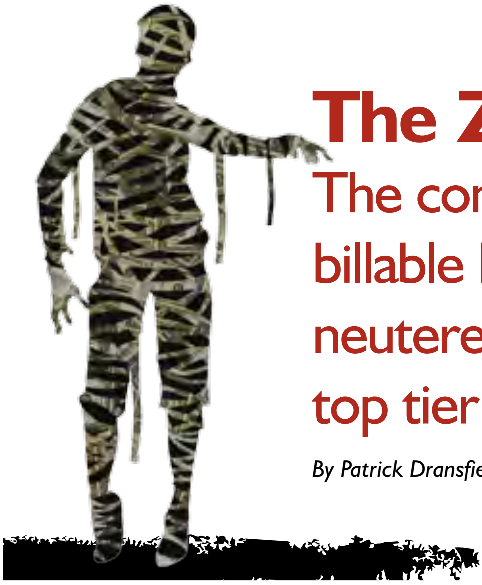
The ZOMBIE lives on!

The continuing half-life of the billable hour and how it has neutered necessary change for top tier international law firms

By Patrick Dransfield and David Miles



My mother and father both came from Huddersfield, in the West Riding of Yorkshire. On a Sunday morning, I was greeted with a smile from my mother:

"Now, which would you prefer….beef or pork?" For those like my father attuned to such things, there was a nuanced emphasis on the latter.

"Oh, I fancy beef, mum".

"Well, we're having pork."

This somewhat surreal exchange was what my father christened 'the Trap Offer'. It seems that traditional law firms (by that I mean partnership structured firms), even ones that appear to be offering an alternative, are really in the majority of billings still offering 'pork', otherwise known as 'the billable hour', in admittedly sometimes a new pastry wrapping. And why shouldn't they if they feel its to their financial advantage and they can get away with it? It has been the standard for a long time now, and no doubt because the first and second generation in-house counsel began their careers in private practice, a measure of payment that is understood by many.

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"The reason why it is so difficult for existing firms to capitalize on disruptive innovations is that their processes and their business model that make them good at the existing business actually make them bad at competing for the disruption." – *Clayton Christensen*

In our opinion the billable hour is really a very unattractive way to pay lawyers for much legal work these days if you are the buyer of their services. It can encourage complacency repetition and inefficiency where younger lawyers are more concerned about making their targets than necessarily being really efficient and cost effective. It takes as its basic premise that most legal work is bespoke and deserving of essentially premium and expensive rates when nowadays because of competition and market forces, legal work is becoming increasingly commoditised. Of course there are always matters that deserve and demand premium hourly rates, but overall there now appears to be a widening disconnect between what private practice is trying to hang on to and what is really in a client's best financial interest. However, in private conversations, partners in private practice in charge of even the most seemingly radical schemes to provide real value for money for commoditised legal work, wink and say "actually what we are really after is the top end work". The work which is supposed to be 'bet the company' premium type work that is largely the domain of the top firms and which quite reasonably is deserving of the billable hour.

It is not surprising that private practice lawyers, especially those who have lived through the golden period of the last twenty plus years and particularly pre-global financial crisis (GFC) are loathe to see change. Its what they understand and how their firms account internally. It's a crucial metric.

"It is hard to persuade a bunch of millionaires that they have the wrong business model", as Professor Richard Susskind aptly puts it. So in-house counsel may well ask for beef, but what they continue to get in large measure is pork even if they don't necessarily know what they are actually eating.

And interestingly, the desire for beef but settling for pork is not just the preserve of private practice. Many on the client side consider radical change too hard. Twenty-five year General Counsel veteran Trevor Faure ends his 'More for Less' general counsel surgeries with the statement that the vast majority of his audience will not implement any of the changes presented during the previous four hours. In some cases the need to quantify the problem will result in the discovery of inefficiencies and perhaps even to consequences they don't want. Sometimes it is better simply not to know.

However, change is coming, even if some don't like it. And surely it is better to be the author of change and to be in control rather than to be its victim. As companies struggle for profitability in this uncertain period of global turbulence, the least efficient and cost draining departments are in sharp focus. A boss and mentor always said 'know your numbers'. And since every other department in a corporation are undoubtedly numbers driven, why not the legal department too? Many are, but surprisingly many are still not.

And for the law firms, we have seen a lot of water go under the bridge. From the original value billing, where there was not a billable hour in sight and which was a much fairer way for both client and lawyer, to the introduction of technology and the billable hour, as law firms and legal work became more complex. And even then the billable hour was not always the most advantageous financial reward to lawyers where they were deserving of premiums for their contribution in transforming a deal and whose input was worth literally millions of dollars. Indeed, during the dotcom boom of 2000 veteran Silicon Valley partners said that the lawyer's time had come and that they too, like the bankers, would be rewarded in terms commensurate with their influence on the deal. Here, even the billable hour was seen as a poor way to reward top lawyers, and we saw firms taking equity and other novel ideas.

During the bull years leading to GFC, wage inflation through the inexorable rise of the billable hour was the norm. Each year, the Magic Circle and top US law firms would inflate their flat rate billable hour by a suitable percentage, knowing that clients would knock them down but they would still achieve their hourly rates or perhaps even a premium on them. There wasn't much transparency. Hourly rates have continued to go up year on year, which suggests clients for the most part are still accepting of them.


