

Best Laid Schemes – Attorney Compensation Schemes

[SLIDE 1]

After 30 years as a partner of a firm that has grown from tens to hundreds of collaborators and from 5 to 50 partners, most of which time I have been a member of the Executive Committee and during 6 years was the managing partner, I cannot believe that I am standing here in an attempt to tell you the best way to split your firm's profits between your partners. And that is because, in spite of decades of sincere attempts, I am not in a position to say that we have perfected our own partner compensation scheme.

Perhaps I am in a better position to alert you to the signposts for success and for failure – which roads to choose and which roads not to choose. But only you will be able to recognise and bypass the obstacles on the way because those obstacles will almost certainly be specific to your own organisation.

Today since we are FICPI and therefore intellectual property attorneys or agents in private practice, I will limit myself to partner compensation systems for pure IP firms, as opposed to general legal practices that include IP departments. I believe that our profession is special and that our partnerships are in many ways different from those of general law firms.

[SLIDE 2]

A pure IP firm by its very nature is largely involved in patent and trademark prosecution. Our partners have different backgrounds interconnected by a profound knowledge of IP law. Thus we have trademark attorneys without any technological training and patent attorneys with mechanical, electrical, electronic, chemical, bio-tech, pharmaceutical and many other specialities – a truly eclectic group.

As specialities change, so do personalities. The rather Cartesian outlook and the expectations of a physicist may well be very different from a trademark lawyer or from a pharmacist.

Our work is also very international and in many firms it is important that we have partners capable of communication in several different languages.

In addition to this, many of our clients are no longer specialised in only one technological area. That means that they have to be handled by different partners or associates.

It is also common in our profession for a firm to centralise certain procedures, such as the filing of applications, recordals of changes of name or ownership, renewals etc. with a view to increased efficiency and consequent reduction of costs. In addition, we provide, as a firm, specialised services that include rigorous control of time limits and work flows.

All this means that any given partner is often neither the true owner of a client nor the person directly responsible for part of the services charged to that client.

Finally, in this vision, our services have a strong tendency to promote client continuity. Notwithstanding the present situation where we see especially large organisations chopping and changing their IP firms with a view to cost reduction, it is normal for a client to continue

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using the same firm over the years. Quite apart from personal relationships, IP portfolios have a certain historical continuity and it is advantageous for the client to know that there is a continuity of representation during the development of its technologies, industrial designs and trademarks.

Once more, we see that although many of our clients may have been obtained through the efforts of individual partners, they quickly become institutional clients.

My conclusion is that, when our profession is exercised in what I call **pure IP firms**, we need true partnerships, i.e. we can and must look at the whole before drilling down to our personal contributions.

Before I go on I would like to show a few very simple slides that are directed to the satisfaction or dissatisfaction of a partner with the money that he actually takes home.

[SLIDE 3] The first question is whether you were satisfied with the profits of the firm last year. If not, probably the major problem is managerial. Independently of that, however, one must ask if you were satisfied with the part that you actually received.

[SLIDE 4] Whether or not you were satisfied with your part and here I do not mean whether you would have liked to receive more (because everyone does), but rather whether you think your portion was a fair portion of the profits, do you think that you deserved a larger part?

[SLIDE 5] And what about your partners? Were they satisfied with their part? Possibly, if you were satisfied and they were not, it could be that you got more than you deserved!

[SLIDE 6] And if you were not all satisfied, can you identify one or more of your partners that failed to pull his or her weight?

[SLIDE 7] And most importantly, is your compensation scheme transparent enough for each partner to understand the reason he received what he did?

[SLIDE 8] This next slide shows a few possible answers to the questions raised in the five previous slides.

- The first column with the respective answers YES, NO, YES, NO, YES and YES indicates a happy firm that has no immediate problem regarding partner compensation. It indicates that each partner thinks his lot was fair, that each partner is pulling his weight and that the compensation scheme is transparent enough for everyone to understand why he received what he received.
- The next column indicates that the scheme is transparent but that the split was not considered fair by you, but fair by all the others. You think that you were prejudiced by someone who got more than he deserved.
- The third column also relates to a transparent scheme but that several partners were not satisfied because, like you, they think that somebody got too much.

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- The last two columns relate to schemes that are not fully transparent. In particular the fifth column shows that only you were satisfied, a clear indication that the others probably think you were favoured and that they do not know why.
- The last column shows that most partners were dissatisfied and that they do not know why the profits were divided the way they were.

