

Appendix 8

Letter from Morneau Sobeco



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March 25, 2004

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JUGCAN-0010

Judicial Compensation and
Benefits Commission
99 Metcalfe Street, Suite 812
Ottawa ON K1A 1E3

Attn: Mrs. Jeanne N. Ruest, Executive Director

Re: **Review of Submissions on the Earnings of Lawyers in Private Practice**

Dear Members of the Commission:

We have reviewed the following documents:

- The January 2004 Report on the Earnings of Self-Employed Lawyers prepared by Western Compensation and Benefits Consultants (WCBC) on behalf of the Department of Justice Canada for the 2003 Judicial Compensation and Benefits Commission.
- The January 30, 2004 Report on The Incomes of Canadian Lawyers Based on Income Tax Data prepared by Sack Goldblatt Mitchell (SGM) on behalf of the Canadian Superior Courts Judges Association and the Canadian Judicial Council with Report Exhibit Book, Volumes I, II and III.
- The February 27, 2004 Reply submission of the Government of Canada accompanied by the February 27, 2004 letter from Mr. Haripaul Pannu of Western Compensation and Benefits Consultants.
- The February 27, 2004 Submissions of the Canadian Superior Courts Judges Association and the Canadian Judicial Council in reply to the Government of Canada's submissions and the report on income trends in the private sector.
- The February 27, 2004 Reply to the report of the Western Compensation and Benefits Consultants prepared by Mr. Michael Mitchell of Sack Goldblatt Mitchell with Appendices containing tables of 2001 data prepared by CRA.

Judicial Compensation and Benefits Commission
March 25, 2004

A key difference between the two January 2004 reports prepared by SGM and WCBC is the database used for the underlying analysis as SGM used data for taxation year 2000, while WCBC used data for taxation year 2001. Both sets of data were provided by CRA.

In 2000, SGM also obtained from CRA similar data for taxation year 1997 for the 1999 Judicial Compensation and Benefits Commission (the Drouin Commission). Morneau Sobeco (MS) subsequently obtained additional 1997 data from CRA on behalf of the Drouin Commission.

Reliability of the Data

In its report, WCBC identified the following issues which may affect the comparability and reliability of the 1997 and 2000 data relative to the 2001 data:

- The change in the standard industrial classification system commencing in 2001 and the grouping of lawyers and notaries under the same Standard Industrial Classification (SIC) code prior to 2001;
- The fact that the 1997 data excluded lawyers with zero net income but did not exclude lawyers with negative net incomes;
- The possibility that income from other sources than the practice of law was included;
- The substantial reduction in the number of reported lawyers from 1997 to 2000 and 2001.

Change in the Standard Industrial Classification System

For taxation years 1997 and 2000, professional income derived from the practice of law was associated with a SIC code 7760 or 7761, which included notaries and paralegals. However, in 2001, CRA adopted the North American Industry Classification System (NAICS) (check with André Sauvé) under which separate codes apply to lawyers and notaries (541110 and 541120, respectively).

WCBC indicated that CRA was unable to measure the impact of including "non-lawyers" in the 1997 data but suggested that the relative magnitude of this group would not likely cause a major distortion in the analysis of the data.

We understand that there are approximately 3,200 notaries in Quebec and practically none outside of Quebec. *La Chambre des notaires du Québec* has advised the Commission that the average net professional income of Quebec notaries in 2000, 2001 and 2002 was between \$85,000 and \$90,000 and that less than 10% of Quebec notaries earned more than \$100,000.

Judicial Compensation and Benefits Commission

March 25, 2004

We agree with WCBC that the impact of including notaries in 1997 did not likely cause a major distortion in the national results given the relatively small number of notaries. Of course, the impact on Quebec results might be more material.

On the basis of the information obtained on Quebec notaries, it is safe to assume that the presence of notaries in the 1997 and 2000 data probably reduced the overall net income of lawyers in private practice measured at the 75th percentile.

If needed, the impact of including notaries could be measured based on the 2001 data as lawyers and notaries are now separately identified.

Lawyers with Zero or Negative Net Income

With respect to the 1997 data, we understand that CRA excluded lawyers with zero net income but did not exclude lawyers with negative net incomes. For instance, the first tile was comprised of 2,606 lawyers with a negative average net income of (\$5,025).

