



Breaking The Circle - the real significance of Freshfields pay bonanza is far more profound than just another Big Law salary arms race.

Written by

[Scott Gibson](#)

Director at Edwards Gibson

May 14, 2024

A couple of weeks back, the UK Magic Circle law firm Freshfields dramatically hiked the base compensation for its newly qualified lawyers (NQs) in London by 20%; from £125,000 to £150,000. Historically, when a Magic Circle firm has shifted compensation, it has always (eventually, and however reluctantly) evoked an approximately equal response from its peers – indeed, that £125,000 became the standard NQ rate for all five Magic Circle firms is due entirely to the rest of the coterie being forced to match Freshfields following its similarly dramatic hike back in 2022.

Will somebody think of the poor partners?

Doubtless, in view of the relatively soft market for legal services in the UK, not to mention weak demand by law firms for external NQs, Freshfields' move will be viewed with disquiet, even dread, by its peers which will have to consider how to respond. To not do so risks falling behind – not so much in the talent war for newly qualified lawyers (right now I'm told hapless NQs are lying around in fields) - but in the oh-so important battle for prestige. Unfortunately, for UK law firm partners, any meaningful response - which of course will also have to involve increasing compensation for associates above NQ (albeit likely to a lesser extent) - will be expensive and have a direct impact on their own compensation. This is particularly so because, in contrast to most previous law firm salary wars, this time there appears no prospect of a corresponding economic boom to generate windfall revenues to defray these sharply increased costs.

Market distortion and the squeezed middle – not very Milton Friedman

In the UK the NQ rate is totemic; for law students and associates alike, it is often a proxy for the objective quality of a given firm. As such UK law firms, often with profitability orders of magnitude below that of the Magic Circle, have pushed to increase their NQ rates as close to the Magic Circle's as possible and, whilst this differential is nowhere near as narrow as it was pre-financial crisis, the gravitational pull is real. Never mind that, on a purely supply and demand basis, this makes absolutely no sense - the most in-demand lawyers in any Big Law firm are always associates with 2-6 years post-qualification experience (PQE), yet because law firms need to keep an artificially high "NQ rate", this is often to the detriment of compensation for more senior (and more valuable) mid-level associates. Indeed, since the breakdown of UK law firm associate lockstep more than a decade ago, associate compensation has become so concertinaed that the differential between an NQ and, say, a 7PQE has shrunk from 2.2: 1 to maybe 1.5: 1 on a good day.

The point is that, almost regardless of the underlying economics, if Freshfields' UK headquartered peer, and near peer, rivals do react in line with historical norms, inevitably there will be pressure on the less profitable mid-tier to respond, which recent history tells us they will do by disproportionately hiking their totemic NQ rate. This will further narrow the compensation differential between their NQs and senior associates and, in effect, artificially subsidise an NQ rate in a market where there is no demand for external NQs. Whilst not very Milton Friedman, this further distortion of the market will doubtless be great news for NQ's – at least in the short term!

"Where will it end?" ...

The Freshfields move has elicited some predictable commentary. The assumption seems to be that the rest of the Magic Circle will (eventually) have to match Freshfields, and that US law firms, which traditionally pay a significant premium on Magic Circle compensation (often equating to c.20% [for "Mid-Atlantic Rates"], up to a little over 40% [for full "New York Rates"]), will in turn have to elevate their own compensation to maintain the pay differential over their UK rivals.

This is a reasonable assumption, and completely in line with every other pay war the London market has seen since the late 1990's. Indeed, last week elite US disputes boutique Quinn Emmanuel did exactly that, hiking its NQ rate from a comparatively parsimonious £152,000 to £180,000 (just under 20%). Moreover, Quinn, which like most elite US firms, maintains a defined associate lockstep, appears to have elevated associate compensation at all levels by at least as much.

