QUARTERLY

VOL. 64, NO. 3 SPRING 2015

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FEDERATION OF DEFENSE & CORPORATE COUNSEL

FDCC QUARTERLY

Spring 2015 Volume 64, Number 3

Contents

Cite as: 64 FED'N DEF. & CORP. COUNS. Q. ___ (2015).

The Federation of Defense & Corporate Counsel Quarterly is published quarterly by the Federation of Defense & Corporate Counsel, Inc., 11812 North 56th Street, Tampa, FL 33617.

The 21st Century Practice of Law: A White Paper

I.
Introduction

There have been warnings in the past about the evolution of the practice of law and the state of the law profession in general. There has always been the notion that lawyers, and law firms, need to remain current in their practice areas, yet foresee the future as it relates to not only the "developing" practice idiosyncrasies, but increased client demands and expectations. Never before, however, has there been such an enormous amount of time and effort put into the study of the evolution. In the past few years, the ever-changing law profession, from the study of law schools to the study of law firms, has been the focus of numerous articles, blogs, studies and even books. This paper seeks to identify some of the problems facing the legal profession in the years to come, and strives to provide insight not only into the basis for the problems but the solutions to those problems as well.

This paper explores the developmental history of law firms, as well as the state and structure of existing law firms. Thereafter, the paper identifies the current problems and the opportunities facing those law firms willing to evolve. Solutions and innovative ideas to succeed in the 21st Century are also explored including technology, outsourcing, legal project management and alternative fee structures. The cutting edge and controversial issue of alternative business structures, including multidisciplinary practices, is also explored. Most importantly, though, this paper identifies real life practice realities and expectations from corporate and industry clients.[1]

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[1] The project which led to this White Paper was initiated by then Federation of Defense and Corporate Counsel President, Timothy Pratt, and was funded, in part, by the Federation Foundation. The White Paper was prepared jointly by an FDCC Task Force comprised of the following: **Wystan M. Ackerman**, Robinson & Cole, LLP, Hartford, CT; **Robert T. Adams**, Shook, Hardy & Bacon, LLP, Kansas City, MO; **Lauren Curtis** and **Michael Lenhardt**, Traub Lieberman Straus & Shrewsberry, LLP, St. Petersburg, FL; **Andrew Gilchrist**, Exxon Mobile Corp., Houston, TX; **Clark Hudson** and **Sezen Z. Oygar**, Neil, Dymott, Frank, McFall & Trexler APLC, San Diego, CA; **Michael T. Lucey**, Gordon & Rees, LLP, San Francisco, CA; **Robert H. (Barney) Shultz, Jr.**, State Farm Mutual Automobile Insurance Company, Bloomington, IL; **Debra Tedeschi Varner** and **Stanley A. Heflin, III**, McNeer, Highland, McMunn & Varner, L.C., Clarksburg, WV. This White Paper was initially presented at the 2014 FDCC Annual Meeting.

II.
The Evolutionary History of Law Firms

The modern law firm dominates the landscape of our legal society. Varying in size, the majority of practicing lawyers operate as associates, partners, or members in law firms. There are still solo practitioners; however, a large number of attorneys in the United States practice with at least one other lawyer. There were two main reasons for this development. First, attorneys needed to adapt their practices to keep up with the expansion of business in the industrial revolution, as well as our expanding nation itself. Second, lawyers who were practicing in groups needed to structure their practice in a way that enhanced and protected the financial interests of the attorneys involved. Thus, the modern law firm evolved.

In the beginning of the 19th Century, the majority of law practices consisted of solo practitioners or groups of two or three lawyers operating out of a small office.[2] Those offices were typically staffed by lawyers, scriveners, and messengers (also known as errand boys).[3] The lawyers prepared documents, met with clients, and appeared before the court while the scriveners handwrote copies of documents. Generally, these lawyers were considered generalists who practiced in many different areas of the law depending on the clients' needs. In 1865, American lawyers did not need any particular education or training for admittance to the bar. Typically, the only requirement for admittance was that the applicant be in good moral standing. Of the law partnerships that had formed, all were small with most focused on commercial law. In 1872, there were only three law firms in the nation with at least five lawyers.[4] However, by 1898, there were sixty-seven law firms with five or more attorneys.[5] As the industrial revolution increased the size and reach of businesses, the need for larger firms developed.[6] The amount and complexity of legal work that large corporations required placed extreme pressure on the law firms of the time. To accommodate their clients, many new firms began to develop by merging with existing firms to form larger firms. Growth in the size of law firms continued, and by 1915 there were approximately 240 firms with five or more lawyers.[7]

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[2] M.H. Hoeflich, *From Scriveners to Typewriters: Document Production in the Nineteenth-Century Law Office*, 16 Green Bag 2d 395, 396 (2013). *See generally* Lawrence M. Friedman, A history of American Law (3d ed. 2005).

[3] *Id*. at 396-97.

[4] James W. Jones and Bayless Manning, *Getting at the Root of Core Values: A "Radical" Proposal to Extend the Model Rules to Changing Forms of Legal Practice,* 84 Minn. L. Rev. 1159, 1169 (2000).

[5] *Id*. at 1170.

[6] *Id*.

[7] *Id*. at 1169.

At the end of the 19th Century, the day-to-day duties of a lawyer began to change as well. Throughout the 19th Century, a majority of lawyers tried cases and appeared in court. However, with an increase in corporate legal work and firm size, the percentage of lawyers at a firm who regularly appeared in court began to decrease.[8] Instead, lawyers began spending more time handling corporate and counseling work. By the middle of the 20th Century, the number of lawyers who considered themselves litigators had substantially declined. This number has continually decreased through the years until, presently, "litigation is no longer the dominant form of legal practice."[9]

The growth in the size of law firms also created a change in the employment status of lawyers. Throughout the 19th Century, lawyers were considered private practitioners who worked for themselves on behalf of their clients. However, the growth in law firms caused the development of a new concept—the associate.[10] Around 1900, firms began hiring associates who were not partners in the firm. Essentially, associates were lawyer-employees, who performed lawyer tasks yet reported to partners in the firm.[11]

During the late 1800's, at the same time the foregoing developments were taking place, many corporations began hiring in-house general counsel. In 1865, The Prudential Insurance Company pioneered the hiring of in-house counsel to devote full time attention to the company's legal needs.[12] Other corporations followed suit, often hiring former judges and justices as counsel. Thus, whereas, in 1850, it was uncommon for corporations to hire in-house counsel,[13] by 1900, it had become a well-established practice.[14] Firms also began to centralize their practices with lawyers devoting most of their time to a specific area of the law.

By the beginning of the 20th Century, the need for expanded legal services continued to increase. The industrial revolution had cast a large footprint on business concerns. The economy flourished into the 1920's until the Great Depression of the 1930's. Despite the difficulties of the Great Depression, the need for lawyers increased. President Franklin D. Roosevelt's New Deal legislation created expansive government programs that required the work of lawyers to write, design, and implement.[15] As a result, lawyers flocked to Washington, D.C. In addition to legislation, the number of government programs and agencies exploded. While administrative agencies had already begun their growth in an attempt to

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[8] *Id*.

[9] Jones and Manning, *supra* note 4, at 1175.

[10] *Id*. at 1169.

[11] *Id*. at 1170.

[12] *Id*. at 1169.

[13] *Id*.

[14] *Id*.

[15] Lawrence Freidman, American Law in the 20th Century, 152 (2004).

regulate industry, the "New Deal" expanded the number, size, and scope of governmental agencies. This logically increased the size of law firms. As there was more "red tape" than ever for businesses to wade through,, businesses needed lawyers more than ever.

