Mr. David Sgayias QC
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February 10, 2000

COMMENTARY ON: "INCOMES OF CANADIAN LAWYERS" BASED ON REVENUE CANADA INCOME TAX DATA

Dear Mr. Sgayias,

Below is the assessment provided by Hay Management Consultants in response to your request to review and comment on the report entitled "Incomes of Canadian Lawyers Based on Revenue Canada Tax Data" provided by the Canadian Judges Conference and the Canadian Judicial Council to the Judicial Compensation and Benefits Commission.

As you know, Hay Management Consultants is a firm engaged in Human Resources Management Consulting and provides expert services in the field of compensation strategy and practice. A brief summary of Hay's credentials is attached, along with curriculum vitae for myself and my colleague Martin Harts.

We understand that this report has been filed with the Commission in order to support arguments for an improvement in the compensation arrangements of federally appointed judges. Specifically, to illustrate the financial dimensions of the choice faced by potential candidates when considering the possibility of appointment to the Bench.

The following comments relate to the data, analysis and conclusions tabled. Unless otherwise stated, all data referenced is drawn directly from the report.

The scope of the data employed can have a significant impact on the utility of any comparison. In this study it is claimed that the data is "highly representative and reliable", and that "there can be no issue as to the reliability of the [Revenue Canada] data". The data provided is drawn from Revenue Canada and Statistics Canada. The data is assumed to be accurate.

The claim of "highly representative and reliable" does not stand up to analysis on the basis that the data used represents only 25% of the pool from which judges are selected. This observation is arrived at by considering the components of the candidate pool that are excluded from the analysis. In particular, three exclusions are utilized as follows:

- 69% of appointees come from private practice (appendix 10 of the Government submission), hence 31% do not;
- 69% of appointees are in the age range 44 to 56, hence 31% are not; and,
- 52% of self-employed lawyers earn more than $50,000 per year*; hence 48% do not.

  * The 52% is calculated from tables 1B and 3B of the report which identify 16,290 self-employed lawyers in Canada earning $50,000 or more in net income out of a total of 31,270.

When these three exclusions are compounded, we are left with 52% of 69% of 69% = 24.8%. This cannot be held to be "highly representative and reliable", particularly when each of these exclusions tends to bias the data in the same (upwards) direction. These exclusions are discussed below.

Additional analysis is provided in terms of an even narrower comparator group, based on urban centres. The discussion below relates to the national picture as it is not felt a further exclusion of up to 50% would enhance the reliability of the conclusions, and because the main conclusions offered in the report relate to the national picture.

The data provided is for lawyers in private practice.

While private practice furnishes the majority of appointments to the Bench, this is by no means the exclusive source. As candidates are drawn from multiple sources (e.g. public sector, academia), the appropriate comparison would be to a weighted average of the feeder groups. The report makes no attempt to balance the various sources, rather it proceeds as if all appointments are from private practice.

The data provided indicates a focus on a particular age range, that being 44 to 56 years.

This range represents the average age of judicial appointments plus or minus one standard deviation. This identifies an age range of 12 years for consideration. In fact, the actual range of ages covered is almost 31 years, from 36.1 to 67.0 (last page behind tab 2).

The statistical methodology of focusing on the central zone of a data range is common practice and recognized as sound methodology when wishing to identify normal / typical practice. Given the data provided on age of judicial appointments it may be reasonable to focus on this range and to exclude both the top and bottom "tails" of the age distribution.

However, a case could also be made to use a weighted average of the three identified age groups. This statistically more rigourous approach would tend to lower earnings figures as the average income of self employed lawyers is lower in both the <43 and > 57 age ranges.

The data provided is for self-employed lawyers, and excludes data from lawyers who are employees.

It is suggested that approximately 56%* of lawyers are self-employed, therefore the data is "highly representative and reliable" – notwithstanding the fact that it excludes 44% of lawyers (who are employees of either the private sector or the public sector). In the absence of data for the missing 44%, it is not possible to support such a conclusion. Indeed, if it can reasonably be assumed that partners (who are self employed) are likely to earn more than their employees, then there is a common sense expectation that this exclusion will have an upward bias on the data. To some extent, it may be that this bias is mitigated by utilizing a restricted age range for comparative purposes. However, there is no data available to assess this impact.

*Based on 31,270 self employed lawyers out of an estimated total of 56,000.

The data provided excludes those earning less than $50,000

This excludes almost half of all self-employed lawyers. Specifically, 16,290 (Table 3B) out of the 31,270 self-employed lawyers (i.e. 52%) earn $50,000 or more. The rationale offered is that any lawyer earning (net earnings) less than $50,000 must be only working part-time, and that this is reason to exclude them from the comparison. This is clearly inappropriate for four reasons.

1. Some lawyers may have made a life-style decision to moderate their work commitments and to accept lower income. Similar work:life balance motivation may be part of the attraction to joining the judiciary, making this a likely source of candidates for judicial appointments. (For example, a lawyer in their mid 40s who is bringing up a young family). There is no basis to suggest that such individuals would not be appropriate candidates for appointment to the Bench.

2. There will be many lawyers whose income falls below $50,000 because they are not successful at billing 665 hours per year at an average of $150 per hour, rather than because they have excluded themselves from the marketplace. The reason for utilizing a rate of $150 / hour is not explained, it is simply stated that this is "an extremely low assumption". However, 665 hours represents a billable utilization of 36%, which is not uncommon in professional service firms.

