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How Firm Compensation Can Drive Bad Behavior

By Melissa M. Lessell

Law firms use many different types of methods and systems to compensate partners and employees. Certain compensation systems have the unintended side-effect of encouraging behavior detrimental to the firm, such as dabbling, hoarding or overbilling. These behaviors may lead to malpractice claims.

Even if the compensation plan used by a law firm is not the cause of a malpractice claim, it will be used as fodder for a creative plaintiffs' attorney in developing themes of greed, incompetence and puffery while pursuing a legal malpractice claim, according to panelists who spoke at a program on this topic presented during the Fall 2014 ABA National Legal Malpractice Conference.

George Kryder, a partner in the Dallas office of Vinson & Elkins, moderated the discussion. He was joined by panelists Jim Rosen of Rosen & Saba LLP, Beverly Hills, Cal.; Bradley Keller of Byrnes Keller Cromwell LLP, Seattle; and Jeffrey Kraus, loss prevention counsel for ALAS Inc. in Chicago. Rosen's experience lies heavily in the prosecution of legal malpractice claims, as compared to Keller, who was described as the ''go-to trial lawyer in the Pacific Northwest.''

At the outset, Rosen said he looks for themes to exploit in a legal malpractice trial; he declared that ''greed is overwhelmingly the most available theme a plaintiffs' lawyer has.''

Rosen emphasized how savvy plaintiffs' attorneys effectively convey a theme of greed by dissecting a law firm's bills, which may show comparatively massive hourly fees, overlapping billers, recognition of conflicts, avoidance, underestimated budgets, anticipatory tasks, over-litigation and over-complication of matters.

Compensation Models

According to the speakers, there are four primary types of compensation models a law firm may use, although many variations exist. A good compensation system will mesh with the values of the firm rewarding valued behavior, such as mentoring, sharing and business generation. The four primary types of compensation models are:

- **Divide the Pie:** In a ''divide the pie'' compensation system, partners agree upon the respective percentage of profits they will receive. This type of system is more common in smaller firms and is considered to be effective in minimizing risky behavior motivated by compensation.

- **Lockstep:** In a lockstep compensation system, attorneys in the firm are paid based on their seniority. Thus, law school graduates of any given year will receive the same base salary, annual raises, bonuses and promotions, regardless of merit. Alternatively, some firms use the lockstep compensation system only at the partnership level. Although the lockstep system has been criticized for failing to motivate lawyers to perform at a higher level, it has its distinct advantages. One is that it does not incentivize risky behavior, such as overbilling or client hoarding, since compensation does not depend on it.

- **Closed Compensation Systems:** In a closed compensation system, the individual compensation of an attorney is decided by a single individual or a management committee. The attorneys do not know what their peers earn. A closed compensation system promotes feelings of loyalty and friendship among the attorneys, as no one has hurt feelings over their rate of compensation as compared to others. Closed compensation systems (which Kraus said he favors), as compared to open, are generally preferred from a risk management standpoint.

- **Open Compensation Systems:** There are many variations on an open compensation system, which, as the name denotes, is one in which the other attorneys know what their peers are making. Although often touted for allegedly reducing employee turnover, certain variations may motivate undesired behaviors such as hoarding and overbilling. Models of open compensation systems include: (1) merit based systems, which use a combination of subjective and objective factors to determine the rate of compensation; (2) origination formulas, in which the compensation amount is based on who brought the client in and who performed the work for the client, which encourages partners to send the matter to the partner with experience in the practice

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area to work; and (3) the ''Eat What You Kill'' model, in which attorneys are compensated based on what they bring into the law firm and work.

The panelists agreed that the Eat What You Kill method is the most troubling from both a risk management and theme development standpoint. They cited a 2012 Gallup poll indicating that lawyers were considered to be the second-to-last ethical and honest profession. The Eat What You Kill compensation plan makes it easy for a plaintiffs' attorney to incorporate the theme of greed as a motivating factor when developing a legal malpractice case.

'Eat What You Kill' Promotes Bad Behaviors

The speakers said the Eat What You Kill compensation system unfortunately has the impact of essentially incentivizing lawyers to hoard work, overbill, dabble, puff up their own expertise and turn a blind eye to the rest of the firm. These behaviors can easily lead to a malpractice claim, if left unchecked.

Hoarding Work

An Eat What You Kill compensation plan motivates lawyers to act as a ''lone wolf,'' hoarding their own work. This is because the attorney will be compensated at a higher rate if he or she alone works on that particular client's files and keeps the client to himself or herself.

