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Why BigLaw Can't Keep Hiking Fees To Raise Revenue

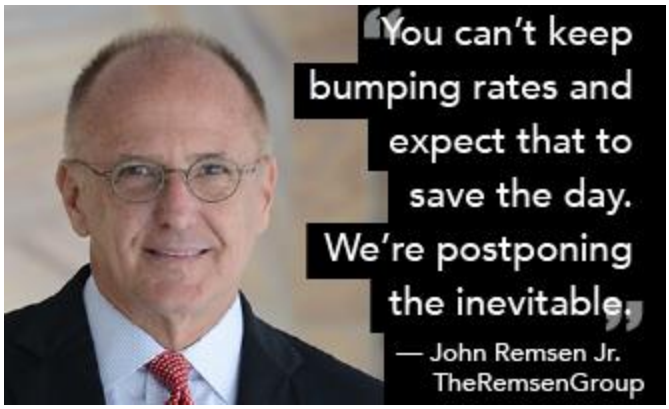
By **Aebra Coe**

Law360, New York (December 14, 2016, 6:15 PM EST) -- A consistent trend has emerged since the Great Recession in which firms raise rates to drive revenue while demand for their services remains mostly flat, driving clients to bring more work in-house — a cycle experts say law firms need to break in order to thrive.

According to a Tuesday report by Citi Private Bank, demand for law firms' services grew by a mere 0.5 percent during the first nine months of 2016, while revenue spiked 3.7 percent, driven largely by lawyer rate increases — results the bank characterized as "typical annual performance of the law firm industry in these post-recession years."

Other studies this year have reached similar conclusions, including a November report by Wells Fargo, which found revenue increases during the first nine months of 2016 did not come from an increase in productivity or demand, and instead were skewed upward by rate increases as well as mergers and mass hirings.

Research also shows corporations are handing more work to their in-house legal teams in an effort to save on costs.



Total legal spending increased by a modest 1 percent over the past year among 276 corporate global law departments surveyed by HBR Consulting for a 2016 survey, while those same departments' spending on outside counsel decreased by 2 percent.

The HBR report concluded that as corporations are increasingly pursuing strategies to do more with less, legal departments have begun to focus on building internal resources and reducing their reliance on outside counsel.

Raising revenue figures through rate hikes, even as demand holds steady, is seen by many in the industry as a short-term Band-Aid for a larger problem — decreased reliance on traditional law firms as myriad new service providers infiltrate the market, including ever-more sophisticated in-house legal teams — and as an unsustainable path to long-term growth.

“Something’s going to break here,” said John Remsen Jr., founder of TheRemsenGroup, a marketing and business development consultancy for law firms. “You can’t keep bumping rates and expect that to save the day. We’re postponing the inevitable.”

The inevitable, according to Remsen, is a transformative change in the way law firms deliver legal services, stepping away from the old model of billable hours and toward innovation in the way legal advice is offered up to clients.

“You have to look to the future — evolving, adapting, getting ahead of the curve, and not being pulled along kicking and screaming. Leaders need to realize that they’re running a business, not a country club for lawyers, and take a much more hard-nosed approach to the business side of the law firm,” Remsen said.

According to Michael Roster, steering committee co-chair for the Association of Corporate Counsel's Value Challenge, in order to drive natural revenue growth, firms should market their legal expertise in specific areas and begin to focus on client outcomes rather than billable hours.

“Clients don’t buy hours, and yet that’s what law firms sell. Clients are looking for expertise and outcomes. As soon as firms begin to market that, they will get back on an even keel,” Roster said.

He posits that recent financial reports reflect that the legal industry is seeing “the last gasp of the old model” where billable hours dominated and law firms increased their fees each year, without any complaint or action taken by clients.

In today’s post-recession legal industry, there are multiple law firms — sometimes dozens — that can competently handle almost any legal matter a company faces, Roster said, which means cost often does come into the equation as clients have their choice of multiple providers.

Roster says he has read more than 3,000 client evaluations of law firms for a survey conducted by the ACC Value Challenge and said that while many elite firms got high scores for the quality of their work, many general counsel said they would not use the firm again.

“A typical comment on the survey was that cost was beyond anything reasonable and the company’s CEO told the general counsel, ‘Never use them again,’” Roster said.

