

Moving Beyond the Billable Hour

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In a tough economic environment, clients face financial pressures that high legal bills compound. Even when the economy is good, the forces of global competition and the pace of today's business require that legal services be cost-effective and efficient, especially in the technology and financial markets my practice serves. In short, smart clients are always cost-sensitive. But for decades most law firms have responded with only one offering—the billable hour, and hourly rates have risen incrementally year after year after year.

History will record that the economic downturn of 2008-09 began a process of fundamental changes in the U.S. legal market. Law firms have moved in one of two directions, either reaffirming the billable hour's supremacy or rethinking the way they partner with clients to maximize value.

To stick with the billable hour in the face of clients' cost-sensitivity, law firms must find ways to give more value per hour. They might simply reduce hourly rates, but the legal profession has never embraced that option. I don't expect many firms often will. Instead firms have attempted to accomplish more within a single hour by creating more efficient attorneys. You can be more efficient at something if you do it every day, over and over, so some law firms have chosen to use collections of narrowly specialized attorneys in order to offer efficiency. Sally offers one legal service today, John a different service tomorrow, and so on. I call this the "commoditization" of legal services. Pushing for greater efficiency through specialization is generally good, but it's not enough.

Alternatively, some firms have reached the conclusion that their economic futures lie in partnering with clients through flexible arrangements that may or may not include the billable hour. Customized arrangements can incentivize efficiency

while also incentivizing high quality results. In contrast to the commoditized model of law firms, some firms are addressing client demands for efficiency and cost-containment by exploring alternative billing models. In a nutshell, the idea is to follow a fundamental rule that nearly all businesses, other than law firms, have always known—if you want an outcome, incentivize it financially.

In the simplest model, a law firm may offer to perform a particular project at a fixed price. The law firm will, of course, want to make a profit, so it will manage itself to keep its costs below the agreed-upon fixed price. Firms may offer blended rates (one rate for all hours billed, no matter who bills them), which incentivizes cost-efficient use of more junior attorneys whenever possible. Firms and clients may set target budgets, giving the firm a share of any savings that are realized if the firm is efficient, or requiring the firm to share the cost of inefficiency by writing off a portion of charges that exceed the target. In the "bill+bonus" model—a particular favorite of mine—firms agree to charge only a discounted percentage of actual billable hours (e.g., 90% of actual charges), and the client agrees to pay some bonus if the firm exceeds the client's subjective expectations.

What clients and firms like about these alternative models is that they incentivize mutually beneficial, long-term relationships. In a fixed-price arrangement, skeptics might complain that a firm will be incentivized to skimp on quality. But not only would that violate the firm's professional obligations, it would also work only for a short while. A firm can't offer poor quality for long before it loses clients. Skeptics might argue that blended rates will incentivize use of junior attorneys with too little partner-level supervision. Again, however, professional standards set a floor for a law firm's behavior, and clients will only tolerate inattention by partners so long. In the bonus model, skeptical law firms might worry that clients will never voluntarily pay their law firms more than they absolutely must, but failing to treat the firm fairly will not foster a long-term relationship or incentivize the firm in the future, and, if the firm really does perform well, clients will indeed have an incentive to reward its lawyers.

We shouldn't forget that efficiency isn't the client's only economic goal. Cost-certainty and predictability are sometimes equally or more important, and relying on the billable hour alone sometimes threatens both. Once again there may be alternative billing arrangements that offer solutions. Consider a common retainer model in which clients pay a fixed "subscription" per month for all legal services within an agreed upon scope. In some months the client won't use all the services it has paid for; in other months it will use more than it bought. If the monthly retainer amount continues to favor one party over the other, it can always be reset from time to time. Over the long term, it evens out, and in any case the arrangement achieves

relative cost-certainty for the client with a relatively level revenue stream for the law firm. Knowing the economics will work out over the long term also permits lawyers not to watch the clock so closely, allowing them to spend the time they'd really like to spend on projects when cost pressures might otherwise force them to rush.

In a competitive market, clients need and demand high-value, efficient legal services. I expect the market will cause more companies and more law firms to benefit in creating economic arrangements that work best from a long-term perspective and that offer value to both of them by partnering for their mutual success.

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