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The Billable Hour is Dead. Long Live…?

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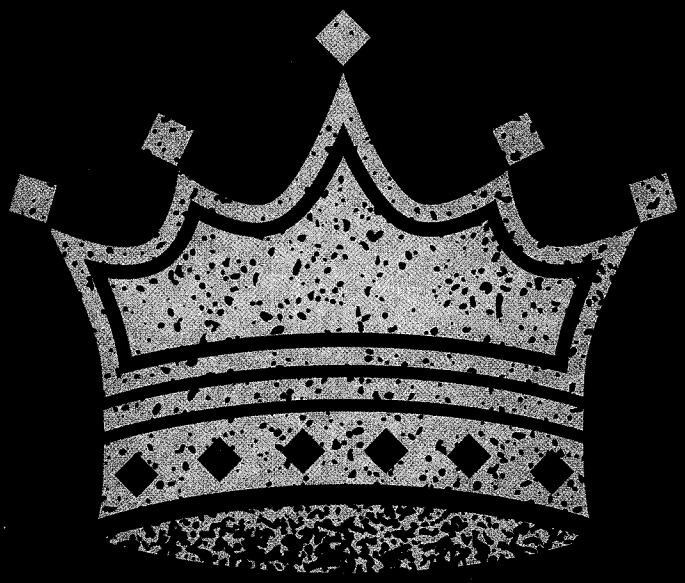

THE BILLABLE HOUR IS DEAD. LONG LIVE . . . ?

By Robert E. Hirshon

As Mark Twain once observed, "the rumors of my death are greatly exaggerated." Is this the case with the demise of the billable hour?

THE CORONATION OF THE BILLABLE HOUR

For most younger and, indeed, middle-aged lawyers, the billable hour has always been the ultimate arbiter of legal fees and of partner, associate, and paralegal evaluations. There are probably some senior partners (a dwindling group) who may still remember when fees were decided by discussions between a lawyer and a client or were based on a county bar association's minimum fee schedule. An aggressive approach by the Federal Trade Commission and the U.S. Supreme Court's decision in *Goldfarb v. Virginia State Bar*, 421 U.S. 773 (1975), ended the use of minimum fee schedules, however, and forced practitioners to devise different methods of billing clients.

Supported by a relatively new profession (law firm management consultants) and enabled by technology, the billable hour soon became the dominant and most easily determinable factor in figuring out how much a client should pay for legal services. Results and value became significantly less important than ".1s" and ".3s." Clients did not complain, however, because new billing formats gave them substantially more information than the previously ubiquitous "for professional services rendered." For a time, everyone seemed happy.

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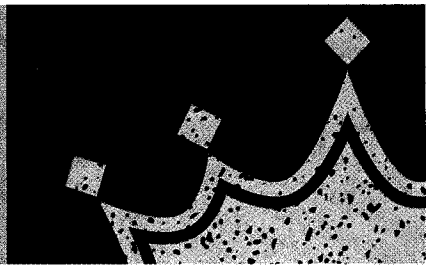
The legal profession, of course, quickly comprehended that pursuant to the hourly approach to billing, two factors were paramount: the total amount of hours it took to complete a matter and the amount of dollars charged per hour. As both transactions and litigation became more complex, law firms found it necessary and easy to justify adding bodies (read: hours) to their clients' legal projects. With the number of legal projects increasing as a result of explosive economic growth in both developed and developing nations, the demand for top legal talent during most of the 1980s, 1990s, and early 2000s was greater than the supply. Hiring associates and putting them to work on billable legal matters was, as one Big Law managing partner stated, "like owning a printing press."

The Great Recession shifted leverage from law firms to clients.



THE CROWN SLIPS

But all good things must come to an end. The Great Recession of 2008 brought a close to the era of ever more costly billable hours. Law firms had already realized they could no longer demand that associates work more hours in a year. Now they unhappily realized they could no longer require that clients pay significantly higher hourly rates.

