Different Incentives for AFA's - GC's vs. Managing Partners

Recently Bruce MacEwan of Adam Smith, Esq. did a great post on his blog on the different incentives that General Counsels (GC's) and Managing Partners have regarding Alternative Fee Agreements (AFA's). GC's are accountable to their shareholders, while Managing Partners are accountable to their partners. Bruce's point was that GC's are incented by their shareholders to reduce costs and push AFA's, while managing partners are incented by their partners to run a profitable firm. I'm paraphrasing a bit, but here's the full post for your info.

So given the current difference in incentives for GC's and Managing Partners, is there a way to reconcile the two points of view and come to some agreement for a mutual goal and appropriate incentives for both sides?

I think there is. I would suggest as a start that law firms start reducing the emphasis on billable hours in their partnership compensation systems. By doing so, this will encourage lawyers to focus more on the profitability of their practice, not on their own personal billable hours. It will also incent them to lever more work down to associates and paralegals, or to outsource legal work where it makes sense. These actions make good business sense whether an AFA is in place or not. This will make your firm more profitable, produce high realization and reduce the overall cost of legal work. Any resulting efficiencies from this approach which produce extra profits can be shared with your clients in the context of an AFA.

And there is much inefficiency in the way that law firms produce legal work now. The fact is that partner compensation systems that incent partners to maximize their billable hours encourage "bloat" in the overall cost of legal work. It also encourages firms to keep too many partners around billing at high rates. It's no wonder that clients are rebelling against this type of system.

Emphasis on partner hours billed has created law firms that are too top-heavy for their own good. Many firms have too many partners compared to associates and paralegals, and partners are "hoarding" work that should be levered down. As a result, the cost of the legal services goes up due to higher chargeout rates on average. The answer is that most firms could probably do with, say, 20% fewer partners (admittedly a number totally off the top of my head), and still handle the same work volume, but in a far more efficient way and at a lower overall cost for the client. The tricky part is that law firms' overall billings will go down, and partners have a vested interest to keep the compensation criteria as is to protect their own interests. It won't be easy, but forward-thinking firms are addressing this issue now. And if you don't address this issue, these forward-thinking firms will steal your clients from you.

So the firm's partner compensation system is the best place to start. The smart firms that de-emphasize billable hours and focus instead on value, efficiency and reducing overall legal costs have the opportunity to take work from firms who are simply too lazy or greedy and won't change unless they have to.

Admittedly, GC's are incented to reduce the overall cost of legal services, so there is a conflict here with law firms' incentive to grow the size of their practice. But, if there is the potential to grow profits in a properly constructed AFA arrangement, then this should satisfy law firm partners who are rewarded for increasing profits for the firm and the client, not just the size of their practice.

And if the choice is to lose a good client playing big annual fees, even at a discounted rate, then partners should really get focused here. As well, by the time the client decides that it wants an alternative fee arrangement, it will probably have been approached by several other law firms offering the same thing, and you'll be yesterday's news.

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