According to Rosen, the hoarding problem happens when the compensation system rewards the generator of the business. This can also cause interior conflicts since partners zealously guard their work and their clients.

As a practical matter, because the lawyer is hoarding all of the work, the other attorneys in the firm do not have any idea of what that lone wolf is doing and no one from the firm is monitoring the quality of work.

As a result, the firm is usually surprised when a malpractice claim arises and the opportunity for curative action or mitigation is lost. Kraus suggested having a second, uninvolved individual monitor the lawyers in each practice group to maintain internal controls.

Overbilling

Another problem that plaintiffs' counsel in a legal malpractice action may exploit is overbilling by attorneys to increase their compensation or to meet firm targets. Overbilling leads to unpaid invoices and collection efforts by the firm, which often are met with a counterclaim for legal malpractice.

Keller said as a defense attorney he finds it ''very problematic'' when a law firm client chronically and systematically overbills.

Rosen said he views the entries on law firm invoices as the ''keys to the castle,'' and touts them as an essential part of developing a legal malpractice claim. Rosen said he often uses time entries for impeachment purposes, compares what work the lawyer told the client was performed versus what was billed and finds that they are often a terrible piece of evidence from the defense perspective.

Keller said he counsels his clients to admit during their deposition instances where they may have overbilled if it occurs on a limited basis. However, if the overbilling is systematic, Keller tries to shift the focus away from the overbilling and greed themes and chooses to focus on the judgment calls made by the attorney.

All of the panelists stressed that attorneys should take more care when preparing their invoices since an invoice is the one type of document it is certain the client will review. As one panelist put it, if it doesn't pass the ''straight face'' test, the invoice should not be sent to the client. Attorneys can use their bills to build good will with a client by performing tasks that should be done anyway, such as reviewing bills or reviewing conflicts, and marking those entries as ''no charge.''

Dabbling

Plaintiffs' attorney Rosen said he loves it when attorneys dabble out of their subject matter because his case theme turns from simple greed to ''greed plus.''

''Greed plus,'' he explained, is when he can pair his standard theme of the law firm's greed with another, such as incompetence. Eat What You Kill compensation systems incentivize dabbling inasmuch as the firm has established a culture in which an attorney loses income by referring work to a colleague specializing in the subject matter of the engagement.

However, Kraus said he believes firms have made significant progress in reducing the instances of dabbling. Decisions as to client intake and work assignments should be the firm's decision—not that of the originating attorney. This methodology allows an unbiased member of the firm to properly staff the case. Additionally, Keller suggested pairing the lawyer who brought in the work with another attorney who has the appropriate subject matter skill set.

Puffery

A true claim situation discussed by the panel involved a legal malpractice case in which a lawyer was confronted with the self-evaluation she had completed for her law firm. In the evaluation form, the lawyer claimed she knew as much about the client's business as the client did. This directly conflicted with her prior deposition testimony in which she claimed that she relied on and deferred to her client in connection with a structured finance transaction which formed the basis of the malpractice claim.

The lawyer's overstatement of her abilities, even in an internal firm document, hurt the defense to the malpractice claim. As a practical matter, Keller recommended defending such a claim by demonstrating, if possible, that the lawyer worked hard to learn her client's business but was not able to learn what her client had been deliberately hiding from her.

Rosen cautioned that plaintiffs' attorneys can now access almost everything via the Internet. In fact, he said he relies on one of his assistants to search for background on each new defendant. As a result, Rosen advised that it is important to monitor information about every attorney and make sure it is presented in a way that is both truthful and palatable.

Kraus stated that law firm evaluation forms, or ''puff sheets'' as they are known colloquially, are one of his biggest pet peeves. He believes evaluations can be done face to face, which would avoid such problems. He said it is essential from a risk management standpoint to ensure that no overstatements are made by attorneys, in puff sheets, promotional materials or in any other forum.

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Lateral Hires Needing to Prove Worth

The panel also addressed problems that arise when lateral hires, eager to integrate themselves into the firm culture and prove their worth, attempt to handle matters they may not be qualified to handle. Indiscriminate client selection is also an issue in an attempt to build a lateral's book of business.

In addition, the speakers noted that blindness to client conflict seemed to happen more frequently with laterals. Kraus cautioned that laterals should be hired with care and that the firm should make a point to integrate them.

Conclusion

In light of these problems, the panel agreed that it is important to adopt a compensation system that rewards sharing so that the work goes to the people who are the most competent. They said a good compensation system should also promote firm values, such as mentoring, sharing and business generation. Although a good compensation system won't necessary eliminate all bad behavior, it will help reduce it and compensate those who are in charge of monitoring it.