

General Counsel Pressuring Firms Amid Recession

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The squeeze is on. Trying to pare their law department budgets amid the economic crisis, general counsel have cranked up the pressure on their outside law firms, demanding slashed fees, predictable bills and improved service. With a stronger upper hand, company lawyers are trying to drive down the cost of using outside counsel.

Of all the budget issues confronting general counsel -- and there are plenty -- outside counsel fees and their lack of predictability are the two biggest worries, according to a [November 2008 survey of 115 general counsel by Altman Weil](#). Nearly three-quarters of the respondents reported that they are implementing 2009 budget cuts of between 6 percent and 35 percent.

Corporate law departments can spend less on pencils and can cut in-house staff to trim around the edges of their budgets, but they won't get close to significant cuts "unless they start going deeper," said Pamela H. Waldow, principal at Altman Weil, the legal consulting firm. Going deeper means digging into outside counsel.

The study reported that the No. 1 target for general counsel spending cuts is outside counsel. More than half intend to decrease the use of outside lawyers in 2009.

The cutting is already here. One general counsel of a large company, which Waldow declined to identify, recently achieved huge savings nearly overnight by firing its large national law firms and switching to smaller regional firms, she said. The change provided the company with top-rate lawyers at a lower cost structure. The company replaced \$700-an-hour lawyers with \$325- to \$450-per-hour counsel, she said.

Some law firms are responding by trying to keep pace with smaller firms. One large law firm pledged to a corporate client that it would match any discounted hourly fees that a competing firm might propose, Waldow said.

Companies are demanding ever more discounted hourly rates.

"We are watching every nickel we spend," said Michael Rowles, general counsel at Live Nation Inc., a Los Angeles-based concert promoter. The company's legal needs aren't slowing down -- its proposed merger with Ticketmaster Entertainment Inc. is pending -- yet the company has aggressively pushed for steep discounts on hourly rates, Rowles said, so far without complaint from its firms.

Retailer PetSmart Inc. has issued similar demands, pressing for 30 percent hourly fee discounts, said Scott A. Crozier, senior vice president and general counsel at the Phoenix-based retailer. Firms that want to continue representing the company are expected to make concessions. "We expect a lot more value," he said. "We expect far better representation and far better performance in terms of success." With outside counsel, it's less about give and take, Crozier said. It's now more about the "take."

The "golden age" of profitability at corporate law firms is over, said Susan Hackett, executive director of the Association of Corporate Counsel. Lawyers wistful about those days are just

resisting change, she said, noting that one lawyer recently complained to her that cutting his fee to \$700 per hour was a "suicide" rate.

Law firms face hard times not only because of slashed fee demands but also because new competition is depressing prices, said Joel Henning, a legal consultant at Hildebrandt International Inc. Overseas firms are trying to pick off their corporate clients, offering hourly rates 30 percent to 40 percent cheaper than what large U.S. firms charge.

"The American law firm is the last of the medieval guilds," Henning said. As demand for their services increased, so did their average profitability.

Those days are gone. Economic crisis is forcing law firms, few of which are built on a true business model, to become market-driven, he said.

"It's not entirely the fault of firms" that they are stuck in a strange, new competitive world, Henning said. Corporations are sophisticated about procurement, but not in the area of legal services. That is changing, and the law firms that can go with that change will succeed, he said.

ALTERNATIVE METHODS

Law firms that think they are accommodating the market's changes merely by discounting hourly rates are missing the point, Henning said. That's not an effective way of offering value, he said.

Similarly, some general counsel think that asking for a discount is all they need to do to manage their legal expenses, he said. But a lawyer's hourly rate is comparable to the rate published in a hotel room -- no one really pays it because it is an artificial number, he said.

Offering an hourly discount won't control hours or expenditures, said Hackett, of the corporate counsel group. "There is nothing to prevent that bill from coming out larger," she said.

The better way of getting improved value for outside legal services is through alternative fees, Henning said.

Some of the more typical alternative-fee arrangements include flat fees per case, project or a packaged group of similar cases. Certain firms have responded creatively, Waldow said. One offered to handle litigation seeking to recover money on a contingency basis, she said.

Law firms can offer a fixed rate on a deal and top it with a success "kicker," said Guy Halgren, chairman of Los Angeles-based [Sheppard, Mullin, Richter & Hampton](#) and a proponent of alternative-fee arrangements.

Many law firms, he said, have a hard time pricing bids that work for their clients and are profitable, too. For example, when a firm is asked to bid on a single-plaintiff employment case, it has to know staffing, plus procedural and other costs. Sheppard Mullin has three alternative-fee "czars" for transactions, litigation and regulatory practices. These attorneys look for opportunities to utilize alternative arrangements. Even so, the majority of work is still being billed at hourly rates, Halgren said. But that is changing, he said.