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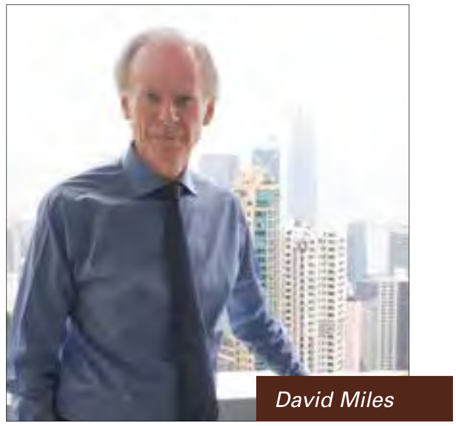
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To quote *The American Lawyer* editorial piece on the 25th anniversary of the AmLaw 100 in 2012: "In the quarter-century since *The American Lawyer* began tracking the nation's 100 largest law firms, total gross revenue for that cohort has multiplied more than tenfold, from US$7 billion to US$71 billion. In nominal terms the average Am Law 100 PPP has more than quadrupled, from US$324,500 to about US$1.4 million. Providing fodder to those who see a widening class divide, the average AmLaw 100 partner earned 11.3 times the average American employee's compensation in 1986, and 23.4 times that benchmark in 2010, the last year for which data is available."

It is no surprise then that the one key performance indicator chosen by *The American Lawyer* out of the many possible is the annual equity partner draw. A great deal of column inches has been dedicated to how managing partners at various law firms, have become obsessed with their AmLaw equity per partner ranking in the AmLaw 100 list. What has been less discussed is what an uncomfortable measure of success this represents and how the AmLaw 100 itself and the legal press more broadly have unduly influenced the legal profession with all these rankings to patterns of behaviour that are in no way in either the clients, or even the profession's best interest.

Curiously, *The American Lawyer* published its first AmLaw 100 in 1987, the same year as Oliver Stone brought us Gordon Gekko and 'Wall Street'. It is as though Gordon Gekko took over the gentlemanly reigns of the profession and declared 'Forget about all this ethical mumbo jumbo – it's what you put in your pocket that is the true measure of a successful attorney. Greed is good!'

We are reminded of a recent Harvard piece of research indicating that the incidence of 'air rage' is much higher when economy class passengers are actually led through the first class cabin on the way to their tiny cattle class seats. In much the same way, many of these annual rankings provoke greed and envy across every class of lawyer and end up making everyone but the very top echelon dissatisfied with their lot.

In other perhaps less obvious ways, the AmLaw 100 score card of earnings by equity partner has contributed to the lack of relative success in emerging markets experienced by American-based international law firms. Generally, it would seem that quite a few American firms have garnered anemic returns on their expat investments, according to a Harvard Business Review study. The main reason, as concluded by J Stewart Black and Hal Gregersen, was that many US executives assume that the rules of good business are the same everywhere. The Asian market has proved especially difficult for international law firms – as we explored in our recent article 'Asia-Pacific exceptionalism and BigLaw global M&A'. Part of the reason for this is that charge out rates for work done in, say Singapore, do not compare with Manhattan. It is very much not a one size fits all global market. The top firms have for the most part continued to pursue only the work that supports their financial model. The rest are continuing to work out whether they can continue to get away with billable hours or whether the creeping growth of fixed price work means they get ahead of this and work with the client with sensible proposals to reflect whats going on in any given market.

The consequences of all this is that it's getting harder to justify equity partners in these weaker and cheaper legal markets and this has a knock on effect for those associates working hard and who in other places would be absolutely deserving of an equity partnership but the economics don't justify it. It makes it very challenging to manage careers.

Some firms have given up entirely on the idea of a standard rate – for example Denton and its poly-centric approach, which attempts to make a virtue out of the differences in the perceived value of legal services in emerging markets as compared to the USA and London.

Either way, the billable hour as a measure of fees has not exported well for many international law firms and the economic imbalance of returns between certain regions is one of the reasons why cohesion in firms is breaking down. But what kind of legacy is this going to leave for the next generation? It's not an exaggeration to say that increasingly law firms are finding it tougher. The global market for the most part is not growing, so for many its all about maintaining market share and eking out more profit from that share. Firms continue to look at ways of securing their position. We have seen the increased dominance of the top firms who go from strength to strength in their chosen markets the growth of defensive mergers, and the creation of federations of firms that view that bigger is best and so on. And we have seen failures and some spectacular failures where firms have completely lost the plot. No doubt we will see much more of the same in these very turbulent times. And then there is Brexit.

We started with a quote from a business consultant whose career is inextricably linked to the concept of disruption in commercial life, Clayton Christensen. And we will end with one:

"A disruptive innovation is a technologically simple innovation in the form of a product, service, or business model that takes root in a tier of the market that is unattractive to the established leaders in an industry."

As we will explore in the next article, the big threat does not even look like Big Law and is happily making progress on the lesser attractive morsels left behind by BigLaw. And guess what, these new players are not billing by the hour!

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