FIRM GUIDANCE

The Lost Art of Leadership

By Edwin B. Reeser

As Peter Drucker said, "Management is doing things right; leadership is doing the right things."

Lawyers do not understand this. (Judging from the advice handed out over the past dozen years, most management consultants typically don't either).

Lawyers have been trying to figure out how to manage their firms, and have been focused on it relentlessly for a decade. They've done this with all manner of very expensive support and assistance from consultants. The key is not whether law firms have been doing it well, or doing it badly. The stark reality is they have been doing the *wrong* things.

The focus on wrong things is evidenced on at least two different and fundamental levels.

The first level is that there has been a complete failure to properly appreciate the "people business" essence of law and the impact of the investment made internally, and the impact of that investment externally on the oft discussed price/value proposition for customers. The most precious and essential element of professional practice is identifying, recruiting, hiring, training, mentoring, promoting and retaining those professionals, and the properly skilled staff to support them. Systems, procedures and technologies are all neat, but they mean nothing without having the best professionals. The cost of every one of those people is very high compared with most other types of business. Capital is important, but compared with manufacturing, sales and distribution businesses, it is a smaller contributor to the creation of revenue. Operating models that treat legal professionals as fungible and interchangeable widgets are wasteful, inefficient and, let's face it, inhumane. Emphasis on reorganization of law firm operations has for the most part been a cosmic waste of time, energy and money. (Going to practice group management models versus geographic management models is but one example. It is nothing more than deciding to play musical chairs by marching clockwise rather than counterclockwise. What is worse, it gives the false impression that the enterprise is actually engaged in something that is going to make a difference.)

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The second level is in the definition of what the "right" things are. Specifically, a very definite, clear and uncompromising definition of a moral "right" thing, which is communicated to all and embraced and adhered to by all, with rigor. It is through the pursuit and achievement of the "right" thing that the culture of a firm is built, and the team commitment by people to each other and for each other can be framed to achieve everything else that matters in the enterprise. Without that group commitment to the value-based mission at the beginning of the enterprise endeavor, nothing can be soundly built or grow, and without it applied steadily to the end nothing of real value can be sustained or survive. Leadership must tend to this culture relentlessly, such that it is embodied in everything the firm does, and thus by everyone in what they do. For the most part, the defining culture has been abandoned or relegated to just words by many law firms. The absence of meaningful actions that unequivocally demonstrate to everyone in the firm that its culture comes with utmost priority characterizes today's landscape of struggling law firms.

The two levels are, of course, related. Without the collapse of the second level of firm culture, the erosion of the most critical component of the "engine" of the business would either not have happened at all, or would be materially less than it is.

This is where the "start over" of the new business model really begins. In some ways, it is the rediscovery of what made the firm successful in the first instance. The price/value proposition for customers is not the problem; it is merely a symptom. Many, if not all, of these struggling BigLaw firms have been successful in the past precisely because they did deliver a price/value proposition that was perceived as outstanding. What happened?

Is the problem bloated overhead and uncontrollable or unmanageable costs? Is it the "billable hour" versus fixed-price or other alternative billing arrangements? Of course not. The problem has been a lack of courage and discipline to deliver a better quality legal product and service for a better price — to provide increased value. Firms have failed to invest in people and the future of the enterprise as an institution. Instead, they have responded to higher costs by just raising prices and flogging people to work more. And in a panicked response to reduced workflows and client resistance to perennial increases in fee levels, law firms cut costs and jobs and stopped hiring new talent without addressing the underlying problems.

Firms have disenfranchised large numbers of partners from the decision-making process, stripping them of any real participation in the exercise of ownership rights. Thus marginalized, and receiving less and less information, they think and act more like piece work laborers and not like shareholder-officers with any sense of responsibility for the actions of the firm or the outcomes and results of the enterprise. Those who question, let alone challenge, the decisions and policies handed down without their participation are harshly disciplined to make the message clear that such debate is no longer a part of the process. Partners in leadership positions are increasingly not leaders, but those with enough power to demand positions and allocate to themselves, and to their friends, increasing shares of money and other rewards. The confusion of the position of leader, with the fulfillment of the role of a leader, has never been more apparent. The short-term approach of present day law firm management appears to have more in common with a smash and grab visit to a Tiffany's counter than exercise of fiduciary concern for one's partners or a long-term responsibility for colleagues' careers.

Can a law firm that has lost its way resurrect itself by finding its culture once again? Obviously that depends on the unique circumstances of the firm and the condition it is in when the effort begins. But not to try to come to grips with the culture challenge is to face a potential dissolution outcome that is likely far more damaging to many more people. Firms with real leaders will have a chance to make it. The first key will be whether the firm retains enough people in positions of power and influence who embrace the core values of its culture, or can identify and put such people in key positions. Has the firm culture been diluted through inattention internally, and through lateral transfer additions made without identifying those core values during the hiring process? A second key is whether, bound together by culture, the firm "leaders" will subscribe actively to being creators of value that benefit the entire firm (and themselves in that process), rather than an elite entitled to withdraw wealth from the firm (even if it is at great cost to those beneath them in the hierarchy).