Paragraph 9 of the SGM reply dated February 27, 2004 suggests that the 1997 data included lawyers with zero net income. We concluded otherwise on the basis of the progression of the net average income of lawyers in the first few tiles.

The negative earnings had an impact on the overall average net income. However, they had no impact once lawyers in private practice earning less than \$50,000 were excluded for purposes of the analysis adopted by the Drouin Commission.

Income From Other Sources Than The Practice Of Law

The Department of Justice obtained net professional income data from CRA for individuals identified as lawyers in 2001 counting either

- net professional income derived solely from the practice of law, or
- total net professional income from the practice of law or other sources.

Table 1 below compares the 1997, 2000 and 2001 net income of lawyers in private practice as reported by CRA first including lawyers with zero and negative income, then excluding lawyers with zero income and finally excluding lawyers with zero or negative income.

The 2001 data is presented either including or excluding the 7,198 lawyers with professional income but no professional income from the practice of law.

The 1997 and 2000 average incomes excluding lawyers with zero or negative income are rough estimates derived for illustration purposes only by excluding lawyers in the first tile which showed negative income.

We note that the 2001 data presented as Conditions nos. 1, 2 and 3 by CRA included the 7,198 lawyers (with professional income but no professional income from the practice of law) but did not include any portion of their net professional income. The results under those three conditions are not presented below as they are not appropriate in the circumstances.

Table 1- Number and Average Net Income of Lawyers in Private Practice in Specified Taxation Years

	Taxation Year		
	1997	2000	2001
Average Net Income of Lawyers in Private Practice	N/A	\$89,800 (28,684) ¹	N/A ¹
			\$119,200 (25,879) ²
Average Net Income Excluding Lawyers With Zero Income (Number)	\$97,000 (31,270) ¹	\$124,600 (20,670) ¹	\$88,100 (16,802) ¹
			\$125,200 (24,000) ^{4,4}
Average Net Income Excluding Lawyers With Zero or Negative Income (Number)	\$106,200 (28,664) ^{1,3}	\$135,600 ² (18,954) ^{1,3}	\$94,000 (15,864) ¹
			\$130,700 (23,062) ^{2,5}

Note : (1) Including only professional income from the practice of law.
 (2) Including the professional income of lawyers with no professional income from the practice of law.
 (3) Rough estimates derived by excluding lawyers in the first tile which showed negative average income
 (4) Derived as Part (A)+ Part (C) of The 2001 data submitted by CRA
 (5) Derived as Part (A)+Condition no. 5 of the data submitted by CRA

We can anticipate a reduction in the number of lawyers between 2000 and 2001 as a result of the change in the industrial classification system adopted by CRA in 2001. However, this change does not explain the substantial reduction in average lawyers' income between 2000 and 2001. In fact, the exclusion of notaries should have the effect of increasing the reported average income of the remaining lawyers as opposed to reducing it given the information obtained on the earnings of Quebec notaries.

With respect to the substantial reduction in the reported number of lawyers in private practice between 1997 and 2000, possible explanations include the increase use of personal corporations. However, to the best of our knowledge, no complete and satisfactory explanation has been found for the substantial reduction in the number of reported cases.

The lawyers' net professional incomes reported for 1997, 2000 and 2001 are not directly comparable because of the significant difference in the reported number of cases. Nevertheless, the number of lawyers in private practice reported in 2000 (18,954) and 2001 (15,864) should represent sufficient samples (the best available) to study the net income of lawyers in private practice.

The 1997 and 2000 results are not inconsistent with the 2001 results if the 7,198 lawyers with professional income but no professional incomes from the practice of law are included. However, if these lawyers are included, the total number of lawyers in 2000 and 2001 becomes inconsistent given the expectation of a reduction in number due to the elimination of notaries and paralegals.

The 2001 average net incomes excluding these 7,198 lawyers are more difficult to explain as the removal of notaries and paralegals should have had the effect of increasing the average net incomes rather than reducing them.

On that basis and considering the above analysis, we find it difficult to attach more credibility to the 2001 results than to the 2000 and 1997 results.

