

FEATURE | LAW

Billable Solution

When attorneys and clients negotiate fees

by Adam Weintraub | photo by Kyle Monk | February 2010

Stop me if you've heard this one: A lawyer dies young and arrives at the Pearly Gates.

"There must be some mistake!" he wails. "I'm only 31!"

St. Peter consults the records and disagrees. "Judging by the number of hours you've billed, you're at least 73."

People have joked about lawyers and billable hours for as long as the system has existed, and there's been talk for a decade or more about shifting to alternative billing methods. Now that talk is rising toward a clamor as the economic downturn puts pressure on businesses to cut costs.

One of the places they're looking to cut is spending for legal services, and law firms and clients are exploring all kinds of new ways to handle the work and bill for it. Approaches to improve efficiency include flat fees for either a whole case or each phase of it, volume discounts, "circuit breakers" that require client approval if costs go too high, and even shifting some work to lawyers in less-expensive markets in other states.

Lawyers in the Capital Region say the shift sets up tricky balancing acts between cost and quality, and risk and predictability. While some specialized work and complex litigation is likely to remain hourly, they say, better management tools and new approaches are making many kinds of legal work less handcrafted and more like a commodity. It's a shift, largely driven by big corporate clients, that's changing the way firms do business and how they position themselves to compete.

"This is a very big time of change in the legal business," says Norm Hile, managing partner at the Sacramento office of Orrick, Herrington & Sutcliffe, "and the economic collapse has made it happen a lot faster."

Orrick — a San Francisco-based firm with more than 1,100 lawyers in 22 offices in the U.S., Europe and Asia — has been among the early standard bearers of the shift to new models. The firm opened its Global Operations Center in West Virginia in 2002 to provide low-cost back-office support to the whole firm, and has started hiring lawyers there to handle some tasks for clients. Orrick also announced in late 2009 that it had signed a one-year, flat-fee deal to handle all legal work for Levi Strauss & Co. except for intellectual property matters.

"We have been urging our clients to do this for a number of years, ... but it's getting more traction now," Hile says.

Gene Livingston, managing shareholder at the Sacramento office of Greenberg Traurig LLP, says he's seen more interest in alternative fee structures in the past couple of years. "It's always been about the bottom line, but the downturn has underlined it," he says. "Our firm is of the opinion that this is a permanent shift in the market."

After 20 years of talking about them, "there has been a significant, by historical standards, move toward alternative fees," says Joe Altonji, a vice president in Chicago with legal consultants Hildebrandt Baker Robbins. "They're happening across the country, but ... they're being driven largely by the big companies."

The notion behind the shift is pretty simple, Altonji says. "People don't want to buy an hour of lawyer time. They want to buy a solution to a problem." Some solutions are simpler than others, and for those simple matters a fixed fee arrangement can make sense. It can also work for more complicated work if there's enough business volume that the firm can project typical costs and work loads. "There are parts of [law practice] that will remain highly customized. ... But most of the work done in this country is not that unique, one of a kind thing."

Some kinds of legal work have long been on a fixed rate model. Government relations work is typically handled on a monthly or annual retainer. Estates and trusts often are handled for a flat fee, based on the complexity of the work involved. But lately transactions, appeals and even litigation are increasingly seen as fair game for flat fee arrangements.

"What will work in this world is when a client really does want to be a partner and [make a deal to] cut their costs without beating up the law firm," Altonji says. With a fixed fee arrangement, "you have a price, and you make more money if you deliver services cost-effectively."

That approach might require a different mix of lawyers, new technology to cut costs and manage risks, and a clear focus

on how to get work done efficiently. It also could demand new skills for partners, particularly in project management.

A survey of large law firms in 2009 by The American Lawyer found that 82 percent of those that responded had used some sort of flat-fee arrangement, but that it reflected a small piece of total revenue and mostly covered routine matters. A related survey of corporate counsels found that 39 percent expect the amount of work billed on other than an hourly basis would increase in 2009, and more than one in four said it would increase by more than 20 percent.

