Last month I gave a talk at a University of Pennsylvania symposium on the business of large law firms. It's a brief summary of some of the challenges in the market, plus a strong recommendation that firms and their clients start developing a "vocabulary of value," which will help them think differently about billing for services.

The Business of (Big) LAW

Exploring the Economic Realities Challenging the Modern Law Firm

University of Pennsylvania Law School

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Keynote by Aric Press

I'd like to start with a word of reassurance.

Despite the various overwrought reports of the past few years, Big Law isn't busy dying. Parts are being sorely tested, but the present of large law firms is strong, and so is the future, for at least one undeniable reason: Big clients, in all their many and varied forms, need the help of big law firms. They haven't found a substitute yet. And, to be blunt, most haven't bothered to look for one.

For all that—and for all the good work that is being done—there is a sense of unease in the practice and business of law. There is so much focus on the price of the services rendered that sometimes I worry whether the transactional part of the relationship, the hiring and paying, is diluting the more important aspect of the relationship, namely the role of the trusted advisor trying to help someone in need.

Some of this is a direct result of the economic dislocation of the last six years. Faced with new demands for cut costs and, occasionally, cut corners, law firms and their clients scrambled to adjust. They didn't have a vocabulary to talk about the value of their services or, often, their methods of delivery. Instead they fell back on simple arithmetic: Hours times Rates.

For all the dollars at stake, this is an impoverished conversation, one that reminds me of nothing so much as what the prison warden famously said in the film "Cool Hand Luke": "What we've got here, is a failure to communicate." (I concede that most of my cultural references are painfully out of date.)

What's particularly worrisome is that this failure to communicate is taking place in a difficult market but one that has only begun to feel the stresses of change. I don't minimize the pain. But let's be clear: the law business is only at the beginning of a period of change and already there is a coarsening or a distortion of the core conversation and practices.

This market has hardly suffered a serious disruption. For examples of that, please consider the entertainment business or publishing or, closer to the practice of law, medicine. There the changes have been rapid, broad, unexpected, and deep. By comparison, lawyers and law firms have, for all the concerns expressed, been forced to change far less.

Big Law is vastly bigger, richer, more ambitious and more diverse than it was a generation ago. And, the pace of practice has sped up in ways almost unimaginable before the turn of the century.

But if you put aside the new instruments that allow lawyers to work 24/7, bounding across time zones and continents, imperiling only their starved-for-attention loved ones, the core of their work would be recognizable to lawyers of earlier eras.

Could William Nelson Cromwell or Paul Cravath operate in today's environment more readily, say, than Louis Pasteur or David Sarnoff? Yes—provided you taught them how to type and control their air conditioning units, and, as we already do for lawyers of a certain age, remind them of their log-ons and passwords.

That isn't to say that things aren't different, only that the changes in the law business have mostly been felt on the margins. Yes, there are some new entrants in this space, and some new money has begun to slosh around. But the old regime hasn't been toppled. It's just under stress.

The reasons are pretty clear. In constant dollars, spending on legal services by American business, when measured in inflation-adjusted dollars, is off about 25 percent over the last decade. During this period, according to estimates prepared by the Legal Intelligence staff at American Lawyer Media, the Am Law 200—the 200 top grossing firms in the land—increased their share of market to roughly 47 cents of every dollar spent by American businesses. It's not clear to me which of those two numbers is the more astonishing, the fall in demand or the concentration of spending.

But to those who worry for a living, the enormous share of market held by those 200 firms is just another reason for concern. For the last three years, according to the estimates, their share has remained flat. Perhaps the Am Law 200 has hit its natural limit. Remember, these firms represent roughly ten percent of the practicing lawyers in the United States. Under what circumstances will they keep capturing a greater share of legal spending year after year?

The stress is intensely personal as well as institutional. Becoming an owner in one of the Am Law 200 firms was never easy but now has taken on the nature of a biblical quest. It may be easier for a camel to get through the eye of a needle than for an associate to become an equity partner. Over the last decade the number of equity partners in the Am Law 200 increased by 1 percent. During the same period the percentage of owners has actually been reduced. Leverage—the ratio of non-owners to owner lawyers—has increased from roughly 2.6 to 3.1 to 1. To put it in Churchillian terms: never have so many worked so hard to benefit so few.