Over the next thirty years, and into the 1960's, law firms kept growing in size. By 1960's, there were thirty-seven law firms with at least 50 lawyers.[16] By the 1960's, the big law firms had entered into what some refer to as the "golden age" for "big law."[17] Large law firms hired associates out of law school and selectively promoted to partners chosen attorneys.[18] If an associate did not get promoted, it was expected that he/she would leave the firm. Often, the firm would find other employment for an associate who was not going to be promoted by referring them to smaller firms or the legal departments of its corporate clients.[19] In the 1950's and 1960's, law firms tended to develop long-term relationships with their clients, particularly large corporations.[20] The corporations did not try to find lower prices and the firms did not have to look for additional clients or lower their rates. Typically, the firm would rely on its existing group of stable clients for a steady stream of work. It was only at this time that law firms begin to track their billable hours as a method of performance review.[21] During this period, law firms continued to grow. In the 1970's, however, consumerism began to tighten the market.[22]

Over the next thirty years, rapid change in the corporate-firm relationship took place. Corporations sought out ways to cut legal expenses. Thus, they began to shop around for lower rates among the various firms.[23] By 2000, corporations had shifted much of their routine legal work to their in-house counsel. Law firms, faced with the reality that they had to compete for work, began advertising their services after advertising for legal services was upheld as a constitutional right.[24] Additionally, law firms became less stable as work flow was no longer guaranteed and promising associates would "vote with their feet" and leave for perceived greener pastures, often multiple times. Lawyers began to hold leverage over their firms as partners could leave when financial difficulties arose. The lawyer who remained at the same firm for his or her entire career became an endangered species. Firms began competing for partners who would often bring their clients with them. Firms tried to

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[16] Milton C. Regan, Jr.; *Law Firms, Competition Penalties, and the Values of Professionalism*, 13 Geo. J. Legal Ethics 1, 8 (1999).

[17] *Id*. at 8.

[18] *Id*.

[19] *Id*. at 7.

[20] *Id*.

[21] *Id*. at 8.

[22] *Id*. at 9.

[23] *Id*.

[24] *Id.* at 10.

counteract by writing financial penalties into their contracts with other partners. For example, a firm might reduce the amount of returned equity a partner could receive if that partner left the firm to compete in the same market. Despite many challenges, the majority of these restrictive efforts failed.[25] Mostly, state courts found these penalties essentially to be non-compete clauses, which violated the client's right to freely choose counsel.[26] However, one California court upheld a financial penalty as valid.[27] Firms adapted, though, and continued to grow. By 2000, law firms with several hundred lawyers had become common. Most law firms kept track of billable hours and meticulously scrutinized these numbers when analyzing associate performance.

Throughout most of the 20th Century, law firms were typically formed as partnerships. After the General Partnership was originally codified in 1914, it became the primary business structure of law firms.[28] In fact, "[l]aw practice in the corporate form was long prohibited in the United States."[29] This, however, led to a new type of business structure. In 1977, Wyoming became the first state to introduce the Limited Liability Corporation (LLC).[30] The Limited Liability Partnership (LLP) followed in 1991 when Texas first enacted this type of structure.[31] The states continued to offer these new business structures through legislation, gaining popularity after the Internal Revenue Service officially recognized the LLC.[32] Accordingly, law firms began to adopt LLC's and LLP's as their business structure. LLC's and LLP's provided partners with unique liability protection that had not previously been available to partners in law firms. Additionally, LLC's and LLP's were taxed as partnerships; thus, they avoided the double taxation placed on traditional corporations. One downside to the LLC was that, to become one, a new entity had to be formed.[33] Thus, transitioning to an LLC was bothersome for existing firms. Alternatively, LLP's required only that the partnership complete a filing requirement to put the public on notice that the firm intended to conduct business under the limited liability shield. One attractive aspect of the LLP is that it provides protection to the individual partners from negligent acts and wrongdoings of other partners. Additionally, partners may continue to participate in management without losing their protection. LLP's have faults of their own, however. As one legal scholar described,

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[25] *Id*.

[26] *Id*. at 13.

[27] Howard v. Babcock*,* 863 P. 2d 150 (Cal. 1993).

[28] Edward S. Adams, *Rethinking the Law Firm Organizational Form and Capitalization Structure,* 78 Mo. L. Rev. 777, 779 (2013).

[29] Christel Walther, *LLC and Lawyers: A Good Combination?*, 50 Loy. L. Rev. 359, 363 (2004).

[30] Adams, *supra* note 28, at 780.

[31] *Id*.

[32] *Id*.

[33] *Id*.

there are three concerns relative to the LLP: "(1) the uncertainty of vicarious liability, (2) the lack of incentive for firms to invest in their associates for fear that they will gain knowledge and then leave for a 'better' job, and (3) the ethics mandate preventing non-lawyer ownership."[34]

These concerns have caused some to argue for a new type of law firm arrangement– the Multi-Disciplinary Practice (MDP). Currently, Rule 5.4 of the Model Rules for Professional Conduct prevents such an arrangement.[35] While it is up to each state's individual bar association to adopt this rule in full or in part, many have done so. Nevertheless, there is a growing movement to consider allowing this type of practice.[36]

Despite the near continual growth and adaptation, not all law firms have been successful. Some of the most prominent failures include the collapse of Dewey & LeBoeuf, and Finley Kumble.[37] While these collapses were caused by various factors, one common problem was that each had acquired a tremendous amount of debt.[38] Today's economy and competitive environment have created instability. Nevertheless, success is possible when the right strategy is employed. In an interview with some successful partners in large law firms, Cynthia Thomas asked each interviewee questions relating to the successful nature of firms.[39] In their responses, the interviewees suggested that firms avoid top-down management and under reacting to the market. They also suggested that firms develop good working environments within the firm and develop succession plans in case a partner does leave.[40] One interviewee suggested that firms should act more like corporations.[41] Generally, with a flair for the obvious, they all agreed that firms needed to adapt to market trends appropriately.

The practice of law has evolved dramatically over the years. So has the concept of the law firm. It has evolved from small general partnerships of two or three lawyers to extraordinarily large multinational firms with several thousand lawyers. Lawyers have become employees instead of private practitioners and the market has become competitive. Large firm makeups

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[34] Adams, *supra* note 28, at 784.

[35] *Id*.

[36] See James Podgers, *Ethics 20/20 Eyes Global Change,* A.B.A. J., Mar. 2010, at 67, *available at* http://www.abajournal.com/magazine/article/ethics_20_20_eyes_global_change (reporting on the mission of Ethics 20/20, and noting Co-Chairman Michael Traynor's statement that "'MDP is on the table'").

[37] Erin Fuchs, *The Eight Most Crushing Law Firm Implosions in the Nation's History*, Business Insider, *available at* http://www.businessinsider.com/the-eight-most-spectacular-law-firm-collapses-in-history-2012-6?op=1 (last visited on May 29, 2014).

[38] See *id*.

[39] Cynthia Thomas, *What Makes Law Firms Succeed or Fail*, Law Prac., Jan./Feb. 2014, *available at* http://www.americanbar.org/publications/law_practice_magazine/2014/january-february/what-makes-law-firms-succeed-or-fail.html.

[40] *Id*.

[41] *Id*.

change so frequently it is a rare lawyer who knows the name of all other equity owners of his or her firm. The business structure of the law firm has changed from general partnerships to partnership-corporation hybrids, while truly becoming big business. Nevertheless, some push for still more change, as does the market. Multi-Disciplinary Practices, where lawyers and non-lawyers form partnerships, might be the next step in the evolution of law firms.

III.
The Present Day Law Firm

The present-day law firm has undergone significant changes in the last several years. The Great Recession[42] forced law firms to reevaluate all aspects of business management, from firm structure and organization, to employee compensation and client development. Additionally, technological advances have made an undeniable impact on the practice of law in the 21st Century. Emerging technologies promise increased efficiency and mobility, but carry upfront costs and security risks. Finally, these changes are taking place in the context of an increasingly intergenerational law firm, where ideological differences among employees with a 40 year age gap make it that much more difficult to adapt to the demands of the new economy.

A. *A New Firm Growth Model?*

The Great Recession is perhaps the single most influential factor affecting views on the structure, organization, and management of the present-day large law firm. Prior to the Great Recession, "large law firms were systematically growing, hiring one out of every four law school graduates as entry-level associates."[43] As one article summarized the data:

> In 1968 the largest firm in the United States had 169 lawyers.[44] By 1988, the largest firm had 1179 lawyers, and there were 152 firms larger than the largest firm in 1968. By 2008, nearly 700 firms employed 50 or more lawyers, 23 firms had over 1,000, the *average* size of the 250 largest American law firms by headcount . . . was 535, and the smallest of these firms was larger than the largest firm in the

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[42] Defined as the sharp decline in economic activity during the late 2000s, which is generally considered the largest downturn since the Great Depression. The term "Great Recession" applies to both the U.S. recession – officially lasting from December 2007 to June 2009 – and the ensuing global recession in 2009. The economic slump began when the U.S. housing market went from boom to bust and large amounts of mortgage-backed securities and derivatives lost significant value. *The Great Recession Definition*, Investopedia.com, http://www.investopedia.com/terms/g/great-recession.asp (last visited Feb. 26, 2015).

