

CREATING THE LAW FIRM OF THE FUTURE

By Ralph H. Palumbo

In the last two decades, the market for legal services has changed radically. Customer loyalty to a single law firm has all but disappeared. Most corporations have created or enlarged in-house legal staffs in order to get better service and reduce legal expenses. Technology has provided more efficient methods for doing legal research and producing legal documents. Needs for specialized legal knowledge and experience have expanded.

Customers in today's legal market place demand value - both in the price and the quality of the services they receive. The more sophisticated the customer, the more demanding. But law firms have done very little to respond. Lawyers provide and charge for their services in essentially the same way they did 25 years ago.

Four years ago, a group of 20 legal professionals started "Summit Law Group." Our goal was to create a 21st Century law firm that would *always* provide a better, faster, higher value legal product to sophisticated purchasers of legal services.

We realized that we could not merely resolve to provide a higher value legal product. A commitment to improve isn't sustainable without institutional changes that impact people's every day behavior. Practices like "total quality management" create temporary improvement. Significant and long lasting improvement in legal service requires law firms to change their organizational structure, management practices, and compensation of lawyers and staff.

We started from scratch by throwing out every convention of traditional law firm organization and practice. For every aspect of our business, we asked ourselves: "How does this help us get a higher value legal product to our customers?" If a practice doesn't pass that test, we don't do it.

We determined that fundamental change would be required. We would have to change our offices and technology so we could lower our overhead. We would have to change our organizational structure to improve the productivity of every lawyer and staff member at Summit. We would have to change our compensation system for lawyers and staff to incent every person to put customers first. We would have to change in ways that would cause every lawyer and staff member to focus all their energy outward, on our customers.

Our task was ambitious: To revolutionize the practice of law.

This article describes some of the fundamental changes we made in creating Summit Law Group and how those changes have resulted in every day performance that significantly improves the value of the legal product we offer to customers.

One point is important to understand. The changes we made to improve our legal product resulted in every person at Summit becoming an active participant in the Firm's work and success. Every person - from the oldest lawyer to the youngest staff member - has the same size office, every person receives all Firm financial and other information, every person participates in important Firm decisions, and every person shares in the Firm's financial success. Some people, even some people at Summit, perceive Summit's egalitarian practices as being motivated by "quality of life" issues. It is important to understand that every change we made at Summit was made for a business purpose - to improve profitability by improving customer satisfaction. Summit's "quality of life" is a by-product. To be sure, it is a very pleasing and important by-product, but one that would not have occurred if our primary goal had not business-driven.

Summit Core Values

To define Summit Law Group, we started by agreeing on first principles. We call these “Summit Core Values.” Core Values are the standard against which we measure our success and against which we gauge whether to implement a new practice. Our Core Values are (in no particular order):

- To create and maintain a law firm in which all lawyers and staff have an entrepreneurial stake in the enterprise.
- To enhance profitability and to attract complex and exciting work by delivering a higher value legal product to sophisticated customers.
- To build net worth by taking risk and investing in clients, cases and projects (to create opportunities to be compensated on a basis other the sale of billable hours).
- To provide a “choice” for customers by being fundamentally different from traditional law firms.
- To have fun.

The Summit Legal Product

Our first challenge was to create a well-defined, uniform and distinct legal product that would attract customers to Summit and create customer loyalty. We wanted a product that would cause customers to stop staying, “we hire lawyers, not law firms,” and start saying they hire Summit because our lawyers and staff provide great service for a great price *every time*.

We use the term “legal product” instead of “legal service” because “product” connotes a service that is defined and uniform. We use the term “customer” instead of “client” because a “customer” is a person who buys your product (or doesn’t buy it if it is not a good value). For a customer, you hustle.

The Right Product. We work with our customers to define the legal product best suited to the customer’s need. No surprises. Sometimes the customer’s business is at stake. Sometimes millions of dollars are involved. The customer needs our best legal product and is willing to pay accordingly. Other times the customer has a simple transaction or needs resolution of a dispute involving a limited amount of money. The customer doesn’t want or need our best work. We *always* deliver a result that makes sense to the customer for a fee that matches the importance of the matter to the customer.

The Right Team. We only do legal work that we can do exceedingly well. We never hesitate to refer work to other law firms if we believe our customer will be better served. We always create the most qualified (and the smallest) team for the job. That starts by working with our customers to make the best use of our talents and the customer’s business people and legal staff. We also have had great success working with lawyers in other firms who bring special experience or expertise. Once assembled, our teams work together seamlessly – whether made up exclusively of Summit professionals, or combinations of our people, the customer’s people and lawyers from other firms.

