

'Billable Hour' Under Attack

In Recession, Companies Push Law Firms for Flat-Fee Contracts

By [NATHAN KOPPEL](#) and [ASHBY JONES](#) in 'The Wall Street Journal'

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With the recession crimping legal budgets, some big companies are fighting back against law firms' longstanding practice of billing them by the hour. The companies are ditching the hourly structure -- which critics complain offers law firms an incentive to rack up bigger bills -- in favor of flat-fee contracts. One survey found an increase of more than 50% this year in corporate spending on alternatives to the traditional hourly-fee model

Pfizer earlier this year reached a deal with law firms, doing away with billable hours and switching to a flat fee. The pharmaceutical company's general counsel, Amy Schulman, talks about what was behind the arrangement.

The shift could further squeeze earnings at top law firms. The past 18 months have been brutal for some big law firms as work that hinges on vibrant credit markets, such as deal making, has flat-lined.

[Pfizer Inc.](#), which spends more than \$500 million a year on legal matters, says it expects to reduce its domestic law-firm spending by 15% to 20%, largely through flat-fee arrangements. It will pay 16 law firms lump sums to handle various portfolios of work, such as litigation and tax matters. "I have told firms you cannot make your historical profit margins" on Pfizer work, said the pharmaceutical giant's general counsel, Amy Schulman.

[Cisco Systems Inc.](#) has notified its stable of outside law firms that it is vital for the company to move away from the hourly billing structure. Cisco now uses fixed fees or other alternatives to the billable hour for about 80% of its legal work, said its general counsel, Mark Chandler.

[American Express Co.](#) also has stepped up its use of alternative billing arrangements, and "I haven't had one firm in 2009 tell us, no, that they flatly wouldn't entertain something that moves away from the traditional straight hourly model," said the company's chief litigation counsel, Stuart Alderoty. "The paradigm has changed."

Money spent on alternative billing arrangements has totaled \$13.1 billion this year, versus \$8.6 billion in the like period of 2008, according to BTI Consulting Group Inc., which surveyed 370 lawyers who work at Fortune 1000 companies. The Wellesley, Mass., firm said that the lawyers reported average cost savings of 15% from using alternative arrangements. It said 63% of the surveyed lawyers planned to increase their use of alternative billing arrangements.

Companies have long complained that legal fees are inflated by a business model in which law firms have high-priced junior lawyers who must be kept busy billing for work that could be handled more efficiently. With the recession, companies have the leverage to force changes, say some lawyers at both client companies and law firms. "Law firms are more receptive to change because they are in the business of needing legal work," said Daniel Fitz, chairman of the Association of Corporate Counsel.

Partner profits were down an average of 4% last year at the highest-grossing firms, according to American Lawyer magazine. Their hourly rates have risen to a range of \$300 to \$1,000. But with the slump, firms have had to dismiss associates, reduce salaries and cut back on hiring of new graduates. "Just like the tech and housing bubbles, there was a legal-profession bubble, and now we are experiencing a correction," says David Antzis, managing partner of Philadelphia-based Saul Ewing LLP, which is doing more fixed-fee work.

Pfizer could have demanded a discount from firms' hourly rates, Ms. Schulman said, but she hopes for a shift to a system that encourages firms to work more collaboratively with Pfizer and with other law firms that service Pfizer. The flat-fee program "should be something fundamentally different that will last beyond whatever people think they have to tolerate because of the economy," she said.

Some legal departments have for years experimented with flat fees for certain types of repetitive, predictable work like patent applications. Attorneys say it is doubtful flat fees could ever supplant hourly billing for the most complicated and high-stakes matters, such as an antitrust fight with the government or a particularly tricky corporate merger, where it's too hard to estimate how much effort it will consume.

In addition, "a client can't expect to have the absolute best team of [trial] lawyers from a firm, and have the lawyers give up all the other work they could be doing on a regular-fee basis, to work 18 hours a day for months of time on a flat-fee engagement," said Barry Ostrager, a Simpson Thacher & Bartlett LLP partner who handles civil trials.

Orrick, Herrington & Sutcliffe LLP, a San Francisco-based firm, has tripled the revenue it generates from alternative billing arrangements in the past year, but maintained profitability through efficiencies, said David Fries, chief client-service officer. Software sends an email to lawyers when they hit certain levels of a fixed-fee budget, as a reminder to work efficiently. Financial analysts file biweekly reports analyzing how lawyers' time is being spent. "You find that someone may have spent 200 hours on something" that isn't crucial, Mr. Fries said.

Orrick has also altered the mix of lawyers it employs, focusing less exclusively on hiring graduates from elite law schools, who can command starting pay of \$160,000. It is employing some college graduates who can perform routine tasks at a lower cost.

Saul Ewing in Philadelphia recently investigated a client's potential corporate acquisition under a six-week flat-fee engagement. The matter was handled about 10% more cheaply for the client than it would have been under a billable-hour deal, said Mr. Antzis, the managing partner. He said "it was still fair to the firm" because "we were incentivized to get done in 10 hours what another lawyer at another firm may have spent 12 hours doing."

At Sidley Austin LLP, Sara Gourley, a partner, said changes made by Pfizer have given her more freedom to put the best mix of lawyers on a legal matter. Pfizer used to have a rule that no lawyer with an hourly rate higher than a second-year attorney's could bill the drug company for legal research. Now that costs are fixed, Ms. Gourley says, she has been able to assign a senior associate to perform Pfizer legal research who could get the answers much more quickly than a junior lawyer might.