

Reality dawns on hourly rates

The recession forced firms to moderate or forego rate increases.

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It took a global economic meltdown and a major upheaval of the legal industry, but law firms seemed to get the message that 2009 was not the year to substantially increase their billing rates.

The national average firmwide billing rate, a combination of partner and associate rates, grew by 2.5% during 2009 to \$372, according to *The National Law Journal's* annual survey of billing rates. That's a relatively small boost compared to the 4.3% increase firms that reported in 2008 and the 7.7% rate climb in 2007.

"Law firms this year increased rates very modestly, compared to the standard rate increase of 6 to 8%," said James Jones, a consultant with Hildebrandt International. "I would have expected to see that, in 2009, when the message [about the state of the economy] finally sunk in."

Firms' inability to increase billing rates to the extent they have in years past is bound to depress 2009 financial results because rate increases have been the single biggest factor in recent revenue and

profit gains, said Altman Weil consultant James Cotterman. The cost cutting firms did during the past year will help mitigate the lower-than-typical rate hikes but likely won't be enough to offset those losses, he said. Firms also reported that they are generating a larger percentage of revenue from alternative billing arrangements, which have grown in popularity as legal departments have looked for ways to cut costs.

Nationwide, the average hourly billing rate for partners was \$457 in 2009, up from \$451 in 2008. For associates, the average rate was \$287, an increase from \$282 last year. Early indications are that billing rates will continue to creep up in 2010. A recent Altman Weil survey of 288 U.S. firms revealed that firms anticipate an overall average rate increase of 3.2% next year. NLJ affiliate *The American Lawyer* recently surveyed 142 managing partners from the country's 200 largest firms, and 81% said they expect to raise billing rates in 2010. The majority of those firms — 77% — said that increase would amount to 5% or less.

Although growth was comparatively slow, most firms did raise their rates. The average firmwide billing rate grew at 76% of the firms that reported detailed billing information in both 2009 and 2008.

The law firm billing information was collected as part of the NLJ 250, *The National Law Journal's* survey of the nation's largest law firms. The survey period ran from Oct. 1, 2008, to Sept. 30, 2009, with 190 firms providing at least some billing information. Firms were asked to report their billing rates as well as their use of variations on the billable hour and alternative billing arrangements. Although firms that reported rates in 2008 did not necessarily do so in 2009, the figures do suggest billing trends, particularly among midsize firms, which composed the bulk of those providing detailed billing information.

Although most firms adopted modest rate increases, 24% reported average firmwide billing rates that were the same or lower than during the previous year.

For example, the average firmwide rate at Denver firm Holland & Hart dropped by 1%. Managing partner Thomas O'Donnell declined to discuss the firm's rate-setting process, but acknowledged that the economy was a consideration.

"When we set our rates, particularly this past year, we do so with great consideration to the economy and its effect on clients," O'Donnell said. "We were very mindful of that."

Not everyone is convinced that simply reducing billing rate growth is the right strategy for law firms in this economic climate. Susan Hackett, senior vice president and general counsel of the Association of Corporate Counsel (ACC), expressed surprise that any firm would boost rates right now. "I can tell you that whenever I talk to clients they actually laugh when they hear about firms raising rates in this environment," Hackett said via e-mail. "Every one of them should have been involved in some kind of cost-cutting or efficiency exercise, just like their clients, and the idea that the way to counter possible decreasing workloads or excess capacity is to raise prices is totally contrary to good business judgment."

Slightly higher rates won't necessarily bring in more money, Jones said. Hildebrandt's Peer Monitor Index, which tracks a number of economic indicators at large law firms, suggests that collection rates have been fairly low this year. "Just because you're charging higher rates doesn't mean you're going to get more money from clients," he said.