Age Groups

WCBC suggested an approach based on a weighted average of the net income of lawyers in private practice in various age groups considering the proportion of judges appointed in each age group. In our opinion, this is a valid approach.

However, it is also appropriate for compensation benchmarking purposes to define a comparator group more narrowly on the basis that a substantial proportion of newly appointed judges are in such narrower group.

We note that in the period between 1989 and 1999, 69% of newly appointed judges were in the 44-56 age group whereas, in the period between 1997 and 2003, this percentage increased to 84%. Accordingly, in our opinion, there is no reason to conclude that this age group is no longer an appropriate comparator group for compensation benchmarking purposes.

Judicial Annuity

We have reviewed the methods and assumptions adopted by WCBC to estimate the value of the judicial annuity. We have also estimated the value of the judicial annuity as a level percentage of pay net of the judges' own contributions for judges appointed at the ages of 45 to 60 in 5 year increments.

The weighted average value of the judicial pension determined by WCBC (24% of salary) was determined on the basis of data for 364 judges appointed between January 1, 1997 and November 14, 2003, (Volume II, Tab 8 of the December 15, 2003, Appendices submitted by the Department of Justice).

A comment from Eckler Partners Limited included in Mr. Mitchell's February 27, 2004 reply suggested that the weighted average value of the judicial pension should have been determined on the basis of the total population of judges as opposed to the population of 364 judges appointed in the period from January 1, 1997 to November 14, 2003.

The average age at the date of appointment for judges in service on March 31, 2001 was 48.7, based on membership data included in the actuarial report on the Pension Plan for Federally Appointed Judges prepared by OSFI as at March 31, 2001. This compares to an average age at the date of appointment of 51 for the 364 judges appointed in the period from January 1, 1997 to November 14, 2003.

It should be noted that for any given group of judges, the average age at the date of appointment will tend to decline over time as judges appointed at older ages are expected to retire or die first.

Considering that the purpose of this exercise is to compare the compensation of newly appointed judges with that of lawyers in private practice of similar age and experience, it is more appropriate to determine the average age at the date of appointment for all judges appointed in any given period of time as opposed to determining such average age only for those who survived to date. Of course, one could choose to take into account the age at the date of appointment of judges appointed over a longer or shorter period of time. In this case, WCBC made use of the available information that is adequate considering that it is based on the experience of 364 judges.

It should be noted that the value of the judicial annuity for any individual judge varies significantly according to the age at the date of appointment and the assumed retirement age. Accordingly, the results are very sensitive to these two assumptions.

In our opinion, the methods and assumptions adopted by WCBC are within the range of acceptable assumptions and are appropriate for compensation benchmarking purposes. Nevertheless, the Commission should reserve its right to review and adjust these actuarial assumptions as it sees fit for compensation benchmarking purposes.

At this stage, our preliminary valuation results are slightly lower than those determined by WCBC (22.5% versus 24% of salary). Subject to this difference being reconciled, such percentage is an appropriate measure of the value of the judicial pension for compensation benchmarking purposes.

Projection of 2000 Salary Data to April 1, 2004

Pursuant to Section 25 of the *Judge's Act*, judges' salaries are increased each year in accordance with the increase in the Industrial Aggregate for the most recent twelve-month period relative to the immediately preceding twelve month period (up to a maximum of 7%).

Judicial Compensation and Benefits Commission
March 25, 2004

Accordingly, if more recent information on the net earnings of lawyers in private practice is not available, it is appropriate to project the 2000 salary data to April 1, 2004, on the basis of the increase in the Industrial Aggregate. SGM estimated such increase to be 6.8%.

We reviewed SGM's calculations in Appendix 13 (Exhibit Book Volume III) and agree with that estimate based on the available information.

In fact, based on the most recent data (December 2003) and assuming increases in 2004 at the same rate as in 2003 (1.6%) between January and March 2004, an adjustment of 7.1% would be justified instead of 6.8% to project the 2000 salary data to April 1, 2004.

The undersigned remains available to discuss any of these issues.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Sauvé', with a large, stylized flourish above the name.

André Sauvé, F.S.A., F.C.I.A.
Partner

/td