha, Beta & O'Gamma receives a letter, signed by each of its top 100 clients, advising it that its hourly rates are too high by a third. The firm immediately responds with significant rate reductions, but then sees that comparable reductions in partner compensation, however regrettable, will be inevitable. What does it *do*?

Firms have a lot less experience reducing compensation. A managing partner might wonder how even to approach what is almost certain to be deep internal resistance. Partnerships, after all, are built largely on promises. On the one hand, a lawyer devotes a lifetime of hard work. In exchange, the firm gives him the security of continuing financial reward above and beyond what is available pretty much anywhere else in the practice of law. To a partner with tuitions to pay, a home purchased on anticipated earnings, and a whole host of what might be considered lifestyle expenses but that, accruing over time, can be hard to undo, the prospect of a firm refashioning compensation may feel like some kind of kind of betrayal, as though all along his career has stood on phantom limbs.

It is no easier for the managing partner. No matter what the business consultants say, it can *feel* personal, especially if he's risen through the ranks with the very lawyers now arriving one by one to his desk. For decades, partnership encouraged them all see one another as peers. Collegiality was a shared professional goal. They grew up together as lawyers.

This isn't merely about greed. That proves too much. With a few saintly exceptions, hanging on to what we've got is a human condition. Moreover, as a management insight, it doesn't give the managing partner a whole lot to work with. Nor does reminding him that it is, after all, an accident of timing. Yes, the economics of running firms have shifted, and, yes, BigLaw is caught in the aftershocks. But a managing partner can feel the demands of a client-driven market in his bones, and accept as inevitable the need to rationalize rates, and it still doesn't make chopping down a colleague's compensation by a third any easier. Granted, much of the world would be thrilled to have money problems on this scale, but there is a personal dimension to the challenge of lawyer compensation that is appropriate, even useful, to acknowledge.

Some firms will manage to hang on to the financial model that has lifted them to greatness. By and large, they will have well-deserved reputations for excellence and an astonishing number of extraordinarily talented lawyers. Their partnership model will endure, and clients hiring them will routinely trade away price-sensitivity for quality. The work will be uniformly important and high stakes, and there will be plenty of it to go around. Other firms will act as though this is their model, when, in truth, they are looking for a way forward without deep and painful disruption and not finding it.

For the rest, there are a lot of tough conversations ahead.

<u>Market-Based Compensation</u>
Market-based compensation exists. Lateral recruiting is alive and well, and recruiters are adept at shopping individual lawyers. While almost all the media attention has been on big-ticket rainmakers and rich paydays, there is sophisticated machinery in place for those with more

modest books of business or, for that matter, no book of business at all. The same market force currently bringing enormous pressure on firms is a force they can harness to their advantage.

Law firms do not always see lateral recruiters as their best friends, and handing recruiters detailed profiles of lawyers in order to gauge their comp against market may seem folly. But the fact remains that market pricing is out there, and in just about every other area of the economy compensation is market-driven. Think about your IT director. If she needs a new manager, she contacts HR to get the ball rolling. HR does its homework and comes back with resumes but also salary ranges tied to candidate experience. Market pricing is available for every department, every position. Relying on it is standard operating procedure.

A firm may be reluctant to talk to a recruiter about a specific lawyer, and decide instead to float a generic profile on a no-name basis ("what's the comp range for a lawyer who . . . ") or ask the question from the perspective of a firm *seeking* such a lawyer. The point is that a recruiter can answer the questions. Yes, there may be as many variances as there are lawyers, but the goal isn't scientific precision but a sense of what other law firms will pay *on the open market*. It won't take long to get a realistic idea of how the market values, say, a partner with good substantive expertise and good case management skills, but a relatively weak record of client development. Plot compensation at select points across a partnership, and clear lines will appear.

Recruiters, like clients, will not assign much, if any, value to a lawyer's history of capably handling administrative duties. Therein lies a correction to an occasionally significant internal value gap that otherwise may be hard for a firm to close.

It is worth noting that the resulting data may be no news at all to individual lawyers. Lawyers test the market, if only because recruiters occasionally call. They've talked. A lawyer who is highly compensated likely knows it. Without market data, though, a compensation conversation can easily devolve into what his colleagues are making. Or reports of what lawyers are making at other firms. BigLaw has allowed for a lot of coat-tailing.

3. NewCo

It is sometimes said that, if a modern law firm were designed from scratch, the result would look nothing like the business model we have inherited. However true that may be, it suggests a need for a complete break with the past. The current model is clearly under stress, yet for all its shortcomings it has served as an extraordinary vehicle of client service for generations.