What started as a moderate voice of concern articulated in the American Bar Association's Commission on Billable Hours Report (2001–2002) became a giant roar as a result of the Great Recession. Although most economists state that the recession began months earlier in December 2007, it was not until "Black Thursday," February 12, 2009, when more than 1,000 lawyers and staff were fired from major law firms, that the legal profession fully understood it was an unfortunate hostage to the imploding American economy. And if that were not enough, the Association of Corporate Counsel (ACC) launched its Value Challenge. Former ACC chair Mike Roster and then–ACC general counsel Susan Hackett took the ABA Commission's report to its next logical step: a direct challenge by in-house counsel to outside counsel to focus more on value and less on hours.

The Great Recession, with its concomitant realignment of supply and demand for legal services, should have allowed clients to put an end to the anomaly of paying more money for a poorly taken deposition lasting ten hours than a brilliantly taken deposition lasting three hours. It turns out, however, that clients did not and (even today) still have not completely accepted the value proposition. For many clients, alternative fee arrangements (AFAs) attempting to mimic value meant simply requesting a discount in hourly rates. As such, most law firms used alternative fee arrangements as the preferred billing approach only when forced. Although there are many dramatic success stories involving the use of AFAs, the attempt to align legal billings with value has not completely succeeded, and many clients and lawyers remain skeptical.

Every year, however, more clients and lawyers experiment with AFAs, and some skeptics become converts. A recent report by Altman Weil reveals that in 2009 only approximately 20 percent of the lawyers surveyed thought that non-hourly billing had become a permanent trend within the profession. By 2012 that number had increased to 80 percent.

The report went on to observe that AFAs were being employed by almost all firms responding to the survey. Yet a substantial number of these firms also reported lower profitability when using AFAs. This suggests that law firms and clients have not yet figured out how to turn AFAs into win-win propositions. If they do not, for financial reasons alone, it is likely that the Bar will embrace AFAs only if absolutely required to by clients.

In this economy, at least for the short term, it appears that law firms will be forced to agree to alternative fee arrangements if those arrangements are demanded by their clients. Indeed, because of greater client interest, almost half of the firms surveyed by Altman Weil reported a year-to-year increase in the amount of non-hourly billing, as measured as a percentage of revenues.

Notwithstanding an increased use of alternative billing approaches, the question remains: Is the billable hour dead . . . or at least dying? Clearly much of what is occurring in the pricing of legal services is the result of old-fashioned supply and demand. The truth is that there are too many lawyers chasing too few monied clients. When supply greatly exceeds demand, prices usually go down. Although the ACC Value Challenge was discussed and formulated prior to the Great Recession, it was unveiled during the recession, a perfect time. Accordingly, the Value Challenge helped to create a "perfect storm": demand from clients for a more rational approach to determining the value of legal services coinciding with a national economic meltdown. These events shifted leverage from law firms to clients in arriving at methods for pricing legal services. Rather than simply requesting discounts based on "most-favored-client" status, companies soon focused on alternative and potentially less expensive models for the pricing of certain legal services.

HEIRS TO THE THRONE

As a result of this change in dynamics, law firms and clients have created numerous alternatives to the billable hour when pricing legal services. The most common are outlined below:

Contingent fees. First up is the "old standby": contingent fee billing. It has long been an alternative for hourly billing. A contingent fee is dependent on the results obtained. This obviously requires a clear understanding of what the results are. In personal injury cases, this determination is usually easy. It is a percentage of the amount recovered for the injuries

sustained by the client. Accordingly, it is tied both to value (the amount received by a lawyer will increase/decrease in tandem with the amount received by the client) and risk sharing (if the client recovers nothing, the lawyer will charge nothing). In other types of cases, however, defining successful results is often problematic, and contingent fee billing is not frequently used.