[43] Eli Wald, *Smart Growth: The Large Law Firm in the Twenty-First Century*, 80 Fordham L. Rev. 2867, 2867 (2012); Aric Press, *Annual Survey Shows the New Reality of Associate Life*, Texas Law Online (Aug. 10, 2007).

[44] Bernard A. Burk & David McGowan, *Big but Brittle: Economic Perspectives on the Future of the Law Firm in the New Economy*, 2011 Colum. Bus. L. Rev. 1, 12 (2011).

> country in 1968. Between 2004 and 2008, the 250 largest American law firms collectively increased in size by about 22,000 lawyers, and by 2008 employed a total of roughly 132,000 attorneys.[45] Between 1960 and 1985, the portion of the gross national product and the portion of national income attributable to legal services both doubled. By 2007, profits per equity partner at the 100 most profitable large firms averaged $1.3 million, 68% more than in 2000.

Enter the Great Recession. The housing bubble burst and capital markets froze. As a result, demand for high-end legal services plummeted. Transactional work was virtually nonexistent, and corporate clients, pressured by budget constraints, were forced to "avoid all but the most essential legal work."[46]

In 2009, major law firms laid off more than 12,100 people, a third of whom were lawyers.[47] The nation's largest 100 law firms also reported a 3.4% decline in gross revenue in 2009.[48] The total number of attorneys in the 250 largest American law firms decreased 4.3% in 2009 compared with 2008, and another 1.1% in 2010.[49] In addition to layoffs, law firms also reported a dramatic decrease in new hiring.[50] As one report put it:

> In 2009 and 2010, numerous firms rescinded existing employment offers or "deferred" new hires' start dates 3 to 12 months or more.[51] Over 100 of [the 250 largest] American law firms reported deferring a total of nearly 2,800 new associates, constituting 42% of their entering classes.[52] Many firms cut associate bonuses in half for 2008 and in half again for 2009, reducing senior associates' total compensation at some firms by as much as one third compared with 2007.[53]

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[45] *Id*.

[46] *Id*. at 28.

[47] Neil J. Dilloff, *The Changing Cultures and Economics of Large Law Firm Practice and Their Impact on Legal Education,* 70 Md. L. Rev. 341, 341 (2011).

[48] *Id*. at 343 (citing Aric Press & Greg Mulligan, *Lessons of the Am Law 100,* Am. Law., May 2010, at 93).

[49] Burk & McGowan, *supra* note 44, at 29.

[50] *Id*. at 29-31.

[51] *Id*. at

[52] *Id*.

[53] *Id*. at 31.

This economic downturn has forced many to question the historically accepted firm growth strategy model given the realities of the new economy. Under the historical pyramid model, each partner mentors and supervises several associates, which ensures profit maximizing and efficient utilization of partners' human capital by exploiting associates' labor.

In addition to fueling internal competition for partnership status, the pyramid structure, i.e., high partner-to-associate ratio, addressed three concerns that partners had about associates: "grabbing [i.e.] usurping the partners' clients and expertise; leaving; quitting after obtaining valuable training but before the firm can capitalize on its investment; and shirking . . . not working as hard or as effectively as possible."[54] For example, "the years-long probationary period limits associates' access to the partners' human capital, reducing grabbing opportunities."[55]

The pyramid structure is just what it is. Lower paid associates, striving to become partner are located at the bottom of the period, with the ultimate goal of inching closer to the top of the period. As each new associate class enters the firm, better associates ladder up in the pyramid, while average associates remain at the bottom. With each passing year, qualified associates advance in the ranks up the pyramid, while the bottom of the pyramid, and ultimately, the firm, continues to grow.[56]

Under the historical firm model, the growth of the firm was achieved internally, with a focus on the supply side of legal services. Historical law firm growth was largely dependent on an insatiable client demand for complex legal services in an environment where corporate entities experienced a period of exponential growth and expansion. Thus, the historical law firm growth model "implicitly minimize[s] the role of clients in explaining . . . growth by making clients, and their demand for legal services, a necessary background assumption" given the economic landscape of the time.[57] This model might be of little use in predicting the growth patterns of the present-day law firm in a time when the "demand for [large-scale] corporate legal services may be stagnant or in decline."[58]

For instance, in recent years, in-house legal departments have become increasingly sophisticated. Technological advances and reduced overhead costs have allowed smaller "boutique" firms to handle the most complex of legal issues, closing the economies of scale gap. The increased use of in-house legal departments, and corporate downsizing, has reduced the demand on law firms to handle more routine issues, thereby decreasing the demand for large numbers of relatively inexperienced associates. This conflicts with the historical growth model.

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[54] Wald, *supra* note 43, at 2869 (citing Marc Galanter & Thomas Palay, Tournament of Lawyers: The Transformation of the Big Law Firm (1991)).

[55] Wald, *supra* note 43, at 2869.

[56] *Id*. at 2869-70.

[57] *Id*. at 2871.

[58] *Id*. at 2871.

To adapt to the changes fueled by the Great Recession, many firms have strayed from the historical model. Firms are shifting focus from the service of large corporate clients to a more diversified client base, transitioning to a partner-heavy structure, and developing niches, specialization, and regional influence. Further, many firms have found a competitive edge in promising hands-on involvement of partners. Perhaps most importantly, firms can no longer rely on a steady demand for legal services, and must pursue strategic "rainmaking" activities, with a focus on client development in emerging markets.[59]

B. *The Role of Technology in the 21st Century Law Firm*

In addition to the changes brought on by the Great Recession, technology has fostered competition between smaller boutique firms and the historically powerful mega-firms by leveling the playing field among those firms willing to embrace emerging technological advances. In order to succeed as a law firm operating in the new economy, firms of all sizes must embrace and capture the benefits of new technologies.

Many can still remember the days when attorneys crowded law firm libraries, when a secretary was outside every office, and when communication was accomplished via messenger. Contrast the modern day firm, where technology is an essential component of every facet of a law practice: email, electronic data storage, video-conferencing, and research, time management, and accounting software have become commonplace. These technological advances are required for the efficient operation of a law firm in the 21st Century.

Technology costs represent a significant line-item in the present-day law firm budget. Today, 43% of firms spend approximately $8,000.00-$14,000.00 per attorney annually on technology related components and advancements.[60] Top technology purchases in 2013 included desktop hardware (58%), laptops/notebooks (49%), storage area networks (48%), network/server upgrades (44%), and disaster recovery (33%).[61] 48% of firms reported that 2-4% of firm revenue is spent on technology, and 43% reported that the firm's technology budget has increased since 2012.[62]

One of the major emerging technology trends in the present-day firm is the use of cloud computing, a web-based service that allows the end user to access data stored on an offsite host server via an Internet connection, replacing the traditional on-site servers.[63] One of the

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[59] *Id*. at 2895.

[60] Int'l Legal Tech. Ass'n., *2013 ILTA/InsideLegal Technology Purchasing Survey* (2012), *available at* http://insidelegal.typepad.com/files/2013ILTAInsideLegalTechnologyPurchasingSurvey.pdf [hereinafter "ILTA survey"].

[61] *Id*.

[62] *Id*.

[63] Legal IT Prof'ls, *Legal IT Professionals 2012 Global Cloud Survey Report* (2012), *available at* http://www.legalitprofessionals.com/wpcs/cloudsurvey2012.pdf.

most important benefits of cloud computing is the shared nature of resources, including software and servers, which ultimately increases efficiency and significantly decreases IT costs. Drawbacks include the transition cost of moving from a complex internal IT system to the cloud, and also security and privacy concerns in relinquishing control of confidential client data to a third party. In fact, security and privacy issues represent the two largest concerns expressed by firms considering a cloud-based system.[64]

In a recent survey, 70% of firms reported that they were actively researching and considering cloud computing, or were already using the cloud. However, overall, firms are still split on whether to actually move to the cloud, with 44.5% in favor and 46.3% opposed.[65] That said, 83.8% of firms participating recognized that cloud-based computing will ultimately overtake onsite computing within 15 years.[66]

C. *The Generation Gap*

As if a shifting economic growth model and constantly advancing technology was not challenging enough, these changes are taking place in the context of an increasingly intergenerational law firm, where ideological differences among employees with a 40 year age gap make it that much more difficult to adapt to the demands of the new economy.