The Right Response. When was the last time a customer called a lawyer with a problem they wanted to solve next week or next month? The Summit legal product is *always* responsive to the customer’s needs and attains the desired result in the shortest possible time.

Lower Cost. Expensive law offices and art collections don’t improve the value of a legal product. Our customers are acutely conscious of their own overhead. We have a duty to contribute by keeping our costs low and sharing the savings with our customers. Because our operations are “leaner” than other law firms, our hourly rates are generally lower. We also staff matters more efficiently. We never

have a hierarchy of lawyers working on any matter. In short, we don't "leverage" our associates because we don't have any.

No Hidden Charges. We know the difference between our own overhead and billable charges. We charge our customers only for costs we incur using third party vendors, such as out-of-town travel, photocopying by an outside reproduction firm, messenger fees, court filing fees, deposition fees, etc. We **don't** charge for secretarial overtime, word processing, photocopying, faxing, local or long distance telephone, computer legal research (unless approved in advance by the customer), and the like. In matters involving unusual expense, we consult with our customers and charge a small percentage overhead fee to account for the direct costs of providing necessary services.

The Summit Law Group Model: Fundamental Change

Most law firms promise legal service that has many, if not all, the attributes we promise of the Summit legal product. Words are easy. The difference between Summit and other law firms is that we have made the fundamental changes necessary to cause our legal professionals to deliver on our promises.

A law firm cannot significantly reduce the cost of its legal service unless it reduces overhead. Otherwise reducing fees is likely to result in reduced lawyer compensation, which in turns makes it harder to attract and retain the best lawyers. Law firm overhead is a function of space cost and staff headcount. You can't cut overhead by saving pencils. Summit fundamentally reduced its space costs by relocating and designing more efficient and less expensive offices. We fundamentally reduced staff by hiring highly qualified legal professionals, paying them accordingly, and by eliminating staff positions not directly involved in customer service.

Delivery of a high value legal product requires world-class performance from all lawyers and staff. Summit makes every lawyer and staff member a part of the customer service team. We reward lawyers and staff based on individual contribution (not seniority) and on overall Firm financial performance.

The traditional hourly rate billing system rewards the wrong thing and creates a disconnect between what is good for the lawyer and what is good for the customer. Summit has created pricing mechanisms in many cases that reward us for accomplishing the customer's objective. Even when we bill on an hourly basis, we guarantee the value of our legal product by giving the customer freedom to adjust our bill for value. No questions asked.

Reducing Space Costs and Improving Efficiency

We cut space costs by moving our offices out of downtown to the fringe of the City. That move alone reduced our lease rate by almost \$10 per square foot. All conventions of law office planning were cast aside. Our lawyers do not reside on the window wall. Office size and location is functional, not related to seniority or compensation level. All members of customer service teams office together. There is limited central filing, and no central word processing, telefaxing, or photocopying departments (and since there are no "departments," there are no supervisors).

We have small (10'x12') offices, furnished with highly functional laminate and metal furniture. Every office – lawyer, paralegal and legal assistant – is the same size and has the same furniture. We don't have an expensive law library (or a law librarian). Our hallways are lined with legal periodicals and specialized publications that we use most frequently. The rest of our library is accessible on-line on every lawyer's and staff member's desktop.

We improved efficiency by giving every lawyer and staff member the best possible technology, and by continually updating that technology. Everyone has a PC and printer in their office. Everyone – lawyers and staff alike – has the authority to buy scanners, cell phones, pagers, PDAs, mobile Internet devices, and whatever other new technology they believe will make them more efficient and responsive. Any Summit lawyer, paralegal or legal assistant who decides that the latest technology release will improve their productivity has simply to place an order. No management approval necessary.

Improving Lawyer Performance

The traditional partner/associate structure of law firms is focused internally. Associates are concerned more about making partner than about achieving the customer's objective. For example, the first draft of a legal research memorandum is often sufficient to the customer's need, but an associate may do two or three more drafts perfecting the memorandum to ensure the partner's approval. Associates are not responsible directly to the customer for the quality and value of work performed, and many associates have little or no dealings with customers.

All Summit lawyers are members of the Firm. All Summit lawyers have direct contact with our customers and direct responsibility for the quality and value of our legal product. All Summit lawyers participate in every aspect of our business, including a share of the Firm's profits. Annual performance bonuses to lawyers are non-trivial. For example, in a successful year, the Firm's youngest lawyers may receive a bonus that is greater in amount than their normal annual compensation.

Moreover, the Summit compensation system creates the right incentives. Lawyers are compensated, not by years of service, but by their contribution to generating revenue. To ensure that compensation is closely tied to contribution, each lawyer in the Firm receives financial information on their own and every other lawyer's performance. Each lawyer is asked to submit proposed annual compensation for all lawyers in the Firm. This information is used by the Compensation Group to set annual compensation.