One major way that law firm fees have been inflated, according to Steven Petrie, chief strategy officer at Faegre Baker Daniels, is through discounting measures. Clients have begun to demand more discounts on law firms' fees as they feel pressure from above to cut legal spending, and law firms have responded by raising their base hourly fees and applying discounts in order to reach the final number charged.

The trend has been driven in part by the emergence of legal operations experts and procurement specialists in corporations, who are tasked with finding the “best deal” for clients.

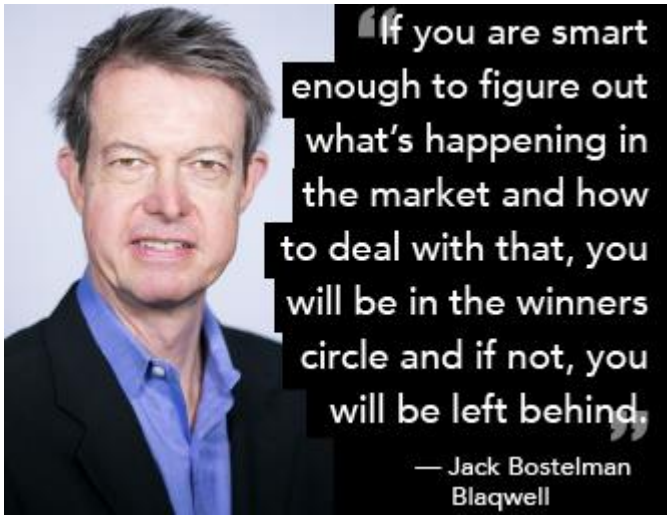
“Traditionally, on an annual basis, law firms have evaluated their rates and tried to achieve increases on those rates. Also, there’s been an increased focus on the client side on what discount they’re achieving. In that setting, law firms often see the importance of increasing rates in some instances so that deeper discounts might be provided,” Petrie said.

While it is the status quo, the practice is not the answer to law firms’ trouble growing revenue and profits, and law firms should instead look to alternative solutions, Petrie said.

“We’re trying to look for alternatives. We’re trying to change the paradigm when talking to clients, proposing flat fee structures that allow for greater predictability and alignment with their perception of value on a matter,” he said.

The best place for law firms to go next, according to Petrie, is value-based pricing: charging clients based on tangible results that are meaningful to their business.

“I think that’s the future, where fee discussions are much more project-oriented and not tied to hourly billing rates and not tied to the notion of hourly time. Then we can get out of this recurring cycle of annual rate increases,” Petrie said.



Remsen pointed to two law firms that have made alternative billing methods their niche, saying the firms are addressing root problems with sluggish demand rather than applying a Band-Aid for ailing profits.

The firms referenced by Remsen are Chicago’s Valorem Law Group and Summit Law Group in Seattle, both of which operate within non-traditional models where value-based billing and alternatives to the billable hour are the norm.

“I think trying to bump up rates and operate under the traditional law firm model is just kicking the can down the road, if you will,” Remsen said. “You’re not addressing the fundamental issues involved in the changing marketplace for legal services.”

Rate hikes are not necessarily unwarranted though, according to Aileen Leventon of QLex Consulting Inc. Much of the work that law firms have tended to bring in-house is routine legal work, which leaves complex and high-stakes work for outside law firms, Leventon said.

That allows for some upward rate movement, as the work that law firms do is more often the kind that offers a high degree of value to clients, she said.

Jack Bostelman of legal consulting firm Blaqwell Inc. says “averages are misleading,” explaining that while the average law firm may see flat demand and will increase fees to drive revenue, the larger picture is more nuanced, with some law firms performing much better than average.

“If you are smart enough to figure out what’s happening in the market and how to deal with that, you will be in the winners circle, and if not, you will be left behind,” Bostelman said.

That contention is supported by the data. According to the Citi Private Bank report, nearly half of law firms, 46 percent, reported demand for their services declined during the first nine months of 2016, while a portion of the industry, 17 percent, saw greater than 5 percent increases in demand.

Bostelman predicts this disparity between the top performers and those on the bottom will lead to increased consolidation in the market, as high-performing firms gobble up those that can’t survive.

“That’s not an accident, it’s following the traditional path of professional services firms as their markets mature. If you look at the accounting industry, it started as a whole bunch of smaller firms that then began to consolidate, and we ended up with the Big Four and everyone else. We see the law firm market headed in that same direction,” he said.

--Editing by Philip Shea and Kelly Duncan.

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