



Looking Back, Looking Forward

BY WILLIAM C. COBB

In the middle of 2009, Texas began to see the effects of the depression hitting other parts of the country, especially as corporations and out-of-state firms with offices in Texas began to pull back. By the end of 2009, the writing was on the wall: 2010 would be another testy year and more cutbacks would be required. This article will review the ramifications for Texas firms in 2010 and explore what might lie ahead for 2011.

There were some general trends that started in 2009 that came to fruition for Texas. As early as May 2009, the *Houston Chronicle* reported that Houston may have missed the recession affecting the rest of the country. That did not happen. In 2009, real estate fell off the map, but companies were looking to see an improvement in 2010. Businesses began to retrench on expansion plans and were faced with a very tight credit market. Although optimistic that 2010 would be better, businesses still held back because of the uncertainties that were ahead.

Corporate entities began to pull back on their merger and business transaction work in 2009 and began to hold up some payments to law firms as they entered 2010. Unsure of new tax and regulatory issues anticipated for 2011, there was more pressure on clients to slow down, wait, and watch. Although law firms saw their receivables increase in 2009, they received some relief in 2010 when clients began to pay again. The health of the banking system was also frightening for law firms trying to reaffirm their credit lines and for clients trying to secure loans for projects.



More clients sought to control their legal costs. Because of client price sensitivity, billing rates in 2010 increased by only 1 percent to 2 percent. In addition, many more law firms were asked to discuss and propose alternative fee and contingent fee agreements. Alternative fee agreements generally provide the client with a budget and fixed fee for a matter or elements of a matter. Contingent fees are based on whether the deal made or did not make, and sometimes with a heavily discounted billing rate through the process. Although often discussed in recent years, 2010 brought many more of those conversations to the client's negotiating table. Look for more in 2011.

As larger and more inefficient law firms sought to downsize, more small firms with comparable experience and lower billing rates were considered for brand name and commodity work. The "Cobb Value Curve" compares the value perceived by the client with the volume of work available to the law firm. At the upper end are so-called nuclear events (4 percent of the work), then "hired for experience" work (16 percent of the work, most of which is not price sensitive). Brand name and commodity work fall below the price sensitivity line. Many of the small and mid-sized regional firms in Texas did fine during the downturn because of their investments in brand name and commodity services. They were well positioned with long-time clients to offer a broad range of services but were not necessarily involved in big-deal matters.

As business work fell off, many firms realized they had too much capacity and the layoffs began in earnest for staff and attorneys in late 2009. Recruits in Texas were asked to show up in January, while in California, Illinois, New York, and other big financial centers, some associates were asked not to show up until September or October of the next year.

According to "Law Shucks: Life in and after Big Law," 14,940 legal workers were laid off from Jan. 1, 2008, to November 2009, representing 5,820 lawyers and 9,120 staff. In 2009 alone, 12,219 (4,656 lawyers and 7,563 staff) were laid off. Other studies show that recruiting slowed in 2009 and 2010 and fewer interns were hired because the acceptance rate became too high.

As early as April 2, 2009, *New York Times* editorial observer Adam Cohen wrote that it was time to rethink the legal profession. Ever since the American Bar Association held several futurist conferences in the late 1990s, consultants and future-thinking lawyers had been predicting the need to rethink the law firm business model of "hours times rate equals value added." Experts predicted that compensation systems would be turned upside down for many law firms as the lawyer with the biggest portfolio of business made the most money. The profession would need to move to a model where efficiency and effectiveness rule and the return on resources would become critical. The lawyer with the biggest portfolio may not receive the most compensation. The lawyer with the most efficient

portfolio (i.e., return on investment of time and firm resources) will receive the most compensation.

Bonuses for associates were down in 2010, even though profits had increased slightly due to downsizing of staff and attorneys. Despite the small growth in profits, law firms were seeking to be more efficient with the professionals they had on hand and were handling any overflow work with contract associates and by outsourcing research and discovery.

Partners are not exempt. In the Nov. 30, 2010, issue of *ABA Journal Daily*, an *American Lawyer* survey found that 70 percent of the 124 law firms interviewed reported that they will be asking partners to leave by 2011 and that 31 percent will be shifting equity partners to non-equity status.

Implications for Texas Law Firms

As credit becomes available for clients, law firms need to prepare. First, they need to realign their relationships with their banks to ensure they have the credit to invest as required. Second, they need to prepare their firm to be more efficient and effective when determining which matters they will take and how they will approach alternative fee arrangements and contingent fees to maximize their return on firm resources. What



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do I mean by efficiency and effectiveness? Firms will need to invest in matter/project management, process mapping, estimating and budgeting, risk management, leadership and team building, and practice group management.

Law firms need to segment their client base to better assess client management. With each client, there is an internal system for determining what they perceive will add value to their business. It may be pricing, the client relationship team, the matter management process, or expanding services to consulting as well as legal services. You can use a model called the Client Investment Model. Set up a box with four quadrants. The top right quadrant is for clients who have high loyalty to the firm and are profitable to the firm. The lower right quadrant is for clients not yet loyal to the firm, but who are profitable. The top left quadrant is for clients who are loyal to the firm, but are not profitable given the firm's overhead and billing rates. The lower left quadrant is for clients who are still question marks for the firm. They should be treated like a venture capital investment because they will use up firm resources. If the client is in the top right quadrant, there needs to be constant contact with them on their needs and their concerns on billing rates, alternative fee arrangements, and services. If the client is in the lower right quadrant, the law firm must build loyalty through meeting the client's legal and quasi-legal needs. Ask what actions will move a client from the lower right quadrant to the upper right quadrant. (The same question should be asked about any client in any quadrant.) Finally, if the client is in the upper left quadrant, the firm will have to review carefully their relationships to minimize lost revenue. In all cases, the firm must be asking what services the clients consider price sensitive and adjust accordingly.