Just a few years ago, GM stared into an abyss. Newspaper headlines reported that a massive government bailout saved the company, but that was only part of the story. What GM *did* with the money was divide itself in two, creating a new corporate shell (NewCo) into which it moved valuable assets, leaving burdensome liabilities behind in a bankruptcy-destined remainder. Law firms aren't corporations, and lawyers aren't cars. But at the heart of the NewCo approach is the compelling notion of a middle path. For law firms, the choice may not be between, on the one hand, hewing mulishly to old ways of doing business and, on the other, plunging dramatically into an abyss. Instead, the challenge may be to identify valuable assets to preserve.

You'll find a lot of merit badges on a law firm sash: immediately responsive, deeply staffed, hard working, thorough, tenacious. There is much for clients to commend. At the same time, attributes like these can have cost implications that make value contingent. (*You spent how many hours on this!?*) A better starting point for a NewCo analysis – and one that is illustrative only – may be a valuable asset that clients seem willing to pay for regardless of price.

<u>Rainmakers</u>

Rainmakers are a point of value overlap for clients and firms. Every firm can point to lawyers who, year after year, pull in marquee clients on high stakes matters, matters for which clients are prepared to pay top dollar, either because the stakes are so high or simply as insurance against disastrous mistakes. (If mistakes do happen, the GC can honestly tell her Chairman she hired the best.) True rainmakers can account for a material share of a firm's annual revenue, and at some firms the productivity of only a few can be the difference between profit and loss. At any firm, the retirement or lateral departure of a rainmaker is a significant event. Managing Partners lie awake at night thinking about them.

Rainmakers sit atop the law firm pyramid. The traditional law firm business model is predicated on a firm's ability, after 8 to 10 years, to identify a select few associates with the potential to become supremely talented, business generating partners. If there is one flaw in the model that stands out perhaps more than any other, it is here. True rainmakers are rare. And, even if a lawyer has the requisite formula of brilliance, ambition, luck, and timing, it takes years to build a significant reputation and, along the way, nurture lucrative client relationships. Law firms do the best they can in what is basically an exercise in predicting the future, but the fact is that a whole lot of people rise through partner ranks making a great deal of money, yet never generate much in the way of business, or do so only inconsistently.

<u>Rainmakers and the Lateral Market</u>

One way of understanding the active market for big-ticket laterals is sheer impatience with the existing model. Many firms are nervous about prospects for growth, or survival, and have decided that the path forward is to become global (if national), national (if regional), or a market killer (if a practice boutique). These aren't changes they can wait years to make. Growing rainmakers the old fashioned way takes too long.

The more active the lateral market, the more lawyers think about it. It is self-perpetuating and not likely to quiet down any time soon. But an overheated market has its costs. It adds a premium to what is likely already premium compensation for top producers. It can also broaden the pool of candidates firms are prepared to gamble on as "rainmakers." Mistakes are costly, and more common than firms like to admit.

The biggest news about the lateral market, though, is in its implications for the law firm business model. If a top producer walks out the door, and she is homegrown, the firm's long-term investment in her collapses. The ramifications go far beyond just her book. She is necessary proof that the model can work.

While firms do not expect every partner to develop a significant book of business, the assumption is that, over time, a sufficient number of partners will develop sufficient business to carry the cost of those who turn out to be less productive, or not productive at all. But the fact is that at any firm partner productivity is all over the map, and over the years many partners experience significant fluctuations in client activity. As a result, firms can rely heavily on the consistently sizable contributions of those at the top. When a rainmaker leaves, the challenge of covering the spread for underperforming partners grows disproportionately. More alarming, though, is that the business model on which the firm has been built looks suddenly and remarkably fragile.

A Rainmaker's Perspective

Many of us grew up accepting rainmakers as the culminating return on a firm's decades-long investment in professional and business development. But what if that perspective were turned on its head? Adopting a NewCo line of thinking, and identifying rainmakers as clearly valuable assets to carry over into a new business model, what would a firm look like that *started* with them?

First and foremost, the new firm would have the capacity to deliver world class legal services. With all due respect to the partnership, a rainmaker's primary relationships are with her clients, and service levels have to be secure. An ability to move rapidly in staffing big matters is essential. A rainmaker counts on having a deep bench of experienced lawyers across a wide range of practices at every level of seniority, along with professional paralegals and e-discovery staff. A full range of administrative services is assumed, as is a history of dealing with premium, price-sensitive third-party providers. She has to be confident when saying yes to a client, no matter how big or demanding the assignment.

