Squeeze Play

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By Emily Heller

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The squeeze is on. Trying to pare their law department budgets amid the economic crisis, GCs have been cranking 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 GCs that was conducted by Altman Weil. (See "Pressure Time" in the May/June issue of GC California.) 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," says Pamela Waldow, a principal at Altman Weil. 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 said they intended to decrease the use of outside lawyers in 2009. The cutting is already here. The GC of one 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 says. The change provided the company with top-rate lawyers at a lower cost structure. In particular, the company replaced $700-per-hour lawyers with those who were charging hourly rates of $325 to $450. Some law firms are responding by trying to keep pace with smaller firms. One large law firm, according to Waldow, pledged to a corporate client that it would match any discounted hourly fees that a competing firm might propose.

"We are watching every nickel we spend," says Michael Rowles, general counsel at Live Nation Inc., the Beverly Hills-based concert promoter. The company's legal needs aren't slowing down – its proposed merger with Ticketmaster Entertainment Inc. has been pending – yet Rowles says the company has aggressively pushed for steep discounts on hourly rates, so far without complaint from its firms. Retailer PetSmart Inc. has issued similar demands, pressing for 30 percent hourly fee discounts, says Scott Crozier, senior vice president and general counsel at the Phoenix-based company. Firms that want to continue representing the company are expected to make concessions. "We expect a lot more value," says Crozier. "We expect far better representation and far better performance in terms of success." With outside counsel, he bluntly adds, it's less about give and take these days – and more about just the take.

Susan Hackett, general counsel at the Association of Corporate Counsel, whose members are footing the bills for outside legal expenses, declares that the "golden age" of profitability at corporate law firms is over. Lawyers wistful about those days are just resisting change, says Hackett, who notes that one lawyer recently complained to her – apparently with a straight face – that cutting his fee to $700 per hour amounted to a "suicide" rate.

Law firms face hard times not only because of slashed fee demands but also because new competition is depressing prices, says 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," says Henning. As demand for their services increased, so did their average profitability. Those days are gone. The current economic crisis is forcing law firms, few of which are built on a true business model, to become market-driven. "It's not entirely the fault of firms" that they are stuck in a strange, new competitive world, adds Henning. 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 says.

Law firms that think they are accommodating the market's changes merely by discounting hourly rates are missing the point, says Henning and others. That's not an effective way of offering value. Similarly, some GCs think that asking for a discount is all they need to do to manage their legal expenses. But a lawyer's hourly rate, Henning points out, can be compared to the rate published in a hotel room. That is, no one really pays it because it is an artificial number. Indeed, offering an hourly discount won't do anything in and of itself to control hours or expenditures, says Hackett, at ACC. "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 genuine alternative fee arrangements. Some of the more typical arrangements include flat fees per case, project or a packaged group of similar cases. Certain firms have responded creatively, says Waldow, from Altman Weil. She points to one firm that offered to handle litigation seeking to recover money on a contingency basis.

Law firms can offer a fixed rate on a deal and top it with a success "kicker," says Guy Halgren, chairman of Los Angeles-based Sheppard, Mullin, Richter & Hampton and a proponent of alternative-fee arrangements. Many law firms, he says, have a hard time pricing bids that work for their clients and are also profitable to the firms. For example, when a firm is asked to bid on a single-plaintiff employment case, it is expected to come up with costs for staffing and all other aspects of the case. 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, acknowledges Halgren.

Alternative-fee arrangements have become essential at Taser International Inc.'s law department because they help the company manage litigation costs, says GC Doug Klint. With 43 lawsuits that were recently pending, along with 82 cases that it has resolved, Taser has developed a "best practices" program for its 10 regional litigation counsel, says 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. "We end up being prepared to go to trial in every case."

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. Rather than paying someone else to do it, Taser has already done the legal heavy lifting of developing the arguments for defending abuse-of-force claims, says Klint. In essence, the company streamlines litigation the same way a manufacturer would streamline the production line.

Some of the more progressive law firms have embraced Taser's methods, adds Klint. What he does he do with firms that continue to cling to hourly billing? "We micromanage them," he replies. The company scrutinizes their work and bills to avoid any surprises. "You can't manage what you don't measure," says Klint, who meets every month with outside counsel to talk about pending work and decides what to assign and what to bring in-house.

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

All that said, alternative-fee arrangements remain far from the norm. The recent Altman Weil survey showed that most in-house lawyers are paying 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, advises Henning. "This is the time," he says. "The savvy ones are doing it."