One could continue with many combinations but it is possible to draw two conclusions. First that it is important to have a transparent scheme that everyone understands, second that the scheme must be considered fair and third that it is very difficult to have a scheme that satisfies all.

[SLIDE 9] Going back now to our Pure IP Firm, I repeat my conclusion that such type of organisation should and must comprise a true partnership in which all partners work together towards a common end before drilling down to their personal contributions. They must all feel “part of the business”. This indeed may well be one of the reasons that the older partner compensation schemes were based on the so-called “lock-step” system mentioned by Stephen where partners climb a percentage or points ladder based on seniority, possibly retreating a step or two as they approach retirement. This type of system has three important advantages:

- a) It is extremely simple to apply;
- b) It is absolutely transparent and each partner knows why he got what he got.
- c) It divides the overall profits of the partnership - as opposed to profits from individualised areas or partner groups – and thus avoids conflicts between the so-called finders, minders and grinders.

To work well, this type of system depends on a cohesive group of partners that work together for the public good.

To maintain the unity of the partnership, to make each partner feel part of the business, at least a part of the overall profits of the firm should be divided in a clear and transparent manner without taking into consideration better or worse results in one or other cost centre. At the same time, it is natural for a partner in a high profit area to expect more than a partner in a low profit area. This is a difficult question because both areas may be essential for the conduction of the firm’s business and the quality and effort required by partners in each area may be identical, the difference in the profit margins merely reflecting the market as opposed to the professional contribution of the partner or the internal management of the firm.

A firm of professionals needs to be managed and it is often true that the role of manager falls to a partner, sometimes based on seniority, other times on a rotary system. A partner who is a good manager has enormous value to a partnership and all partners should recognise this. The managing partner must not only have an understanding of market conditions but also the ability to transmit that understanding to other partners so that they can appreciate the contribution of each of them to a common cause.

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In brief, a partnership is a team and the compensation scheme should take into account the individual contributions of the partners in accordance with their individual merits. After all, each partner was invited into the partnership because of his personal merits and it would not be fair to prejudice him in a compensation scheme for failure to have characteristics that are foreign to him. The partnership must be a team.

Times, however, have changed. Apart from the obvious disadvantage that the lock-step system does not take into account this or that partner that does not pull his weight, allowing the others to provide for him, younger members of the profession have expectations that are very different from their predecessors. They were brought up on computers, are used to see radical and rapid changes and are not patient enough to wait years to become a partner and then further years to work up the lock-step ladder. They are more egocentric and less likely to be faithful to the firm – they are quite prepared to pack their bags and move somewhere else where their needs are met quicker. To be quite honest, if I come from a generation in which investment in the continuity of a career was considered a virtue, I cannot altogether blame the young if they see virtue as getting results sooner rather than later.

[SLIDE 10] So we see some items to consider that may well bring conflicts into the partnership when planning a compensation scheme:

- The rule should be transparent and simple
- Unity of the partnership should be promoted
- Experience should be recognised
- There should be incentive for each partner to contribute
- New blood should be rewarded
- New lifestyles
- What to do with more and less lucrative cost centres

[SLIDE 11] One of the characteristics with some known schemes is that the rules are complicated. At first glance they might seem quite clear but, in practice, take into account so many variables that are not easily measured and what is supposed to be largely objective ends up being largely subjective.

The compensation due to partners with experience and that due to new blood is another question that brings conflict. The more experienced partners have a maturity that the young do not yet have and, moreover, are certainly responsible for the situation of the firm as a whole – the institutional value of the firm. The young blood, on the other hand, may bring in new ideas, work harder and conquer new clients. A delicate balance must be found between the two.

On the other hand, the compensation scheme should include strong incentives to benefit financially those partners that really do contribute more than others. Such contributions may be based on many different fronts, such as billing revenue, client procurement, development of new areas of business, reorganisation and so on. There should be an opportunity for all partners to make special contributions in accordance with their specific qualities.

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In the present time and age, lifestyle has become an aspect that professionals are taking more into consideration. Thus, the scheme should permit reduced earnings for those that want to spend more time away from the office.

Finally, assuming that you already have a scheme in operation, any alteration to make it more modern and take into account partner qualities and/or contributions previously not taken adequately into account will be considered unjust by those benefitted by the present scheme and just by those who up to now have considered themselves penalised. It will certainly create new tensions among the partners.