Alternative-fee arrangements have become essential at Taser International Inc.'s law department because they help the company manage litigation costs, said general counsel Doug Klint. With 43 lawsuits pending and 82 cases that it has resolved, Taser has developed a "best practices" program for its 10 regional litigation counsel, said Klint.

"The challenge for us is that we don't settle lawsuits" filed by criminal suspects claiming injuries as a result of law enforcement officers using a Taser weapon, he said. "We end up being prepared to go to trial in every case."

Taser applies the same efficiency and quality standards to legal work that it does in manufacturing, he said.

Beginning in 2008, Taser required all outside counsel to work under a fixed "not to exceed" fee schedule in litigation, grouped into several phases, including motions, discovery and trial. The company developed standardized model documents, which minimizes document prep time billed by outside lawyers. Taser has already done the legal heavy lifting of developing the arguments for defending abuse-of-force claims, he said. It doesn't have to pay someone else to do it. In essence, the company streamlines litigation the same way a manufacturer would streamline the production line, Klint said.

Some of the more progressive law firms have embraced Taser's methods, Klint said. Not all have gone along, however. For those firms that refuse to give up billing hourly? "We micromanage them," Klint said. The firm scrutinizes their work and bills to avoid any surprises.

"You can't manage what you don't measure," Klint said. He meets every month with outside counsel to talk about pending work and decides what to assign and what to bring in-house.

Sometimes Taser makes a conscious decision to exceed budget on a case, "but we know about it beforehand," Klint said. "We do not want to be surprised."

Although some observers advocate applying a manufacturing model to providing legal services, the law is not the same as selling pencils, said Francis M. Milone, chairman of [Morgan, Lewis & Bockius](#). "You can't just look at costs of legal services. You have to look at outcomes," he said. Companies want certainty, he added. "We believe and clients believe it does create a better result. They know they are not going to get nicked and dimed on it."

NONPROFITS JOIN THE MOVEMENT

Even nonprofit organizations are exploring alternative fees, said Angela F. Williams, general counsel of the YMCA of the USA, the Chicago-based umbrella organization for the nation's 2,686 YMCAs. Williams recently submitted a request for proposals to four firms on an employment matter and one of the factors in evaluating the firms was alternative fees.

One firm offered no discount, another offered an hourly discount but a third offered to accept a cap on legal costs. "Thinking outside the box -- that's what I appreciate," she said. "Now's the time for outside counsel to really listen to the needs of in-house counsel and respond in a way that maximizes the service."

Christina Martini, a partner at [DLA Piper](#) who works with Williams on the YMCA's intellectual property matters, said that she still bills by the hour but focuses on aligning her firm's interests with those of its clients. The point is to make the relationship predictable for the client. "I think it's all about communication," she said.

With corporate clients threatening to send lawyers packing, firms are forced to demonstrate that their prices bear a clear relationship to the value of their services, said Ralph Baxter, chairman and chief executive of [Orrick, Herrington & Sutcliffe](#). It's understandable why clients are frustrated with the way lawyers bill because fees are disconnected from value, he said.

"I do think at the end of the day there is a way to arrange this that will be better for everyone," he said. "We've got to adapt to changed times."

Orrick has changed its staffing model, hiring less costly nonpartner lawyers. In addition, in 2002 it consolidated its back-office staff in Wheeling, W.Va., to conduct electronic research and prepare transcripts, among other tasks. The firm has been examining how it performs nearly everything it does, to better understand its costs of providing services.

Such self-examination is new and different for firms to endure, Baxter said.

Lawyers resistant to alternative fees may argue that their work is too unpredictable to price with any certainty, but "that's bull," said Hackett. "It's mind-boggling to me they've actually bought this," she said of corporate lawyers who don't challenge that claim.

Still, alternative-fee arrangements remain far from the norm. The November corporate counsel survey showed that most lawyers spend fewer than 10 percent of their legal expenses under these arrangements.

Law firms should not wait for their corporate clients to suggest a new way of paying, said consultant Henning. "This is the time," he said. "The savvy ones are doing it."

The Association of Corporate Counsel is helping companies and outside lawyers get the party started, inviting small groups to meet and brainstorm alternative-fee deals and try them out. The program is called [Value Challenge](#) and the first of 20 meetings took place in mid-March in New York City. The New York group came up with 37 ideas, said Hackett, who participated in the discussion.

The idea is to encourage people to try new things, she said. They leave the meeting, talk with their outside lawyers or their corporate clients and try one or two new ideas, she said.

But change won't come as a result of a top-down approach from a trade group, she said. It will require companies and their lawyers -- traditionally risk-averse -- to "step out of their comfort zone."