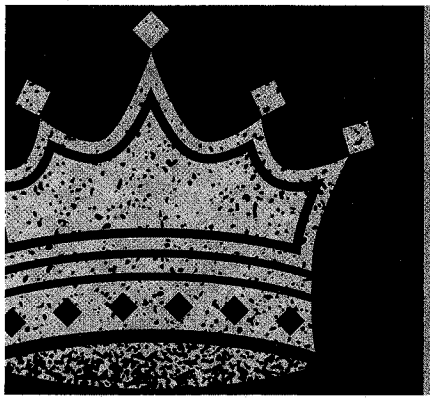
Reverse contingent fees. Recently, defendants and their counsel have explored contingent fee arrangements known as reverse contingent fees as a way of pricing legal services. A reverse contingency allows for compensation based on an avoidance of exposure to liability. Although in some cases it may be difficult to determine the amount of exposure escaped, it is clearly not impossible. Most lawyers know how to place a value on their cases, and defense counsel relying on both personal knowledge and public reports of damage awards in their jurisdiction have become adept at assessing the likelihood of both liability and the amount of damages.

Fixed fees and flat fees. In addition to contingent fees and reverse contingent fees, fixed or flat fees are often-used alternatives to hourly billing. A fixed or flat fee is the price that a law firm charges no matter how many hours its lawyers spend on the matter. A fixed fee may be the total fee for the engagement or may apply to discrete components of a matter, such as fixed fees for discovery, for pretrial motions, and for the actual trial. Because clients and law firms recognize that flat fees can disincentivize the production of quality work and often lead to representation by more junior lawyers, many believe that fixed fees are more appropriate for simple or commoditized legal work. There are some notable exceptions, however, to this thinking.

Blended rates. Blended hourly rates apply to all hours billed on a matter. The blend includes the lower rates of associates and the higher rates of partners. A blended rate often works best for high-risk and complex work. It can, however, lead to over-representation by junior talent. And unlike capped fees or fixed fees, it does not provide the client with budgeting predictability.

Percentage fees. Another popular alternative fee arrangement is a percentage fee, either constant or graduated and based on the amount of the transaction. Some courts allow fees to be determined by the value of the estate being probated. The fees for many bond issues are likewise determined by the percentage of the amount of bonds sold.

Combined approaches. Many alternative fee arrangements combine various approaches. Thus, some firms create fee schedules based on a low blended hourly rate plus a contingency. Other firms base their fees on all the factors set forth in the ABA Model Rule of Professional Conduct 1.5. Alternative fee arrangements may even include an amount retrospectively set, based on the value received by the client.



The future of alternative fees depends on the trust between attorneys and clients.

THE KINGDOM OF TOMORROW

Ultimately, whether alternative fee arrangements supplant the billable hour will depend on the level of trust between attorneys and their clients. Both buyers and sellers of legal services have become comfortable with the billable hour. Change comes hard. Law firms that increasingly rely on alternative fee arrangements report that making the switch from billable hours is difficult and often takes a lot of hand-holding.

Creating a law firm billing model based on AFAs is not impossible. Bartlit Beck Herman Palenchar & Scott, LLP, a Chicago litigation boutique, has demonstrated that the billable hour can be killed. No cases accepted by Bartlit Beck are billed by the hour. Recognizing the need for additional hand-holding, however, the firm states: "starting with day one we make it our job to make [clients] feel comfortable by providing them with constant communication." The AFA most often used by Bartlit Beck is a flat monthly fee that fluctuates depending on the stage of litigation. The most expensive fees are billed for trial. Additionally, the firm and the client agree to a success bonus. The firm demonstrates its diligence not by providing its clients with bills listing the hours spent on their cases, but rather by providing them with complete transparency. At Bartlit Beck, lawyers copy their clients on every relevant e-mail, even internal ones.

Many firms report spending more time discussing ongoing matters with their clients in cases that are billed with AFAs than they do in cases that are billed by the hour. These firms report that clients know the "clock is no longer running" and are pleased with the increased communication about their cases. These firms also report that there is "no turning back." They believe that the billable hour will die.

Admittedly, the firms that rely completely, or mostly, on AFAs are unique. Bartlit Beck's novel paradigm has yet to be replicated. But alternative fee arrangements are being increasingly used by more and more law firms. Clearly, the billable hour no longer rules the kingdom alone. Whether it fades away into oblivion, however, is not yet a certainty. ■

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