Describing the current generation gap, it has been said,

> For the first time in history, four generations are working alongside one another. The [World War II] Generation (or Silent Generation), born before 1945, comprises five percent of today's workforce. Baby Boomers, born between 1946 and 1964, make up the largest share of the workforce at 38 percent. Generation Xers, born between 1965 and 1980, represent 32 percent, and Generation Yers (or Millennials), born between 1980 and 2000, are 25 percent.[67]

The Silent Generation values "an honest day's work" and prefers face-to-face communication. Firm loyalty is extremely important to the Silent Generation, members of which are often troubled by the younger generation's willingness to hop from one job to the next. The Baby Boomers gave birth to the "Me" decade of the 70's, and thus are sometimes criticized for being egocentric. The Boomers also started the "workaholic" trend, motivated by a desire to attain wealth and success. Boomers also value respect and demand consideration in the decision-making process. Members of Generation X are independent thinkers and value a

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[64] *Id*.

[65] ILTA survey, *supra* note 60.

[66] *Id*.

[67] Matthew Malamud, *Technology and the Intergenerational Law Firm*, Trial, January 2012, at 22, 24.

work-life balance. Gen Xers are not typically viewed as "team players," and think "job" while Boomers think "career." Generation Y demands constant feedback, and responds more positively to a mentoring relationship as opposed to an authoritarian environment.[68]

Millennials are of particular concern in the present-day firm. During 2015, Millennials will overtake the number of Boomers in the workforce.[69] In a recent survey, "86 percent of Millennials thought of themselves as hard workers, yet only 11 percent of HR professionals" held that same opinion.[70] The survey also found that "82 percent of Millennials responded as being loyal to their employers," however, only 1 percent of HR professionals felt that Millennials were loyal employees.[71] These results reflect a severe disconnect between Millennials and upper management, which is troublesome considering the inevitable influence Millennials will wield in the workplace in the near future.

Technological advances have also highlighted the generational differences in the modern-day law firm. For example, 75% of Millennials use mobile technology in the courtroom, compared to just 23% of Baby Boomers.[72] 83% of Millennials use social networking sites like Facebook and LinkedIn, compared to 50% of Baby Boomers.[73]

Although the foregoing descriptions are no doubt generalities, there are certainly tangible differences between the generations, which make up today's workforce. These differing and often-conflicting value systems can present significant managerial and interpersonal challenges for the 21st Century law firm. Perhaps more importantly, these generational differences can affect endeavors as varied as marketing efforts and client relations, to jury selection and even outcomes at trial. Therefore, to effectively operate in a now multigenerational workforce, it is critical to recognize and respond to generational variances.

Certainly, the modern-day law firm will be faced with challenges in the years to come. The traditional firm growth model may no longer be tenable, given advances in technology and the increased sophistication of in-house legal departments. Constantly changing technology has forced law firms of all sizes to rapidly embrace emerging technological advancements to stay competitive. These challenges are taking place in the context of an increasingly multigenerational environment in which employees' differing ideological and

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[68] Nancy Peppard, *Closing the Generation Gap,* Law Prac. (June 2006), *available at* http://www.americanbar.org/publications/law_practice_home/law_practice_archive/lpm_magazine_articles_v32_is4_an1.html.

[69] Deirdre Reid, *The Path to Y: Inviting and Including the Next Generation of Members*, Bar Leader (September-October 2013), *available at* http://www.americanbar.org/publications/bar_leader/2013-14/september-october/path-y-inviting-including-next-generation-members.html.

[70] *Id*.

[71] *Id*.

[72] Malamud, *supra* note 67.

[73] *Id*.

cultural values affect the manner in which they interact with each other and respond to external pressures. Despite these challenges, those firms which recognize and respond to the demands of the new economy will undoubtedly achieve success practicing law in the 21st Century.

IV.
On the Horizon: The Problems and Opportunities Facing Law Firms of All Shapes and Sizes

The current realities of the legal marketplace are harsh. Within the recent past, twelve major law firms with more than 1,000 partners have collapsed.[74] Included within the list of firms are Dewey & LeBoeuf LLP, Finley Kumble, Coudert Brothers, LLP, Dreier LLP, and Heller Ehrman.[75] At the time of its collapse, Coudert Brothers had been in existence for 153 years. The collapse of these firms, and others, is often said to be the result of increased debt, but at the end of the day, it comes down to money or the lack thereof. The demand for Big Law's[76] services fell precipitously when the economy crashed in 2008. The demand has remained depressed ever since.[77]

With lack of adequate available income to pay the increased debt and salaries, attorneys were let go and, eventually, doors were closed. Some have commented that these collapses are indicative of a great collapse of "big law".[78] The flip side, however, is that the concern about law firm collapses is overblown as, despite harsh economic times, some firms continue to grow and will continue to increase revenues in the future. Regardless of one's point of view on the collapse of Big Law, the reality is that the legal world is changing and, in order to survive in the future, attorneys must learn from their own mistakes as well as the mistakes of others and overcome those mistakes to create opportunities. Law firms must adapt to the ever-changing world that has squarely and abruptly confronted them. For some, the adaptation will be well planned and voluntary; for others, it may be a matter of forced survival.

An analysis of the obvious money shortage problem goes beyond the inadequate cash flow and out of necessity must identify and cure the cause behind the money problem. Quality of life, quantitative legal billing analysis, commodity work and outsourcing all impact a firm's cash flow. As one commenter stated: "The golden era is gone, but this is not because the law itself is becoming less relevant. Rather, the sea change reflects an urgent

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[74] Noam Scheiber, *Big Law Firms in Trouble: When the Money Dries Up,* New Republic (July 21, 2013), *available at* http://www.newrepublic.com/article/113941/big-law-firms-trouble-when-money-dries.

[75] *See* John S. Dzienkowski, *The Future of Big Law: Alternative Legal Service Providers to Corporate Clients*, 82 Fordham L. Rev. 2995, 2995 (2014).

[76] *Id.* Scheiber defines "Big Law" as any law firm with 100 or more attorneys.

[77] Bernard A. Burk, *What's New About the New Normal: The Evolving Market for New Lawyers in the 21st Century*, 41 Fla. St. U. L. Rev. 541, 542-43. (2014).

[78] Scheiber, *supra* note 74.

need for better and cheaper legal services that can keep pace with the demands of a rapidly globalizing world."[79] This sea change does not, however, do away with the need for quality lawyering and thoughtful client counseling. Somehow the two must find a way to meld into a mutually advantageous relationship.

The top challenges identified by the State Bar of Wisconsin's Board of Governors' Challenges to the Profession Committee were reported as economic pressures on the practice, technology and the practice of law, regulation of the legal profession, and new lawyer training/development.[80] Larry Ribstein identifies seven factors he believes threaten the survival of the traditional law firm model: (1) "the rise of in-house counsel"; (2) "reduced size and scale advantage"; (3) "increasing partner-associate ratios"; (4) "changing clientele"; (5) "limited liability"; (6) "increasing global competition"; and (7) "deprofessionalization of law practice."[81] A comparison of the two lists establishes more similarities than differences.

Corporate America has had to adapt to changes as a result of the economy. With corporate clients serving as the backbone of many firms, attorneys need to adapt as well. Corporate America is looking to its attorneys to change. With the recognition that certain legal tasks could be managed inside, in-house legal departments have grown, resulting in a necessary decrease in corporate client reliance upon private law firms.[82] With corporate client loyalty to the same law firm declining, corporations are spreading their legal work "among a number of firms in order to create competition and control costs."[83]

While the billable hour may not be dead, law firms are faced with the reality that clients are focusing on added value and increased efficiency.[84] "Recession-induced budget cuts forced" . . . law departments to rethink" the legal services pricing structure.[85] Moreover,

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[79] Rachel M. Zahorsky, *Law Job Stagnation May Have Started Before the Recession—And It May Be a Sign of Lasting Change,* A.B.A. J. (July 1, 2011), *available at* http://www.abajournal.com/magazine/article/paradigm_shift.