By connecting all our lawyers directly with customers, by giving every lawyer a say and a stake in the Firm, and by creating a compensation system that rewards contributions to customer service, we cause our lawyers to behave in ways that enhance the value of Summit's legal product. We get the best performance from our lawyers – not by rules or procedures – but by putting the incentives in the right place.

Improving Staff Performance

We cut our staff head count by eliminating middle-level law firm bureaucracy. We have a highly competent, but thin, management team consisting of an experienced businessman to manage finances and related matters, a full-time technology person, a small accounting staff, and a receptionist. We have no supervisors, no personnel manager, and no employees to do menial tasks such as mail delivery, photocopying or faxing.

Over 95% of our staff is directly involved in providing legal service to customers. We hire only experienced legal professionals and we pay them accordingly. Summit legal assistants support 4-5 lawyers, they work directly with our customers, and they perform many tasks traditionally assigned to paralegals. Our paralegals also work directly with our customers and they perform many tasks performed by lawyers in other law firms.

Our management staff and legal professionals add more value because they have the same stake in Summit as do our lawyers. All lawyers and staff receive *daily* and monthly financial information. All lawyers and staff participate in Firm meetings, including annual events such as the Firm weekend and periodic strategy meetings. All lawyers and staff participate in major Firm decision-making. For

example, if we are considering a new lawyer who has 25 years of experience and a big book of business, that lawyer will be interviewed by every Summit lawyer and staff member. And all lawyers and staff members will be involved in the decision to hire the new lawyer.

We prove we are serious about staff's contribution by our compensation system. All staff participate in the Firm's financial success. Quarterly bonuses are paid based on the Firm's financial performance. If we achieve or exceed budget, all staff receive a bonus for that quarter. Annual bonuses are based on individual contributions and the Firm's financial performance. Staff bonuses aren't token. In a highly successful year, bonuses for some of our senior staff were greater in amount than their normal annual salary.

The result is world-class staff performance. Our staff have as much stake in achieving the customer's objectives as do our lawyers. For example, a lawyer working late on a critical project does not need to arrange for overtime staff assistance. Staff members will stay late to get the job done without being asked and without anyone having to approve their overtime (which, by the way, we do not charge to our customers). Every law firm has a few exceptional employees. At Summit, extraordinary performance by our legal professionals is the norm.

Again, the critical thing to understand is that we don't have policies or procedures to instruct staff on their responsibilities. Instead, we have an organizational structure, management and a compensation system that incents the highest level of staff performance. Staff perform because they know they are important, respected members of the Summit team and because they are financially rewarded -- especially when the Firm does well.

Getting Away From the Hourly Rate

Formerly (25+ years ago), legal fees were based not only on the time spent, but also the nature of the service, the result achieved and the amount at stake. Charging an appropriate legal fee was a matter of professional judgment. That changed in the mid-1960s when customers began demanding detailed billing statements.

Today, most lawyers are paid as hourly laborers. The hourly billing system does not reward efficient legal service. Plodding, pedantic legal service is rewarded. When lawyers are paid by the number of hours worked, conscious or unconscious self-interest can and does affect a lawyer's judgment as to what legal services are required.

An experienced lawyer is often able to give an answer that has a 90% probability of being correct. If the lawyer spends only few minutes giving the answer, the lawyer is paid little for his answer -- despite the fact that years of experience and a high level of expertise and judgment is required to give a good answer. Paid by the hour, the lawyer is under-compensated for the service provided. If the same lawyer assigns two associates to research the problem and write memoranda on the issues, the probability that the client will get the right answer may increase from 90% to 95%. The lawyer will make much more money and, in a few cases, the improved probability may be worth the extra fees charged. But in most cases, the customer would have been better off to accept the 90% answer and pay less for the advice.

A billing system in which the incentives for the lawyer are contrary to the interests of the customer is inherently flawed. Summit has fundamentally changed the pricing of its legal product. We work closely with our customers to define the legal product that is appropriate to the customer's need. We always try to come up with a pricing arrangement that provides incentives to us if we can achieve a fast, innovative and lower cost means to accomplish the customer's desired result.

Summit has been more successful than other firms in creating alternative pricing arrangements because *every* Summit lawyer has authority to propose *any* pricing system that the lawyer believes will match the Firm's incentives to the customer's goals. If an innovative pricing arrangement works well in one matter, we use it again. If a pricing arrangement doesn't work, we change it to one that does and don't repeat our mistake. To be truly innovative, you have to learn to make your mistakes *faster*.