The answers will not be in bold stroke mergers, absorption of chic specialty practices, or expansion to new markets in new locations. Think about it. Those are all strategies that send the following message to the entire firm: "The future success, indeed survival, of this firm depends on people who are not here now, and who have yet to be found." Is that a message of a successful organization that motivates its membership to move forward with energy, enthusiasm, passion and resolve? Such moves by those occupying leadership roles exhaust the spirit of those in the firm, and waste the financial resources desperately needed to work real change, increasing the difficulty of recovery.

Firms just have to find those leaders and put them in the positions necessary to make it happen, and get behind them with the support needed to work positive change. It won't be easy. It will be worth it. It is a simple matter of choice, sponsored by a single question: Do you have the courage and culture to do it, and to do it together? If you do, then get to it while there is still time. If you don't, stop wasting time and money and making the hole deeper by pretending that everything is fine.

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Alternative Fees Require Trust Between Lawyers and Clients

By Oleg Cross

Disdain for the billable hour — expressed by both clients and lawyers — has lingered for years. Many have wondered whether the current downturn will provide the necessary impetus for change, and the rise of alternative, value-based fees. And while many law firms and clients have expressed a willingness to try new fee arrangements, most are still hesitant. After all, the devil you know is better than the one you do not. Hesitation notwithstanding, however, in the past 12 months many firms — both large and small — have increasingly began experimenting with various alternative billing arrangements.

Flat Fees

Flat fees are hardly new. Lawyers have charged flat fees for years for routine business transactions, mortgage closings, uncontested divorces, even appellate work. In litigation, however, flat fees are novel, and getting increased interest. Just earlier this year, for instance, Pfizer Inc. developed a new program in which the company invited several preferred law firms to do work on flat-fee bases. If a giant like Pfizer can pay flat fees for its cases, other companies will try to follow suit.

Yet a common sentiment lawyers express when a client asks for a flat fee is: "This type of litigation is just too unpredictable." Of course, for some types of litigation — true bet-the-company cases, for instance — flat fees may be difficult to set. One way some firms have tried to hedge their bets in doing so is to look for prior years' billings for a similar matter, and then quote a fee based on that amount. And while such an approach provides a measure of predictability, these are not true flat fees, as they reflect the premium inherent in billable hours.

Fortunately, the majority of litigation is not of the bet-the-farm variety. These are routine contractual disputes, single-plaintiff employment cases and similar garden-variety matters that most companies are bound to face. For such cases, flat fees can be a godsend in reducing costs. Firms, on the other hand, may benefit from the volume of such routine cases, while its younger lawyers can get more hands-on experience.

Further, even in larger cases, flat fees can drive the work to more specialized practitioners who are best positioned to give a flat-fee estimate. For instance, a seasoned patent litigator likely knows well the costs of litigating a case to trial in the Eastern District of Texas. Depending on the number of patents at issue, the size of the company, the complexity of the accused product, etc., that lawyer could give a tailored flat-fee estimate for the entire case.

To be sure, most flat fees will not yield record-breaking profits. This is, however, a buyer's market for legal services, and even the largest companies may go a long way to reduce legal costs and change the way they work with outside counsel.

Combinations

Classic contingency fees have been a staple of the plaintiffs' bar. Large law firms have generally shied away from contingent fees, and for good reason. First, defense work does not lend itself to such arrangements. Second, leverage (i.e. the ratio of associates to partners) creates additional financial risks of charging contingency-type fees.

This model somewhat changes this paradigm, allowing firms to shoulder some of the risks historically allocated to the client, without eliminating regular cash flow.