The Capital Region has relatively few of the giant corporations that have been the biggest force in pushing for changes in legal fees. Still, as the capital of a heavily regulated state, Sacramento has its share of law offices that handle matters here for big corporations based elsewhere. Locally based clients also have become more interested in alternative fees.

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“Up until about six months ago, when push came to shove clients were unwilling to move away from the hourly billing model,” says Michael Kvarme, managing partner at Sacramento-based Weintraub Genshlea Chediak PC. But the firm recently took on litigation where the client is paying a flat monthly rate, and other clients, particularly in real estate, have inquired about monthly or quarterly fees.

McDonough Holland & Allen PC hasn’t seen any pressure from large clients for flat-fee deals, possibly because of the kinds of cases it handles for those companies, says Jim Leet, chairman of the Sacramento-based firm. That’s not to say that clients aren’t looking to control costs, though.

“We entertain alternative fee arrangements all the time; the key is whether they’re fair for both parties,” he says. A flat fee might be appropriate for regular, routine work, such as handling uncomplicated purchase or sale transactions, he says, while for riskier work it might be more appropriate to put a fee cap in place.

It’s common to set up billing guidelines, such as requiring client approval before the firm incurs certain kinds of charges or assigns more than a certain number of associates to a case, Leet says. “I think people really want to add certainty to the budget process. ... With clients that have regularity of work, you can get a pretty good idea of what things are likely to cost.”

But there can always be surprises. Greenberg Traurig recently agreed to charge a flat fee for an appeal of a California regulatory decision. From the early filings, it looked like a fairly straightforward case, but when the sides began trading filings, a host of new issues were raised, all of which had to be addressed, Livingston says. “We’ll have to write off some of that time.”

The Miami-based firm handles litigation work in Sacramento for national companies, including some “where we’ve agreed to flat-fee arrangements for certain aspects of the case” such as the discovery phase, Livingston says. “I know of other situations where we have proposed discounts of billable hour rates based on volume.”

Those volume discounts match up with a trend among big corporations to strip down the number of law firms that handle their outside work. The Levi Strauss deal with Orrick may be the most extreme example, but it’s far from alone. Pharmaceutical giant Pfizer Inc., for example, has cut dozens of law firms since 2004 and by last year was down to 19, with each working for a flat fee paid in monthly installments.

Downey Brand LLP — with 130 lawyers, the biggest law office in Sacramento — is focusing some of its business development efforts on expanding and deepening relationships with Fortune 500 clients, looking to tap into the fewer-firms-at-a-better-price trend. “There have been some clients that have asked about volume discounts if they are able to increase their volume,” says managing partner Jeff Koewler.

The shift sets up a new dynamic for law firms competing for business. The push by big companies to cut legal costs and concentrate on a smaller number of firms in some ways favors national law firms that can handle higher volume. But it also hands some advantages to smaller firms in markets where costs are lower. That’s part of the reasoning behind Orrick’s West Virginia center, which allows some work from expensive markets to be handled at a low-cost location.

The focus on containing costs has made firms in low-cost markets more attractive. “One of the things we’ve seen, particularly in the past year and a half, is regional firms with lower billable rates have become a lot more competitive,” Hile says.

Says Koewler: “There’s an opportunity for firms like ours that do very good work at a lower cost. Cost reduction will survive long past this economic downturn.”

The ample space, available labor and comparatively smaller salaries in Sacramento makes it a low-cost market for Greenberg Traurig, says Dan Leacox, director of government affairs for the firm here. About 10 employees at the firm’s local office handle case calendars, research and other tasks for Greenberg offices as far away as Miami.

Some fear that the emphasis on cost control and treating legal services as a commodity could hurt the quality of work, but most see advantages to using automation and lower cost workers to handle largely routine legal work.

The transition, though, will take training and new tools. Several of the local firms interviewed say they were taking steps to get ready, whether through staff training, new models for setting lawyer compensation, more comprehensive systems for tracking costs or rethinking what skills their leaders need.

"I don't know of a single law firm that has project management skills as one of the criteria for partnership," Altonji says. "In five years, I bet I'll know a lot."