Expect a close second to be her core team. Every rainmaker has a team of trusted, time-tested partners, counsel, and associates on whom she depends for quality legal counsel. They take care of much more besides: managing client relationships, tracking legal developments, drafting pitches and writing articles, and consistently making their lead partner look very, very good. They reach into the firm for additional resources as needed, and firms prioritize their staffing requests. At compensation time, they are recognized for their contributions, but are likely to follow their leader if she leaves.

Up to this point, the value perspectives of rainmakers and firms seem aligned. With respect to compensation more generally, however, they may well diverge. Rainmakers know their value has risen disproportionately to that of other partners. It is evident in the lateral market, in their contributions to firm revenue, and even in a single big litigation or transaction. Clients may be willing to pay a premium for top lawyers, and perhaps their core teams, but count on them pushing back on fees for the 20 or 30 *other* lawyers and paraprofessionals pulled in to work on a matter. Rainmakers face the same fee pressures as everyone else. It is rare these days for anyone to be handed a blank check.

As clients push back on fees and rainmakers command ever higher valuations, the pot of money at year end can be smaller for partners with modest books of business, or service partners, or young partners just starting out. The money has to come from somewhere, and scaling further back on administrative ranks and other overhead won't cover the spread. Fault lines in many partnerships are deepening.

It should surprise no one if a rainmaker resists capping her own compensation but sees reducing other partner compensation as inevitable. Traditional partnerships may have encouraged partners to see one another as peers, but as a cultural value that was a lot easier to maintain in an era of soaring revenue. Partner compensation has roots in a time when firms could afford to place a high value on the fact of partnership. Today, firms face tough choices about how to allocate revenue, and cultural values are increasingly contingent. More and more, compensation is about productivity. It is fair to assume that, based on personal experience, rainmakers understand this as well as, if not better than, anyone.

Re-approaching Partnership

To a first-year associate, the prospect of an 8 to 10 year partnership path has always seemed unnervingly long, even if a 65-year old managing partner looking back on a 40-year career might smile at the memory. But in terms of the time it takes most lawyers to build a reputation and develop a meaningful roster of clients, it is barely enough to get off the ground.

The up-or-out partner track has evolved rapidly in recent years, and career paths have proliferated. Equity partnership is still the brass ring, but today, if you are not invited to join equity ranks, you may be named to any number of non-equity partner (or counsel) roles. Regardless of the promotion, the need to make a decision after, say, ten years, has always been fiction. Once upon a time, it may have made some kind of sense. Today, an outsider looking at the compensation increases that can accompany promotion might well ask, *What's the hurry*?

Abandoning the 8 to 10 year track to equity partnership opens up possibilities for relieving some of the compensation pressure on firms. There are probably as many ways of going about this as there are firms. One approach would be automatic promotion to non-equity partner of *every* lawyer whom the firm considers potential equity material. The promotion would work to the benefit of the lawyer and firm both, starting with the fact of an enhanced commitment. For the lawyer, it opens up a more realistic path to practice development and building client relations and relieves artificial and unrealistic pressure to produce. For the firm, it reduces the risk of making equity partner decisions prematurely.

While the compensation scale for non-equity partners would be higher than that of associates, it could be well below that of equity partners. In compensating associates, firms are paying for their emerging legal skills and experience, rather than their capacity for business development. The same would hold true for non-equity partners, with compensation picking up right where associate salary scales leave off. More substantial increases could be reserved for later.

Promotion to equity partner might happen at any time, but the decision could be based on a demonstrated capacity to generate business. Non-equity partners with fledgling books of business, or whose business development was inconsistent, could be recognized and encouraged with incentive bonuses tied to production.

Many firms routinely depart from the traditional equity-partner track in individual cases. The advantage of tossing out the model entirely is that it releases firms from outdated value assumptions and allows them to tie partner compensation more directly, and more transparently, to production.

None of this, by the way, necessarily keeps a rainmaker from leaving a firm. It may or it may not. For that matter, you may not be the least bit persuaded by the foregoing analysis of rainmakers, the lateral market, and the traditional equity partner track. It doesn't matter. The purpose here, illustrative only, is to introduce the NewCo analysis as a strategic planning device. Whether you start with rainmakers, key energy clients, or your historic affiliation with a Japanese law firm, the point is to identify valuable assets at the core of your enterprise, and then extrapolate out from them into everything that you do.

– Herb Thomas