[80] State Bar of Wisconsin, *The New Normal: Challenges Facing The Legal Profession: Board of Governors' Challenges to the Profession Committee* (July 2011), *available at* http://www.wisbar.org/SiteCollectionDocuments/News/FINAL-report-July-2011.pdf [hereinafter "*Wisconsin Study*"].

[81] Larry E. Ribstein, *The Death of Big Law*, 2010 WISC. L. REV. 749, 760-67 (2010); *see generally* "Lawyers As Lawmakers," 69 MO. L. REV. 299 (2004); Larry Ribstein & Erin O'Hara, *The Law Market* (2009).

[82] *See* Daniel Currell & M. Todd Henderson, *Can Lawyers Stay in the Driver's Seat?*, 38 Int'l Rev. L. & Econ. 17, 23 (2014).

[83] Dzienkowski, *supra* note 75, at 2999.

[84] *See generally Wisconsin Study*, *supra* note 80.

[85] Burk, *supra* note 77 (citing Karen Sloan, *For Litigators, a Different Kind of Recession*, NAT'L L.J. (August 17, 2009), at 6, *available at* http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202433112312).

advances in technology "fueled the rapid expansion" of document review and information organization "outsourcing firms both abroad and domestically."[86] Clients who recognized that they could pay less, sometimes much less, for their legal process work will continue to expect a reduction in fees and will not pay more. "[C]lient willingness to treat . . . legal process work . . . as a commodity service [performed at reduced rates] will result in even greater price competition"[87] and perhaps less work for law firms unwilling to perform commodity functions. Recognizing client demands, some firms have "start[ed] their own internal legal process functions, staffed by less-credentialed contract and 'staff' lawyers at much lower salaries and billing rates," thus allowing the firm to still generate income, but at a cost savings to the client.[88] This process is referred to as "insourcing."[89] Use of commodity firms to do commodity work, however, should not be confused with a client's willingness to sacrifice when it comes to handling complex legal issues.

Recognizing the cost savings potential, some general counsel have "elect[ed] to develop in-house expertise for recurring work," such as common types of litigation, or for recurrent legal process tasks, such as discovery related issues and to determine where and from whom needed documents and information can be gathered.[90]

Law firm leaders have been known to focus on billable hours and profits over people, to engage in risk avoidance to the point of stagnation and to engage in top-down management. William Pollard once warned, "The arrogance of success is to think that what you did yesterday will be sufficient for tomorrow."[91]

Often times, firms promote lawyers to management roles who have poor–or no–management skills. In comparison, despite tough economic times, "many small law firms are thriving and doing quite well organizationally and financially."[92] Solo owners are growing beyond being solo practitioners and "building law firms with 15+ attorneys and 30+ total office personnel."[93]

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[86] Burk, *supra* note 77, at 583.

[87] *Id*. at 584.

[88] *Id*. at 583.

[89] *Id*.at 585.

[90] *Id*.

[91] C. William Pollard, The Soul of the Firm 114 (1996).

92 John W. Olmstead, *Survival in Turbulent Times Using a Business Plan to Focus the Small Law Firm,*, http://www.olmsteadassoc.com/resource-center/Survival-in-Turbulent-Times-Using-a-Business-Plan-to-Focus-the-Small-Law-Firm.aspx (last visited Feb. 28, 2015) [hereinafter "Survival"].

[93] *Id*.

While some note that the future of law firms as we know it is bleak, law firms, no matter the size, are still in possession of their best asset, their people.[94] "[H]uman capital and knowledge base should be leveraged instead of billable hours."[95] One commenter noted: "[e]xisting practice barriers will giveaway and many firms will create multidisciplinary practices. These firms will function as multidisciplinary professional service firms and their rosters will include specialists from other professions such as accounting, finance, management consulting, psychology, and counseling."[96] Of course, without a revision to the Model Rules of Professional Conduct (Model Rules), this type of practice will not give way in most parts of the United States. In this regard, the United States will continue to lag behind other countries.

"Lawyers don't generally have sophisticated procurement, project management and commercial skills. These skills are important for managing complex legal matters, and there is a large and growing class of non-traditional legal service providers who are cultivating those skills."[97] "Architects supply key intellectual input to a building project. By the same token, law firms could end up supplying key intellectual input to a legal matter."[98] "To do the work effectively, lawyers will need to develop procurement, project management and other skills not native to their planet."[99]

Along this line, one prediction is that products and services will continue their century-old migration away from one another–that is, a legal product (information) will be more easily separable from a legal service, such as analysis of a factual situation.[100] Clients could still go to a single law firm, which would then coordinate all of the activities of various service providers.[101] In the last decade this has evolved to include things like legal research, document analysis and management, and other higher value-added work. Businesses with large or sophisticated in-house legal departments could coordinate their own legal matters–stitching together a network of Legal Process Outsourcing firm, law firms and individual lawyers to serve their needs.

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[94] John W. Olmstead, *How to Reinvent Your Law Practice in Order to Prosper in the 21st Century,* http://www.olmsteadassoc.com/resource-center/how-to-reinvent-your-law-practice.aspx (last visited Feb. 28, 2015) [hereinafter "Reinvent"].

[95] *Id*.

[96] *Id*.

[97] Currell & Henderson, *supra* note 82.

[98] *Id*.

[99] *Id*.

[100] *Id*.

[101] *Id*.

Olmstead notes:

> Law firm members fail to 'innovate and think outside of the box.' They simply respond and mimic the actions of other law firms. Twenty-first century law firms will need to know how [to] be creative and be market leaders with creative client solutions as opposed to market followers.[102]

Firms will also have to grasp the concept that all equity attorneys must generate work. Although it is critical to support well-established "rainmakers," each one has a shelf life as age, death and retirement, thins the number of established contacts. Thus, everyone has to make marketing efforts that bear fruit.

V.
Cockroaches and Crocodiles: A Proactive Approach to Succeeding in the 21st Century Practice of Law

A. *Technology, Outsourcing, and Standardized Forms*

1. Technology

Over the past thirty years, advances in technology have affected nearly every aspect of human life. These advances have caused fundamental changes in the way Americans communicate, manage their finances, conduct business and even govern their social calendars. Businesses in all industries and professions have had to adapt to keep up. The legal profession is no exception.

From the beginning of the 19th Century, through the beginning of the 20th Century, practicing lawyers went about their day-to-day business in roughly the same way.[103] In the 20th Century, the telephone, typewriter, and copy machine changed the way lawyers communicated and alleviated the need for scriveners. Despite these inventions, lawyer's day-to-day operations changed only slightly. They manually researched published code books and case law, communicated by telephone, mail, or in face-to-face meetings, prepared documents on typewriters, and physically filed court documents at the clerk's office.

In the 1980's, things began to change. The expanded use of the personal computer provided attorneys with the ability to prepare, edit, and replicate documents more efficiently than ever before. With the invention and widespread usage of the Internet, lawyers could send these documents through e-mail. Lawyers no longer had to wait for important docu-

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[102] Reinvent, *supra* note 94.

[103] M.H. Hoeflich, *From Scriveners to Typewriters Document Production in the Nineteenth-Century Law Office*, 16 Green Bag 2d 395, 396 (2013).

ments to arrive via snail-mail.[104] Instead, technology provided nearly instantaneous access to this information, as it advanced through the 1990's and to the present. The space needed to store data and the amounts of information that can be stored in that space have increased exponentially. Methods of communication only vaguely resemble the traditional landline phones of a few years ago. Now, smart phones allow lawyers to communicate through voice conversation, video conversation, and text. Additionally, personal devices allow lawyers access to email and other Internet based services anywhere at any time. The ability to communicate to individuals in other parts of the world has created an effect, which some authors have referred to as the "flattening of the globe.[105]

One of the most time-consuming parts of legal work is research. While still time intensive, online search engines with expansive databases allow lawyers to be much more efficient in conducting research. Less time is wasted searching through irrelevant case law. Instead, lawyers use keywords and topics to access information at the click of a mouse and the "law library" is any place with Internet access. Law firms subscribe to these databases by paying for varying levels of access. Depending on the plan, lawyers have nearly every type of case law or statute at their fingertips.