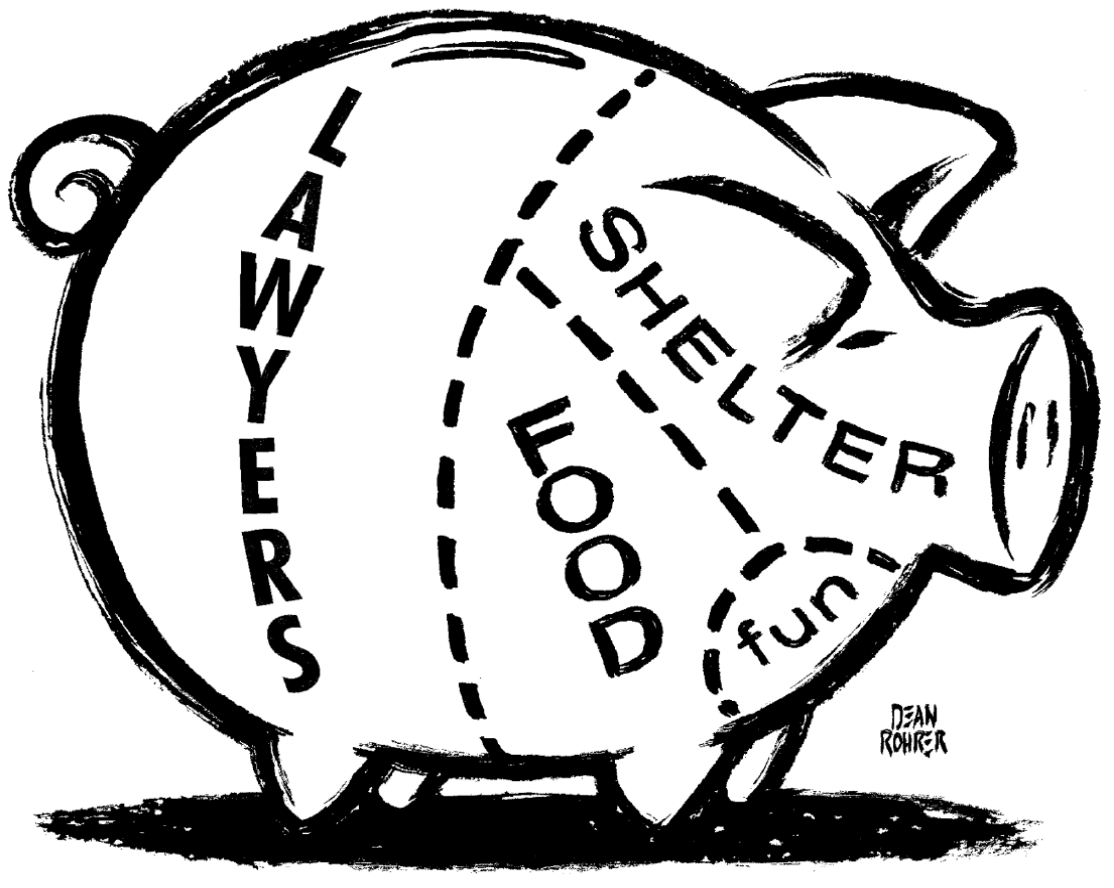
Specifically, in this approach, a law firm quotes a total flat fee for a case, and asks for a large percentage of that fee — between 60 percent to80 percent — to be paid monthly, on a pro rata basis. The other 20 percent to 40 percent is held back. If the law firm wins at trial or achieves some other positive pre-determined outcome (e.g., summary judgment, denial of class certification, etc.), the client pays the other 20 percent to 40 percent as a success fee. If the firm loses, it never gets the remainder of the fee. This way, there is a relationship between the total fee and the result.

Firms like Chicago-based Bartlit Beck Herman Palenchar & Scott and Valorem Law Group have received a fair share of accolades for successfully implementing this model, making it attractive both to clients and its own lawyers. While such firms make this model work, however, it can present significant risks to firms that continue to rely on leverage as part of their business model.

Bill-to-Budget Fees

Most clients demand budgetary predictability, even in large litigation matters. It is not uncommon for billing partners to prepare monthly budget estimates, which are then updated monthly, or even weekly. One of the easiest ways to provide some budgetary certainty, without departing from the billable hour, is to have an agreed-on budgetary cap — either quarterly or annual — on how much the firm can bill for a particular matter. Some clients even establish umbrella budgetary caps for all litigation matters that a particular law firm handles for them. This can work especially well if the company is routinely involved in the same types of lawsuits, with predictable case strategies and costs.

In this model, the law firm bills the client on an hourly basis, but any amount billed over the agreed-on cap is not expected to be paid. This way, the client gains budgetary certainty and can still monitor the work being performed, while the law firm gets some certainty in its expected cash flow, up to the amount of the agreed-on cap. The obvious downside of this approach is that, while it provides some budgetary parameters, the underlying basis for the fee is still the billable hour. Thus, the law firm continues to have the incentive for inefficiency. Still, if the services are provided on a billable-hour basis, budgetary caps can help rein in the billable hour.



Task-Based Fees

In this approach, a law firm carefully develops a budget for each stage of the litigation, and then adjusts it (with client approval) only if there are major changes in the case. For instance, a firm can submit a proposed itemized budget to research and file a complaint, conduct basic discovery (where the volume of the documents and number of witnesses is already known), even draft dispositive motions. If the case takes an unexpected turn, lawyers submit a proposed amendment based on the new facts. This approach is really not that novel.

Of course, firms routinely submit budgets for a proposed motion for summary judgment or a discovery task, and then try to make sure their lawyers bill within that budget. The difference is that with task-based fees, the fee will remain the same, regardless of how much time the lawyers spend. Any changes to the fee schedule must be pre-approved by the client, and can be made only in light of new facts (e.g. significantly more documents than previously expected). For many in-house counsel who submit detailed budgets to management — and then must stick as closely as possible to the budget — such arrangements can be very useful. But while this approach has the potential for a higher correlation between fees and value, it also requires an existing relationship of trust between the outside counsel and the client. After all, the client must be confident that a law firm will not exploit the facts of the case to re-set the fees.

The current wave of client demand for alternative fee arrangements is likely to change law firm financial metrics significantly in the next few years. And as firms experiment with variations of the aforementioned alternative fee models, firm leaders should consider two notions. First, the rejection of the billable-hour model is not only driven by economic belt-tightening, but also the clients' desire for fees to be value-based.

Those firms that can successfully disconnect their profitability from leverage and the standard billable-hour model will likely benefit the most from this sea change, even flourish. More importantly, all alternative fees require a comfortable relationship of trust between the outside lawyer and client, where value, not profitability, takes precedence.

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