We are not able to come up with an innovative pricing arrangement for every matter. And some customers prefer to be billed on an hourly basis. In these cases (which are still the majority of our matters), we have a value-based pricing system that matches the customer's perception of value to the amount due. Our billing format is:

| | |
|------------------|----------|
| Proposed Fee: | \$10,000 |
| Value Adjustment | \$ _____ |
| Amount Due | \$ _____ |

Our customers are sophisticated purchasers of legal services. They are good judges of the value of a legal product. We encourage them to adjust our proposed fee – up or down – to match the value received by the customer. Whatever amount the customer places in the “Amount Due” blank is the amount the customer owes. No questions asked. We are willing to be judged and compensated on the basis of results, not time expended.

This is another example of getting the right performance from our lawyers and staff by having the right incentives. We know that our customers can pay whatever they believe our product is worth. No lawyer or staff member wants to be embarrassed by having a customer significantly reduce our proposed fee. The result is that our lawyers take more care to work with customers at the beginning of the engagement to define the scope and cost of the legal product to be provided. And they take more care to ensure that the cost of our legal product matches the customer's objectives.

Our experience with value-adjusted fees has been terrific. Our customers have voluntarily paid us tens and even hundreds of thousands of dollars more than our proposed fee in matters where the value of our product substantially exceeded the fee proposed. Other customers have asked us to raise our hourly rates in order to better reflect our value. We even benefit when a customer discounts our proposed fee (a rare event) because we get immediate notice that something is wrong and we have time to fix the problem and save the customer relationship.

An unexpected benefit of our value-based pricing is that it has significantly reduced our accounts receivable. We get our bills out by the 10th of every month and ask to be paid promptly. Most of our customers respond -- we believe in part because it's hard to object to paying a fee that the customer can adjust to any amount the customer believes fairly reflects value.

The Experiment is Not Over

Summit has many challenges yet to face. We have grown from 14 lawyers to 32 lawyers in less than 4 years. It is easier, when small, to manage closely-knit customer service teams and to maintain an informal, inclusive decision-making structure. As we grow, we will have to adapt. Growth will force us to continue to experiment and change in order to maintain Summit's Core Values. In doing so, we hope to continue to push the envelope in finding new ways to provide high value legal products to customers.

Summit's long-term success will be greatly influenced by how demanding customers become. So far, the biggest surprise to us is the fact that many customers continue to tolerate unnecessary and expensive legal services. We have experience in complex multi-party matters where we know our service has been every bit as good or better than other law firms and the cost of our product has been 30% or more less than the other firms. While we cannot always achieve this degree of efficiency, we are

almost always able to save our customers money by keeping our team small and efficient, and by only doing that which is critical to the outcome.

It is not surprising that customers continue to retain large, prominent law firms. It is surprising, however, that customers continue to tolerate two and three tiers of lawyers doing tasks that are non-critical to achieving the customer's objective.

Since Summit's lawyers have all practiced at large firms, we understand the dynamic. We predict that it will be extremely difficult -- even for experienced and diligent in-house counsel -- to eradicate practices that are bred into the structure and organization of outside law firms. Many companies have imposed restrictions on law firm billing practices. Those restrictions have very limited effect. We believe the answer lies in demanding the kind of fundamental changes we have implemented at Summit.

Ours is only one way to skin the cat. There are certainly other models that could have success. But we believe that general counsel who want better legal service for better prices will not achieve the result they desire unless they change the pricing system in ways that reward law firms for results and penalize them for inefficient, ineffective service. We also believe it will be exceedingly difficult for general counsel to achieve their desired result if they do not encourage, or even demand, that the law firms restructure in ways which permit them to maintain profitability (at least for the firm's most talented lawyers) while at the same time providing a higher value product to the customer.

About the Author

Ralph H. Palumbo, is a Member of Summit Law Group PLLC, 1505 Westlake Avenue North, Suite 300 Seattle, WA 98109 (Telephone: 206-676-7000 Email: ralph@summitlaw.com Web site: www.summitlaw.com).

Mr. Palumbo has a unique depth of experience in complex commercial litigation, environmental matters and corporate and business law. His trial practice includes cases involving antitrust and trade regulation, product liability, securities, and other complex commercial litigation. In the environmental area, he has broad experience in matters of all types, including litigation and administrative proceedings under federal and state laws that govern hazardous wastes, hazardous substances cleanups, clean air, clean water, and natural resource damages. Mr. Palumbo also has extensive experience in mergers and acquisitions, franchising, licensing and general corporate matters for companies in the retail, high technology, banking, and manufacturing industries. He is a graduate of the University of Washington (B.A., magna cum laude, 1969) and of Stanford University School of Law (J.D., cum laude 1972).