One of the more recent developments, cloud computing, is also changing the way lawyers practice. Cloud computing refers to the process "where data is stored on servers owned by third parties and accessed using the Internet."[106] Thus, any document that has been saved to the cloud can be accessed by an appropriate device that has Internet access. According to practitioner, Nicole Black, "[cloud-computing] is one of the most important technological advancements driving change in the delivery of legal services."[107] Black interviewed one lawyer who said: "[W]hen I'm in court and someone claims I never filed an order, I can pull out my iPad and access a copy of the filed order right in court."[108] This type of ability provides an attorney with a significant advantage over the opposing counsel. Further, this technology reduces mistakes and miscommunications between lawyers, clients, support staff, and judges, all while improving efficiency. It also lets smaller firms who are technologically savvy compete more effectively with the larger firms.

The ability to remotely access information saved in a central location allows lawyers to work on projects together while they are physically located in other parts of the country or world. One lawyer can edit a section of a document and save it to a cloud service, then

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[104] Nicole Black, *Lawyers, Cloud Computing, and Innovation: How Cloud Computing Facilitates Innovation in the Delivery of Legal Services*, 9 I/S: J.L. & Pol'y Info. Soc'y 593, 594-95 (2014).

[105] *See generally* Carlo D'Angelo, *Overseas Legal Outsourcing and the American Legal Profession: Friend or "Flattener"?*, 14 Tex. Wesleyan L. Rev. 167 (2008) (citing Thomas L. Friedman, The World Is Flat: A Brief History of the Twenty-First Century 66-67, 189 (2005)).

[106] Black, *supra* note 104, at 593.

[107] *Id*.

[108] *Id.* at 597 (quoting from her interview with California attorney, Erin Levine).

another lawyer can access the same information and work on the same document from a distant geographic location; the lawyers can also edit a document simultaneously. These advances in technology have been extremely beneficial to lawyers.

2. Outsourcing

Outsourcing is a popular trend in the legal profession today. Generally, outsourcing involves the sub-contracting of certain aspects of a business's operations. Most corporations outsource some part of their business operations. While other professions have experienced this phenomenon, many previously thought that outsourcing would not affect the legal profession. This proved to be wrong, at least in part, because of the technology advances previously discussed. Realistically, law firms have been outsourcing research and discovery tasks for years.[109] However, recent trends show that offshore outsourcing has outpaced domestic outsourcing. In 2008, a report issued by Forrester Research predicted that the offshore outsourcing of legal services would increase to a 4 billion dollar a year industry by the year 2015.[110] Initially, offshore outsourcing in the legal industry began when corporations decided to outsource work that was traditionally completed by their general counsel's support staff. Technological advancements, however, have made the offshore outsourcing of entire corporate litigation departments possible.[111] This led one professor to ponder whether current laws might eventually be changed to allow offshore lawyers to appear before American judges remotely.[112]

A majority of all legal process outsourcing goes to India and the Philippines. There are two main reasons for this. First, a large number of law schools in India and the Philippines provide English based curriculums.[113] Additionally, those curriculums are rooted in the same English common law system as the United States.[114] Second, wage rates in India and the Philippines are a fraction of those in the United States.[115] In fact, many of the Legal Process Outsourcing (LPO) firms in India pay higher wages than native law firms.[116] Further, many law students from India obtain LLM degrees from American schools. Therefore, Indian LPO firms are able to provide many legal process services to American law firms and corporations at a lower cost without diminishing the quality of the work product.

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[109] *See* D'Angelo, *supra* note 105, at 171.

[110] *Id.* at 170 n. 6.

[111] *Id*. at 183.

[112] *Id*. at 177.

[113] *Id*. at 171.

[114] *Id*. at 174.

[115] *Id*.

[116] *Id*.

Many scholars have written on the possible concerns associated with the offshore outsourcing of legal work. The trend towards offshore outsourcing has led many to predict a sharp decline in jobs for graduating law students in the United States.[117] In his article on offshore outsourcing, John Okray indicated that Indian lawyers earn an average $22,000 per year, a fraction of what American lawyers earn.[118] According to the Economic Times of India, Indian lawyers are charging American law firms as little as $7 per hour for some services.[119] Additionally, there are more than enough Indian lawyers to complete the work. The availability of inexpensive alternatives could eventually lead to a decline in legal work, a decline in law school enrollment, and, eventually, a decline in the number of lawyers.

Another concern has been the potential for violations of the rules of ethical conduct. Conflicts of interest could easily occur. If two firms representing opposing counsel submit portions of their caseload to the same LPO, problems will arise. Even if the LPO firms run conflict checks, who is going to enforce strict adherence? Another area of concern is the likelihood of misunderstandings. While employees at offshore LPO firms have studied English, the language barrier might cause misunderstandings and difficulties in communicating complex subject matter. A final area for concern rests with the work product itself. With LPO firms offering more and more services, the potential for receiving insufficient work product increases.

Until recently, generally the only type of legal work being outsourced has been back-office work such as document review and research. However, recent technological advancements have expanded the list of services that LPO firms are offering. One firm, Vee LPO, advertises a variety of legal services consisting of contract drafting, contract review, contract management, bankruptcy form preparation, e-discovery, litigation support, deposition summary, legal research and drafting, animated reconstruction of accidents, legal transcription, legal coding, proof reading, medical record review, and other miscellaneous services.[120] While most LPO services are back-office related, services such as contract management and bankruptcy filing allow LPO firms to take a more active role in the legal process. Indian and Philippine LPO firms are even providing services to individual clients. Americans have begun hiring Indian lawyers via the Internet to prepare divorce petitions, contracts, and other legal documents.[121] With so many offshore firms preparing documents for American law

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[117] John Okray, *Legal Process Outsourcing—Coming to A Practice Area Near You?,* Fed. Law, Sept. 2013, at 4, 5.

[118] *Id*.

[119] *Middle Class Americans Reach Out to Lawyers in India via Internet for Legal Aid* (Oct 5, 2013), http://economictimes.indiatimes.com/news/news-by-company/corporate-trends/middle-class-americans-reach-out-to-lawyers-in-india-via-internet-for-legal-aid/articleshow/23540519.cms (last visited Feb. 28, 2015f) [hereinafter referred to as "Economic Times of India"].

[120] *See e.g.*, VEE LPO, http://www.veelpo.com/ (last visited Feb. 28, 2015).

[121] Economic Times of India, *supr*a note 119.

firms and citizens alike, the use of standardized forms has become prevalent. Great caution and professional skepticism should accompany a form driven practice because all cases are unique.

3. Standardized Forms

Standardized forms, specifically contracts, have been used in the American legal system for quite a while, but the scope and breadth of standardized forms has grown to include business areas as diverse as commercial contracts to marital property settlements. Most states have adopted standardized forms for the filing of certain court documents. This has allowed many clients to proceed *pro se*. One area where *pro se* is most common is in divorce actions. Among the standardized forms that states have adopted, divorce petitions and related forms are some of the most commonly used.[122] It is cheaper for individuals to fill out a standardized form and proceed *pro se* than it is to hire an attorney. Thus, many people, sometimes more than half of divorcing couples, proceed *pro se*.[123] This phenomenon has only grown with the online production of standardized forms.

Clients, lawyers, and LPOs all have access to jurisdiction specific standard forms that are provided online. While access to this information can be beneficial to those who cannot afford representation, there are some concerns. First, research has indicated that "[o]ne-third of pro se litigants who had problems with forms and the legal process did not get help."[124] Therefore, it is likely that individuals who are proceeding *pro se* or purchasing online kits to prepare legal documents are missing out on relevant and helpful advice that could be obtained through actual representation, often at great cost in the long run.

Another type of standardized form is the standard form contract, often referred to as an adhesion contract. These are common in purchase agreements, business contracts, service contracts, and business transactions. The prevalence of such contracts is a cause for concern. For instance, some have discussed at length the lack of mutual assent in these contracts.[125] Instead, as one judge described, "[t]hey are said to resemble a law rather than a meeting of the minds."[126] While somewhat controversial, standard form contracts have been upheld as a way of increasing efficiency.[127] Another area where standardized contracts are used has been in the charters for businesses. While all corporations have standard default rules that

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[122] *See* Robert B. Yegge*, Divorce Litigants Without Lawyers*, 28 Fam. L.Q. 407, 409 (1994).