Although I know managing partners who think that hourly billing will return when the economy comes back, I disagree. The tipping point has been reached for the old business model. Granted, the very high end of the Cobb Value Curve is not subject to price sensitivity, but at the lower end, clients have price sensitivity on perceived brand name services and commodity services (more than 80 percent of the work). Brand name and commodity services are subject to a major shift in pricing structures. Because of culture and the old compensation systems, many firms will not be able to make the change. Some may recall the years in which big CPA firms tried to invade the middle markets. Their culture of inefficiency and hourly billing model contributed to their failure.

As partners are asked to leave or move to non-equity status, there are several actions to consider. Prepare partners who are approaching 65 to move to Medicare Parts A and B with a

Medi-Gap Plan, which will probably be cheaper for them and will move them off firm group insurance as primary coverage. Second, move the equity partners to non-equity over a three-year period to ensure stability in the firm. Some partners will move to non-equity immediately to get out of the pressure cooker. With too much pressure to move, some will decide to go to another firm with their clients and cause disruptions at the associate and staff levels. Law firms that have moved equity partners to non-equity over a three-year period have had the best success. Granted, the job market is tight, but that does not change the process. Don't rush it.

Looking Forward

Before 2009, large firms invested heavily in specialty services that required higher billing rates, higher overhead, and higher leverage. Are there ways to reduce the investments that firms have to make in supporting those clients? Are there ways to outsource work to lower-rate law firms or firms with very efficient ways of handling those client matters? Will large firms have the leadership to change the culture and focus on efficiency and effectiveness? There are a huge number of articles on the change process that many law firm leaders are not reading. Start reading them and lead.

Move to alternative billing to ensure that clients feel secure in their legal expenses and know that the firm is managing matters in the most efficient manner. The firm must be able to prove it can manage with backup systems and programs that are client-oriented. Smaller firms have proven that, in many cases, they are more innovative in structuring pricing. Can large firms do this?

With their capital base, will large firms invest in the use of more expert systems to deliver services and will they use lower associate leverage to provide services? Compare British firms that have created expert systems for sophisticated and complicated matters (e.g., www.blueflag.com). This has reduced their reliance on leverage and put the accumulated knowledge and other resources of the firm in play.

Small, regional firms must focus on the Client Investment Model to ascertain client values and the client's business needs. The firm must find out what the client is concerned about and provide the legal and quasi-legal services it needs. Put clients in touch with other businesses that will help their business. Enable them to grow and prosper through your firm's contacts and reference base. Knowing the client's real needs will make you an adviser and not just a lawyer.

Focus on the return on your investment in clients and ensure that you are getting a return on your investment in the client or from those to whom they refer you.

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Summary

The legal world changed in 2009 and 2010 and the profession is entering a new era where the old business model is moot and a new business model is taking over. Law firms need to anticipate those changes and adjust. The old business model of “hours time rate equals value added” is gone. Disintermediation is at work. Disintermediation means that the middle level of information providers is disappearing. The Internet and expert systems have replaced those people. Clients are looking for expertise and advisers. As I’m fond of saying, “What the

printing press did to the monopoly a priest or rabbi had over the interpretation of the Bible, the Internet will do to the monopoly the lawyers have over the information in the law.”



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WEATHERING THE STORM TEXAS LAWYERS AND THE ECONOMY

Regional Perspectives: East Texas

BY JENNIFER PARKER AINSWORTH

As in many other areas of our state, the practice of law in East Texas is always evolving. Over the last 10 years, we have seen ups and downs in a number of practice areas “behind the Pine Curtain.” There are four trends in particular that have affected the practice of law in East Texas.

Since the passage of tort reform, many lawyers have seen a decline in tort litigation. Plaintiffs’ lawyers seem to be filing fewer cases and many firms that had standard insurance defense practices for decades have seen this practice dwindle, with many insurers consolidating their cases with fewer defense firms or relying more heavily on “captive” counsel.

An area of strong practice growth in the East Texas area has been oil and gas. Following the rise in oil prices in the last five years, as well as improvements in technology, we have seen significant increases in exploration in East Texas. In particular, the development of the Haynesville Shale and other East Texas formations has reinvigorated the oil and gas practice and has attracted newer attorneys to the field. The increase in exploration has resulted in increased demands for title work and opinions, contract negotiations, and condemnation work, as well as litigation.

The recent economic downturn has affected many real estate and business practices over the past three years. Although traditional residential and commercial real estate practices may be slower, foreclosures offer steady work.

The Eastern District of Texas federal courts are considered “rocket dockets” for intellectual property litigation, attracting litigants from all over the country. As a result, we have seen significant growth in this field over the past 10 years. This challenging new practice area has sent many local attorneys to their law libraries to learn new areas of law while our federal district judges now preside over one of the busiest intellectual property dockets in the nation.

When I joined Wilson, Robertson & Cornelius, P.C. 10 years ago after moving back to East Texas, the majority of our income was derived from insurance defense litigation, real estate work, and general business practice for our local clients. One partner, who is a skilled, board certified oil and gas attorney, had not touched a title opinion in several years and was doing business litigation and appeals. Ten years later, our insurance defense litigation has significantly reduced, but our oil and gas partner is so busy with title work that we have hired additional lawyers to help him. Real estate has declined but is still active.

Despite these changes, the overall volume of civil case filings has risen in our area over the past 10 years. With its vital, active legal community providing services in a variety of areas, East Texas remains full of opportunity.

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