3. The statistical practice (discussed above) of eliminating both "tails" of a distribution in order to provide representative data appears to have been overlooked. In this case, a very large tail is excluded from the bottom of the distribution while no attempt is made to remove data from the top tail. Good statistical practice suggests that representative data would exclude extremes of the data at both ends to provide best results. This adjustment would make a significant difference to the conclusions drawn. For example, the analysis indicates that the average salary of the top 1/3rd (i.e. top four twelfths) of self-employed lawyers in the age range 44 to 56 and earning more than $50,000 exceeds $340,000. However, if we exclude the highest twelfth, and look only at the 9th, 10th and 11th twelfths (Table 7B), then the average drops to $264,607.

4. This selective exclusion might be reasonable if there were evidence to suggest that a preponderance of outstanding candidates are drawn from the very highest earners amongst the legal population. However, there is no data to support such an assertion, nor is there any evidence to suggest a correlation between earnings and the competencies required to be an effective judge. Indeed, it could be the case that the highest earners amongst the legal profession tend to be corporate dealmakers rather than litigators, and that their experience may not be the most appropriate for candidates to the judiciary.

Comparison Point

Beyond the issue of the scope of who to include / exclude from the comparator group is selecting the appropriate point of comparison. The report recognizes that it would not be appropriate to use the absolute highest earners in the group as the point of comparison and arbitrarily selects the average (mean) of the top third. No justification is provided as to why this comparison point is selected. Why not simply the overall "average"? Why not the average of the top quarter? Why not the 50th percentile, or the 75th?

There is no theoretically "correct" comparison point to use. Compensation professionals would recommend that an organization should identify an appropriate comparator group (or groups), and then identify a point of comparison that allows the organization to achieve its goals. Once this has been established, then the relative position of the organization to the comparator group can be tracked over

time, and this can serve as one input to the decision making process. No fiscally responsible organization would select a comparison point and implement compensation decisions with respect to this comparison without first establishing whether this is the level necessary to achieve the business goals.

The key issue is whether the compensation practice is adequate to achieve the goals of the organization – namely to attract and retain outstanding talent. There is no evidence to suggest that problems currently exist with respect to recruitment and retention. To drive compensation based on an arbitrary market comparisons would be a clear case of "the tail wagging the dog"! The pun is deliberate.

While there is no theoretically "correct" comparison point, there exist statistical best practice that would indicate that "the average of the top third", as calculated, is clearly not appropriate. The analytical approach taken to this study is based on distribution of earnings and position in range. In selecting the top third, the relevant range is stated to be that spanning the 67th percentile to the 100th percentile. The median of this range is the 83rd percentile. Setting aside all of the objections as to the scope of the comparator group, or the selection of the top third, the 83rd percentile would be somewhere in between $183,254 and $257,904 and probably nearer the lower figure (Table 5B) – i.e. not "in excess of $340,000".

The compensation profession recognizes the use of the "median" as the appropriate measure of central tendency rather than "mean", specifically because the mean is subject to inappropriate influence by extreme values that do not indicate the normal / typical practice for the comparator group. In the private sector an aggressive tie in to comparable market data for executives would be the 75th percentile.

Total Remuneration

Above and beyond the selection of the comparator group and the appropriate point of comparison, there is a question of whether we are comparing apples with apples. There are various benefits and perquisites associated with being a self-employed lawyer and with being a judge. Any substantive difference between the value of these should be considered along side the cash component of compensation. The fact that one group tends to allocate more of the total value of compensation to cash earnings rather than non cash benefits than does the other group requires that a broader compensation perspective be taken. The current study makes no attempt to take this into consideration.

The single most significant component of the non-cash compensation package for judges is the annuity. If it is the case that (self-employed) candidates for the judiciary will typically not have already made provision for their retirement, then consideration should be given to the cost that they would incur in funding their

retirement were they to remain in private practice and not benefit from the annuity provision.

By way of illustration, a 50 year old individual commencing to fund a retirement income of $120,000 per year (in constant money terms), planning to retire at age 65 and expecting to live to the age of 80, would need to invest approximately $57,500 per year (assuming a 5% real rate of return on investment). Even allowing for maximum RRSP contribution room, this would require over $90,000 per year in pre tax net income to achieve. While this is only an illustration, it is important to appreciate that a simple comparison of judicial salaries to self-employed net income can lead to inappropriate conclusions.

Conclusion

Leaving aside the issue of the appropriateness of utilizing a private sector comparison to inform decisions regarding judicial compensation, we recommend that great care be exercised in employing the data, analysis and particularly the conclusions offered in this report.

In the absence of any data for the population from which 31% of appointments are made (i.e. only considering private practitioners), and using only the Revenue Canada data supplied, we conclude that current salaries position the judiciary favorably relative to their private sector colleagues. Specifically, we suggest that a very favorable position would be to match or exceed the median of the top third of all self-employed lawyers in Canada aged 44 to 56, reducing this figure by a very conservative estimate of the cost of funding their retirement.

This 83rd percentile value is between $183,254 (the average of the 10th tile) and $257,904 (the average of the 11th tile). If we assume that only $50,000 / year (in pre-tax earnings) is required to fund retirement, then we can confidently conclude that accepting an appointment to the Bench will be financially advantageous for at least 5 out of 6 of self-employed practitioners in the age range 44 – 56, when compared to remaining in private practice, based on the current level of judicial salaries.

Yours truly,

Philip Johnson