[123] *Id.*

[124] *Id*. at 410.

[125] Donald B. King, *Standard Form Contracts: A Call for Reality*, 44 St. Louis U. L.J. 909, 912 (2000) (citing *Siegelman v. Cunard White Star,* 221 F.2d 189, 206 (2d Cir. 1955)).

[126] *Id*.

[127] Deborah Zalesne, *Enforcing the Contract at All (Social) Costs: The Boundary Between Private Contract Law and the Public Interest,* 11 Tex. Wesleyan L. Rev. 579, 588 (2005).

govern the structures of those corporations, other types of businesses are less formal. This is intended to allow entrepreneurs to structure their businesses in a way that will be most functional to the business's goals. Many entrepreneurs are forming their new business by purchasing standardized forms for charters available in online kits. These kits allow entrepreneurs to avoid hiring attorneys. However, the standard form charters often lack the thought and foresight needed to structure a business properly. Nevertheless, the availability of online standard form legal documents continues to grow.

One such provider of online legal documents is LegalZoom.com. LegalZoom was co-founded in 2001 by Robert Shapiro and offers legal documents ranging from business related documents to personal use documents like wills, trusts, and divorce petitions.[128] Other documents offered by LegalZoom include incorporation amendments, trademark registrations, bankruptcy forms, and real estate deed transfer documents.[129] Under the real estate deed transfer section of the website, LegalZoom promises to complete: (1) research to determine the exact legal description of the property; (2) filing the real estate deed with the County Recorder's Office; and (3) when required, review by an attorney licensed in the jurisdiction of the real property.[130] However, LegalZoom has plenty of critics.[131] Several lawsuits have been filed against LegalZoom, including one in which the plaintiffs gained class action certification.[132] Among other things, the lawsuits have alleged that LegalZoom participates in the unauthorized practice of law.[133] While the first suit settled, lawsuits in other states may proceed. This is a result of the differences between the various states definition of the practice of law.[134]

There have also been critics of the quality of services offered by LegalZoom. Lindzey Schindler, in her article on the ethical implication of online forms, describes the investigation of an estate planning lawyer into Legal Zoom's services.[135] As part of his investigation, the lawyer used one of LegalZoom's products to create a will.[136] The lawyer contended that

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[128] Lindzey Schindler, *Skirting the Ethical Line: The Quandary of Online Legal Forms,* 16 Chap. L. Rev. 185, 186 (2012).

[129] *See* LegalZoom, http://www.legalzoom.com.

[130] *Id*.

[131] *See e.g.*, Schindler, *supra* note 128, at 194.

[132] *Id*. at 191-92.

[133] *Id*.

[134] *Id*.

[135] *Id*. at 193.

[136] *Id*.

the document contained some mistakes that would have cost him a significant amount of money in probate if he had filed that will.[137] According to Schindler, "[t]he question remains if under current ethical rules, a service with the potential for such missteps and mishaps is, or should be, allowed to continue selling its services."[138] Nevertheless, LegalZoom continues to offer services to anyone willing to pay.

4. Embracing Change

The practice of law has changed dramatically in the last thirty-five years. Advances in technology have changed the way lawyers think and act. However, not all of the effects of this development have been anticipated. With the availability of new document storage and access methods, some back office duties have become transferable. Following the lead of other professions and industries, the legal profession has begun outsourcing certain parts of the legal process to both domestic and offshore firms. Offshore firms have outpaced their domestic counterparts because of their ability to charge rock bottom prices. This has raised several concerns for the future of the legal profession and the quality of work performed in the profession. Despite these concerns, clients continue to ask for cheaper prices and access to standard forms. Thus, combined with the capable employees and the availability of standardized firms, offshore outsourcing appears to be a trend that is going to grow.

As noted by one commentator on the subject, "[m]achines may, at least at first, neither greatly help nor substantially harm other classes of lawyers and some of their functions."[139] Oral advocates and litigators are placed in the category of attorneys for whom machines will not impact, purely from the appearance before the tribunal. Also included are attorneys in specialized practices with fast-paced changes. Perhaps the most noted characteristic of the attorney that cannot be replaced by a machine is the art of persuasion.[140] The future for the journeymen lawyer, contract drafters, document review, is not as bright as noted above.[141]

Perhaps the most concerning aspect of the machine intelligence era is predictive analytics. "Predictive analytics is a new discipline that combines data with analysis to make predictions."[142] Legal experts predict that law, "with its massive amounts of data from case law, briefs, and other documents, is conducive to machine data mining that is the foundation of this new predictive science."[143]

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[137] *Id*.

[138] *Id*. at 194.

[139] John O. McGinnis & Russell G. Pearce, *The Great Disruption: How Machine Intelligence Will Transform the Role of Lawyers in the Delivery of Legal Services,* 82 Fordham L. Rev. 3041, 3042 (2014).

[140] *Id*. at 3049.

[141] *Id*.

[142] *Id*. at 3052 (citing Eric Siegel, Predictive Analytics: The Power To Predict Who Will Click, Buy, Lie, Or Die 15 (2013)).

[143] McGinnis & Pearce, *supra* note 139, at 3052.

Lawyers, as counselors and advisors, must capitalize on the imperfections of predictive analytics and a machine will not be able to replace the judgment of the lawyer knowledgeable about the judge, the jury and the Court. Accordingly, lawyers—as counselors and advisors—must take advantage of the unique opportunity to provide the service of their skill and judgment to the client.

B. *Personnel*

This section of the paper describes how law firms in the 21st Century re making significant changes to their personnel at all levels, including both lawyers and staff.

1. The Reclassification of Associates

Traditionally, most medium-sized to large law firms hired new associates directly out of law school, and they all were placed on a partnership track, expected to be considered for partnership in typically 8 to 10 years. This was often an "up or out" system, in which the strongest-performing, hardest-working associates would advance to partner, while the majority of associates would leave the firm at some point during the first 8 years to become an in-house attorney or join another firm.

Recent years have seen a major shift in the associate ranks. Larger firms have started to hire contract attorneys to perform document review and sometimes other smaller tasks, at much lower compensation and lower billing rates. These contract attorneys are not intended to advance in the firm to more significant roles. They are typically supervised, at least in large part, by associates who are on a partnership track. In some circumstances, firms or clients directly have turned to outsourcing rather than using contract attorneys employed (permanently or temporarily) by a law firm.

Other firms have created a position of "practice group attorney," a role in which these non-partnership track lawyers provide support for the partners and partnership-track attorneys.

Many firms have substantially decreased or eliminated hiring of new associates directly from law school. This is driven in part by clients' unwillingness to pay for hours billed by entry-level lawyers. These firms have shifted to hiring lateral associates who were trained by those firms that do hire out of law school, or who gained experience through a judicial clerkship, government service, or public interest position.

One concern that the rise of non-partnership track associates raises for law firms is that newer lawyers who do not have a route to partnership will do only the minimum acceptable quality work, work the fewest acceptable number of hours and otherwise not be invested in the future of the firm.

For associates on a partnership track, that track has lengthened. In some instances associates are promoted first to a "counsel" or "senior associate" title, and then to non-equity partner, and perhaps finally to equity partner if and when they are able to develop or substantially contribute to a book of business. One concern here is that if the road to true partnership (equity partnership) is so long and difficult to navigate, lawyers who might have made excellent partners in years past will give up too soon on achieving equity partnership

and move in-house or to other positions. In the long run, this will leave firms without enough talent at the highest level, where they need it most.

2. The Non-Partnership Track Attorney

Many law firms now employ a significant percentage of lawyers who are non-partnership track attorneys. These are experienced attorneys who have more than 8-10 years of experience and whose expertise is desired, but they either choose not to pursue partnership or are viewed as not having or unlikely to develop partnership potential. They have various titles such as "counsel" or "of counsel" or "senior associate" or "senior attorney." They typically command billing rates equal to or greater than senior partnership-track associates. Because of their billing rates, they provide a significant level of profit for their firms. However, these lawyers may take work away from partnership-track lawyers who need the experience in order to develop their skills.