And those are the ones we might call lucky. Firms now openly talk about having to demote or defenestrate partners who are "underperforming." In The American Lawyer's

surveys of law firm leaders, a majority routinely report that they have de-equitized partners in the past year and plan to do so again. And roughly an equal number predict that they would force partners to leave their firm. Diamonds may be forever; partnership evidently is not.

This tough, stressful climate takes its toll. I'm a consultant now and in the course of my work I meet even more often with folks in this line of work than I did as editor of The American Lawyer. Recently I had dinner with a psychologist whom law firms call in to help mediate their internal conflicts and reprogram their badly behaving partners. How much has this aspect of his practice increased in the past year? Seven fold!

And that's just the service provider side of the equation. The picture is not easy on the client side, either. Since Lehman Brothers collapsed and the Great Recession began, clients have been under serious financial and budgetary restraints. More than one general counsel has said that hiring outside counsel now is a luxury so she better make sure it is also a necessity. But as some clients have brought more work inside—and understand it is only some clients that have—they have been expected to manage it without increasing budgets as fast as their workloads. More is expected of them, the clutter on their desks only grows, and the world in which they operate never becomes less complex.

Caught in this vise, two things happened. The legal marketplace took on the hallmarks of a souk, without any exotic charm. And a ferocious segmentation developed. The two are related. For the most difficult, most risky work, customers go to the lawyers they think can save their bacon. When the CEO is invited to meet next Monday morning for an intimate chat with Preet Bharara, his general counsel doesn't ask for a litigation budget, he asks for time on Lorin Reisner's or Bill McLucas's or Kathryn Ruemmler's calendar. There aren't any atheists or legal market reformers in a foxhole.

And that critical, high priced work is tending to go disproportionately to a select group of firms. Every firm in The Am Law 200 gets a taste of it, but maybe two dozen now dominate that high-end segment.

Then there's the rest of the big firm market, where price is sensitive and clients aren't willing or able to pay premium rates. Think of the post-Lehman times as an age of growing discernment. Customers are simply more careful, more exacting, in deciding which lawyers to hire and at which price points. They expect and frequently receive discounts. This is not an inspiring process, filled as it is with posturing and work-arounds.

The firms increase their rates; the clients get their discounts. There are winks and nods; everyone is in on the game. It's the hotel room effect: there's a price posted on the back of the door and then there's the number available on Priceline. Once lawyers took inspiration from fictional characters such as Atticus Finch or Horace Rumpole. Now, too many take their lead from an aging Captain Kirk, William Shatner, now out of uniform, bloated, and no longer a master of the universe.

These often-cynical discounts are a testament to the continuing power of the billable hour, at least in the United States. When Acritas, the global brand research company, asked 1500 clients about their use of the billable hour, this is what they found: Outside the U.S., about 31 percent of the work was billed on some method other than time. In the

U.S., clients put the figure at 13 percent. This is, in my judgment, not the proudest example of American Exceptionalism.

Why does the pattern persist? For one thing, it's what lawyers and clients know. There is comfort with the familiar, if occasionally also contempt. For another, despite too much rhetoric at too many conferences, in practice both firms and clients prove to be reluctant, even hostile, when offered opportunities to move in new directions. Also it's hard to estimate costs and risky to be wrong. Think of it this way: Veteran professionals can tell their clients nearly everything about the likely outcome of a case, but they're still reluctant to predict how much it might cost. In other words, they are comfortable assuring clients about the clients' substantive risk; they are frequently uncomfortable taking on much of their own commercial risk.

But there's another factor at play here, too, and this one is pernicious: too often there is an absence of trust and fair play.

I know that the plural of anecdote isn't data, but sometimes an example can be telling. My current favorite involves a household-brand national firm who recently entered into a fixed-price agreement with a large national client. Under the deal, the firm would handle litigation for two divisions. The firm would make the staffing decisions. It would study the business to find remedial actions to prevent new cases. And it would review its progress with the client every quarter. The client would pay a fixed fee that was roughly a 10 percent reduction from the previous year's expenses.