Hackett has heard anecdotal evidence that some firms have raised rates on paper in anticipation of clients requesting deep discounts. It hasn't been unusual lately for clients to request discounts in the range of 10% to 20% off hourly rates, Cotterman said. Recent rate increases in the range of 2% may represent an attempt by firms to keep up with inflation and maintain some level of growth. A one-year rate freeze would have significant long-term effects on firm revenue, because rate increases compound over time — much as the long-term value of a 401(k) retirement fund would decline if contributions were suspended for a year, Cotterman said.

Four law firms reported partner billing rates of \$1,000 or more, including Buchanan Ingersoll & Rooney at \$1,020, Foley & Lardner at \$1,035, Jenner & Block at \$1,000 and Locke Lord Bissell & Liddell

at \$1,045. The "movers and shakers" who charge upwards of \$1,000 are not the norm and tend to have specialized practices and close relationships with high-ranking government officials, Cotterman said.

SILVER LINING

One silver lining Hackett has found in the dismal economy is that more clients are ditching the billable hour. Increasingly, clients are asking firms to enter into alternative fee arrangements that take into account the overall costs of their legal matters. "Some might say, 'I really don't care what your rates are — that's not my problem. This is what I'm willing to pay for the work...you figure it out from there,'" Hackett wrote.

The billing survey highlighted the degree to which alternative billing arrangements are becoming an important part of the way law firms generate revenue. Nearly every firm that responded to the survey said that it charged fixed or flat fees, retrospective fees based on value, contingency fees or a hybrid of those options. Among the firms that reported the percentage of revenue derived from alternative fee arrangements, 57% said that amount represented 10% or more of their revenue during 2009. By

comparison, 50% of firms during 2008 reported that alternative fee arrangement accounted for 10% or more of their revenue. An October survey of 587 general counsel by *The American Lawyer* and the ACC revealed that 39% of those chief legal officers saw an increase in the amount of their legal work handled through alternative fee arrangements in 2009.

"I get a sense in the past 18 months that in-house counsel's concern with the billable hour is deeper than its has ever been," said John Murphy, chairman of Shook, Hardy & Bacon, which reported that 25% of its revenue now comes through alternative fee arrangements. "I don't think I've seen an RFP [request for proposals] come across my desk in the past year that didn't ask if you are amenable to an alternative arrangement, and what that might look like."

Shook, Hardy & Bacon has offered alternative fee arrangements for years — most notably including its agreement to provide products liability defense for Tyco International Ltd. for a monthly fixed fee, which has been in place since 2004. Murphy predicted that the percentage of revenue generated by alternative fee arrangements would grow in the coming years.

"It wouldn't surprise me if we are in the 30% to 35% range," he said in speculation about 2010.

During the past 15 months, Orrick, Herrington & Sutcliffe has roughly tripled its volume of alternative fee arrangements, said chief client service officer David Fries, who oversees the firm's pricing. Approximately 25% of the firm's revenue is generated through alternative fee arrangements, which include its deal to handle all of Levi Strauss & Co.'s legal work, with the exception of intellectual property matters. "Before this year, there was a lot of talk about alternative fee arrangements, but not much action," Fries said. "There really wasn't a huge movement from law firms, and there was little interest from most legal departments in doing things differently."

The faltering economy has put clients under greater budget pressure and highlighted the conflicting interests of the client and the law firm under the traditional hourly billing model.

"There is no doubt in my mind that there is enormous inefficiency in the historic hourly billing model," Fries said. "People just threw bodies on the matter."

Although there is no question that alternative fee arrangements are growing in popularity, it's unclear whether those arrangements could ever produce the record profits to which firms had grown accustomed. "I don't think we're going to see increases in law firm revenue that we saw from 2003 to 2008," Murphy said.

Alternative fee arrangements can be a good thing for law firm bottom lines, but profits will depend on efficiency, Jones said. "Alternative pricing arrangements aren't necessarily less profitable for firms," he said. "It depends on how you manage the work. All at once, there is a premium on doing things efficiently. Law firms have never really had to deal with that before."

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