Whilst it is probable that some Mid-Atlantic-Rate-paying US firms will react to Freshfields' move (especially if other UK firms follow), the suggestion by some commentators – including one quoted in the national press last week - that the US elite will seek to maintain "at least a 40% difference" with their UK rivals is simply incorrect. This is because, if US firms already paying full New York Rates were to add 40% onto Freshfields' new NQ rate of £150,000 (a little under US\$189,000 at today's exchange rate), their NQ compensation would be £210,000 (c. US\$262,000) which is more than a fifth up on "The Cravath Scale" which is the benchmark for elite US firms in New York (currently \$225,000 [c.£180,000] for NQs – or as Americans call them "First Years").

Any suggestion that changes in the London market will have any more than a peripheral influence on the New York-calibrated Cravath Scale is fanciful. The most US firms can move to in London is the Cravath Scale, which is currently 20% up on Freshfields' new NQ rate – i.e. c.£180,000 (coincidentally the exact amount Quinn Emmanuel has shifted its NQ compensation to). Anything more than this will only happen if US firms raise compensation in their home market. Admittedly, there is some wiggle room for US law firms in London (up-or-down) depending on how the exchange rate is fixed.

Pay at a UK firm is now closer to New York Rates than at any time in history

From a compensation perspective, the importance of Freshfields' move is not that it may have renewed a salary arms race in the London market, but that a UK headquartered law firm is paying its English qualified London associates proportionally more, by far, than at any time in history when measured against full New York Rates. Probably the only other time the gap came anything near as close to this was in 2006 when the (then) market trend setter Allen & Overy was paying NQs £63,300 vs First Year Full New York Rates of \$145,000 which, because of an incredibly weak US\$ (at one point trading at 1.87 to GBP vs 1.25 today) theoretically narrowed the gap to a little over 22% (although in practice artificially favourable fixed exchange rates at most US firms kept the differential to at least 30%) .

Breaking the circle - the *true* significance of Freshfields salary hike

In effect Freshfields is now paying (high) Mid-Atlantic Rates in London. This is likely a very deliberate statement to the market. For some time Freshfields has been actively eschewing the term “Magic Circle”, seeing it as too British, and preferring instead the moniker “global elite”. Although not the most profitable UK Big Law firm (Slaughter and May and Macfarlanes outcompete it on that metric), it has been the most successful in the most important market of all - the US - where, through strategic and successful lateral hires, it has become a genuine contender.

Viewed in this context, Freshfields latest salary offensive in a tepid market may, in part at least, be an additional tool to help distance itself in its home market from its erstwhile peers. Of course, if so, this will only work if the UK elite do not follow, or at least take their time to do so. On the last occasion Freshfields hiked associate compensation there was a marked reluctance from most of the Magic Circle to follow- indeed only Clifford Chance reacted with the usual knee jerk speed leaving Allen & Overy and Linklaters to trail by a year, and Slaughter and May even longer. For this reason, there is no absolute certainty that they will all follow this time, at least not as quickly nor as fully. If so, that will be good news for the UK mid-tier.

Risk vs Reward

For in demand associates, salary wars always seem such fun! Never mind that they don't always end so well when markets cool. For law firm management, adding £millions onto their fixed costs is a risk. There is a reason associate compensation is lower in London than New York – it's not that US associates are any smarter or harder working than their UK cousins, or that their firms are better managed (though they may of course be all these things!), it is simply that US clients accept higher fees. Hence, even relatively middling US players are able to pay their New York associates on the Cravath Scale and remain solvent. The US aside, Magic Circle firms tend to be more global than most of their US competitors and, whilst they work on truly premium matters, they work in many jurisdictions where the recovery rates are much lower than London. Doubtless Freshfields have

factored this in and, to be fair, the growth of its (presumably very profitable) US business has been coming along nicely. Moreover, an associate compensation hike may of course do exactly what it says on the tin and help inoculate it against talent raids by rapacious US rivals in London.

That being said, a sharp hike in compensation for hundreds of lawyers in London at a time when both the legal services market, and the associate recruitment market, is anything but peachy, will have an impact on Freshfields' bottom line. This is not without risk; Freshfields needs to keep its financials as sexy as possible in order to attract and retain all those expensive Stateside laterals - not to mention hang on to its existing high performing partners in London and elsewhere.

© *Edwards Gibson*