All went well for two quarters, until the client's CFO reviewed the arrangement. The firm was living up to its obligations, disposing of cases quickly and beginning to suggest changes in company operations that would reduce the client's exposure. But the CFO was unhappy with what he found. By looking at the firm's "shadow billing" records, he concluded that he was being overcharged. Had he stuck with the billable hour rather than this newfangled deal, he'd be paying even less.

So the CFO effectively aborted the deal, insisted on a 10 percent discount off the current year's billing rates, and dispensed with the remedial efforts as largely speculative.

The firm was aghast. This was an important client so it couldn't just walk away. However, not only had all its effort at crafting a new arrangement just been tossed aside, but after agreeing to the newly imposed discount, its realization rate plummeted to roughly 70 percent.

The head of the firm was rueful. And having been singed badly, he said he was unlikely to rush into another elaborate alternative billing arrangement like this one again. He'd prefer to take his chances with Hours x Rates, even discounted rates.

There's no accounting for knavery and this episode may just be an example of that. But I think it's as likely to be another byproduct of the Cool Hand Luke syndrome I mentioned earlier.

The pre-deal discussions focused mostly on the pricing arrangements. A pricing consultant advised the firm on the matter. Ten years ago there weren't any pricing officers in The Am Law 200. Today there are more than 100. And that's a good

development, for they are forcing lawyers and clients to look more carefully at their actual costs of doing business.

But in my view, the discussion can't begin and end with incurred costs and projected savings. What's missing in that sort of regimen is an explicit talk about what these matters were actually worth to the client.

That was certainly the case with the unhappy example I cited. The negotiators at the table didn't know how to talk about the value of the matter in any other way but what it might cost. The other half of the equation, benefit and worth, just wasn't on the agenda.

After all this time, the legal market lacks a language to describe and a method to calculate value. Knowing it when they see it isn't a very satisfying legal principle for defining pornography and it is even less useful as the basis of a complex and dicey lawyer-client relationship.

But without such an inquiry parties to these arrangements invite disappointment, misunderstanding, and another generation of heartache that will badly serve both sides, but especially outside lawyers.

The zeitgeist of corporate America is metrics. And the result is that, in my view, too many executives and their boards now believe that the only things that matter are those that can be measured. That is not true, of course, but it is the received wisdom of the moment. If that is the case, how should the performance of lawyers be measured?

By:

- Their results?
- Their responsiveness?
- Their risk-avoidance?
- Their work product?
- Their bedside manner?

Or, as they are now, just by their bills?

As I suggested earlier that is an impoverished measure and an impoverished dialogue. And it is prevalent in-house too. When I talk with general counsel and ask how they are assessed internally they say it's by whether they've hit their budget goals. For most, that's a matter of cost control as few are profit centers. Really? A decade and a half into the new century the best measure of a lawyer is his or her bill and ability to make budget? I hope not.

Addressing this issue, I suspect, will be part of what I hope will be your long careers. I urge you to start thinking and talking about it from the beginning. Change in this area is likely to be incremental which in our space is a polite word for slow. The sooner you start addressing it, the sooner your conversations with clients and colleagues can break the tyranny of thinking of yourselves as sellers of time, and you can begin to think of yourselves as what you are: purveyors of judgment, care, and courage.

I leave you with two thoughts. First, you are entering the profession at an exciting time. There are great and thorny issues facing all of us and lawyers will be at the center of solving many of them. Foremost among them is the spread of the rule of law, both around

the world and ever more deeply at home. You are part of that effort. If you find yourself in a place or a job that makes light of that, leave. This is too important to be made trivial.

Second, you are entering a profession that has a public service obligation. Part of your duty, and I mean duty, is to find ways to help provide legal services to those who otherwise can't afford them. There are many reasons to do that: personal and political, as a career enhancer or a place for training and experimentation. Choose whichever ones appeal but please, don't forget that it is a professional reason, an obligation to your colleagues and to your fellow citizens of the nation and the world.

Again, this is a great time to be a lawyer. I envy not only your energy but also the opportunities that await you.

Thank you for your attention.