The best time to make changes is when the profits are good. When profits are high, everybody is more or less satisfied and those who are taking home a larger percentage than perhaps they deserve will look at the monetary value of any percentage reduction with less critical eyes. Even those who consider that they do not receive a sufficiently high percentage will be more prepared to negotiate on an amicable basis.

Unless, therefore, your firm is on a serious downtrend – in which case other managerial decisions will probably be necessary – a good rule is to wait until profits are rising again before trying to write new rules governing partner compensation.

[SLIDE 12] Choosing a reward system:

The choice of a reward system for partners is not a lottery in which one simply picks out one of the seven known systems mentioned by Stephen:

- The present cultural values of your firm or any changes you might wish to make in those values should be a key point in the choice. To take an extreme example, if the firm presently has a lock-step system and the choice of the new reward system is eat-what-you-kill, you can expect both accentuated dissatisfaction from most quarters and, in a short period of time, a drastic change in cultural values of the firm. On the other hand, if the intention is to guarantee the present cultural values of the firm and the reason for changing the system is to recognise the high flyers and give incentive for partners to contribute more, the new scheme will have to take into account a number of variables, almost certainly billing and preferably representation, management and training which also require man hours.
- Size of the partnership may also affect the choice. In a very small partnership, it is relatively easy to have an equal partnership scheme. However, if the firm is new and the partners are ambitious, one can expect growth and with entry of new partners of differing value and merit. In that case, an equal partnership scheme would quickly become unsatisfactory and the partners should decide to introduce variables, such as a scale based on seniority, financial contribution and so on.
- For larger firms, individual partners may well head teams. In such a case, the scheme might have to take into account the financial contribution of the team. However, in many firms and as a result of technical specialities, members of one partner's team may well also be members of teams of other partners. In such situations, it might be better to have a scheme in which a

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partner heading a team is recognised in a more subjective manner or by a given factor dependent on the size of his team or even in appropriated time spent in managing and/or training the team.

- For true “boutique” firms where the emphasis is on client fidelity and quality of service in specialised areas, the reward scheme may take into account client satisfaction and financial results of the individual partner because that type of firm must “mind” and “grind” conscientiously if it is to maintain an acceptable profit level.

- For firms that are market aggressive and thus concentrate on client procurement and cost effectiveness for the client, profits depend on procurement, working systems – that is to say, management – and billed time, all three being of extreme importance. In that type of organisation, there is no room for partners that do not contribute fully.

- Many firms have a two-tiered partnership system. For arguments sake we can call them equity partners and associate partners. A decision must be taken as to whether the same rewards system should apply to both. Probably the simplest solution is for the system apply to the equity partners with the associate partners having a fixed value bases to which bonuses are added using similar criteria to those used for the equity partners.

- Most IP firms use hybrid billing systems that charge fixed fees for some services and time based fees for others. This obviously introduces a factor of complication if the firm would like to reward its partners on amount billed based only on time. On the other hand, the market is changing and we are seeing more and more clients shying away from time charges and looking for flat fees. And sometimes, due to client requirements, a flat fee is applied to a complete process over time and not to a single service. For example, a single fee for the examination stage of a patent application, independently of the number of office actions. This means that some cases might represent a financial loss whereas others might represent a considerable gain. In that case, some form of compensation for these variations should be built into the rewards scheme.

My suggestion: Since it is almost impossible to talk about compensation schemes without giving one’s own opinion. However insecure it might be, I will finish with my recommendation to be found on the next slide - **[SLIDE 13]**.

Behind that question mark, however, I do have a cautious opinion:

1. Check your present system really does call for change. If so, study the possibility of adapting it to satisfy demands from certain partners without creating too much resistance from the others.
2. Any alteration in an existing system must take into account the present starting point - for example the percentages of participation that the existing system uses.
3. Independently of any basic change to be made, ensure that the system is transparent to all partners so that, be they in total agreement or not, the rules are clear and the only true surprise at the end of the year resides in the firm’s profit and not in the manner it has been split between

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the partners.

4. The system should include a major share based on the overall profits of the firm so that all feel rewarded by the results of the partnership team.

5. A first minor, but substantial, share should depend on objective criteria based on least one of: (a) the financial results of the cost centre or cost centres in which the individual partner participates; and (b) the amount billed by the partner;

6. A second minor, but substantial, share should depend on criteria that are part objective/part subjective, including: (a) procurement; (b) institutional representation; (c) training; and (d) management.

Thank you for listening and I can only apologise for my total inability to provide you with an infallible formula.