Many law firms also now have a significant number of non-equity partners, some of whom either do not have the interest in or are viewed as unlikely to achieve equity partnership. These also might be considered non-partnership track attorneys. They command partner-level rates but are paid a salary and do not have an ownership interest in the firm. In most cases they do not have a significant book of business and instead serve primarily as "service" partners, working on matters originated by equity partners. They are often partners in title only (although partnership agreements vary on this) and may have little job security in some firms if their source of work dries up. Their partner title coupled with lack of profit sharing or voting rights in firm decisions can result in a lower morale among this group of lawyers in some firms.

3. Internships

In the "old" days, many large and even medium-sized firms would hire law students as "summer associates." These programs would involve paid training of the law students as well as "wining and dining" of them to help persuade them to join the firm after law school. The vast majority of summer associates would receive offers of employment after law school. At this time, the largest law firms competed for talent from the top 25 law schools.

In recent years, these summer associate programs have been substantially scaled back or completely eliminated by many firms as their entry-level hiring has decreased, and as the market has changed. Many firms have focused on lateral hiring instead, because clients will not pay for the time of entry-level lawyers and the firms do not want to absorb the cost of training them.

At least one firm, Greenberg Traurig, has started a "residency" program. "Residents" are entry-level lawyers who are not hired as new associates through the firm's summer associate program. They are paid substantially less, billed at a much lower hourly rate, and spend a significant part of their time on non-billable training. After a one-year residency, the residents can advance to become a partnership-track associate or take on another non-partnership track position, or leave the firm.

4. The Legal Secretary Replacement

Gone are the days when a legal secretary would work for one or two lawyers. In some cases this has been driven by technological change, with most young lawyers being trained to type quickly from their elementary school days, and only a few old-timers still using dictation (which can now be done effectively by computer). Most secretaries now serve four, five or six lawyers, or function as part of a pool that serves an entire practice group. Since the financial crisis of 2008, many law firms have substantially decreased their overall secretarial ranks.

Legal secretaries, now often called legal assistants or some other similar title, also perform a variety of additional tasks. This includes, for example, document organization and trial or hearing preparation work that was previously assigned to paralegal, but for which clients are no longer willing to pay for paralegal time. While there was a time when some of the largest firms would charge for secretarial time by the hour, there is probably no client that will still pay for that service. As one of the now quite limited number of law firm employees who do not generate income for the firm, legal assistants are continually pressured to be more productive, perform higher-level work, and serve more masters.

5. Is there such as thing as a Law Librarian?

One might think that law librarians in law firms would no longer be needed in light of the cost-cutting measures of recent years. However, generally only the large law firms had librarians, who were small in number during the "golden years," and their role has generally not been completely eliminated. They are typically capable of efficiently performing high-level paralegal work, and their time can often be billed as such. While there is no longer a need to maintain large rooms full of case reporters, digests, treatises, and similar resources, as many of the resources are available online, law librarians can be quite effective and efficient in using the online resources and performing other work that requires old-fashioned research, such as researching legislative history not available online.

C. *The Financial Impact of Law Firm Failures and Downsizing*

In the last ten years, there have been more big law firm collapses than the combined number over the last 50 years.[144] Nearly all of the large firm failures have been a result of extraordinary debt incurred by the firm. Many commenters point to the traditional structure of the Big Law Firm as the culprit. Large firms have traditionally paid lucrative salaries to associates, even first year associates, while billing their clients high hourly rates. In recent years, the clients – usually corporations – have begun to balk at paying such high rates for these hourly charges. As a result, some firms have cut back on associate hiring. Additionally, some firms have necessarily altered their operations by requiring equity partners to produce more billable hours and decreasing the pay structure for junior associates. Other firms, out of necessity, have reduced the number of partners or, in severe cases, collapsed entirely.

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[144] *See* Fuchs, *supra* note 37.

Whether a law firm fails or downsizes, there are many financial implications involved in the process. First, the remaining assets and debts need to be allocated properly. Second, any remaining work that has not yet been completed must be finished and the fees allocated. Third, tax issues must be resolved. Finally, private contracts with third parties need to be addressed.

The first type of financial implication is the impact felt by partners and associates during the division and allocation of assets and liabilities. Historically, the general partnership has been the most popular business structure for law firms. However, new structures including the LLP, LLC, and others hybrids have become increasingly popular.[145] In both a general partnership and a limited liability partnership failure, a firm goes through the process of dissolution when one or more partners decide to end the partnership.[146] A partner's withdrawal from the firm has the same legal consequences as those associated with dissolution.[147]

While dissolution is the end of the current partnership association, it does not mean that the firm is going out of business.[148] A lawyer's claim to income from a firm does not terminate upon dissolution.[149] If one or more partners leave the firm, the rest of the partners may choose to continue the firm's business. When this happens, the exiting partner will take his or her share of the partnership's equity. Generally, the partnership agreement will specify the payout entitlement of each partner. Some agreements have tried to limit the amount of payout that an exiting partner can receive if he or she joins a new firm that competes with the old firm.[150] Firms added this type of non-competition clause in an attempt to create firm stability by preventing partners from leaving. This attempt failed. Courts have generally disfavored restrictive covenants, save for one exception. The Model Rules allow partnership agreements to place restrictions on the payout of retirement benefits when a lawyer leaves to compete with the firm.[151] However, deciding what constitutes a "retirement fund" is difficult. Thus, courts consider many factors when determining whether payments are true retirement benefits or those relating to other types of departure payments.[152]

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[145] Adams, *supra* note 28, at 779.

[146] *See* Mark H. Epstein & Brandon Wisoff, *Comment, Winding Up Dissolved Law Partnerships: The No-Compensation Rule and Client Choice,* 73 Cal. L. Rev. 1597, 1604 (1985).

[147] *See* Robert W. Hillman, *Law Firms and Their Partners: The Law and Ethics of Grabbing and Leaving*, 67 Tex. L. Rev. 1, 37 (1988).

[148] Epstein & Wisoff, *supra* note 146, at 1604.

[149] Hillman, *supra* note 147, at 41; *see also* UNIF. PARTNERSHIP ACT § 38, 6 U.L.A. at 456.

[150] Hillman, *supra* note 147, at 46.

[151] *Id*. at 46.

[152] *Id*.

After dissolution, the partnership continues to exist until the winding up process is complete.[153] During this process, any remaining debts and assets of the firm are allocated. Creditors are paid first, providing there are enough assets to cover the debts. Absent additional guarantees, creditors may not recover firm debts from the personal accounts of partners as long as there is limited liability.[154] Today, limited liability is common with the prevalence of LLP's and LLC's. After the debts have been paid, assets are divided according to the partnership agreement. Additionally, "[t]wo aspects of a law firm's winding up require special attention."[155] Those two aspects include, "the allocation of income generated from the winding-up process" and the "relative responsibilities of lawyers for liabilities arising after dissolution."[156]

The first aspect of winding up that requires special attention is work in progress. When a partner withdraws from a firm, clients may depart with him or her. It is the client's prerogative to retain counsel of its choice. However, the departing partner may not keep fees earned from work that had been started before dissolution and remained incomplete at the time of dissolution. Many cases have been litigated due to conflict between the former partners over who will collect fees associated with this incomplete work.[157]

This common law doctrine known as the "unfinished business doctrine," prevents partners from collecting fees for work that was unfinished or in progress at the time of dissolution.[158] While firms technically enter dissolution after the withdrawal of a partner, practically, the "unfinished business doctrine" applies only to firms that are completing the winding up process.[159] When a firm enters the winding up process, the fees collected from work in progress, whether on a contingency fee or hourly rate, are considered property of the firm.[160] Accordingly, the doctrine requires former partners or their new firms to account to the partnership all fees from unfinished business.[161] Because the partnership continues to exist until the winding up process is complete, any fee collected as a result of the former firm's work in progress or unfinished business must be reported.[162] Absent a contrary agree-

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[153] Epstein & Wisoff, *supra* note 146, at 1604.

[154] Adams, *supra* note 28, at 779.

[155] Hillman, *supra* note 147, at 41.

[156] *Id*.

[157] *Id*.

[158] Epstein & Wisoff, *supra* note 146, at 1606-07.

[159] Peter W. Rogers, *Note, Who Gets the Jewels When A Law Firm Dissolves? The Unfinished Business Doctrine and Hourly Matters,* 108 Nw. U. L. Rev. 311, 318 (2013).

[160] *See generally* Mark I. Weinstein, *The Revised Uniform Partnership Act: An Analysis of Its Impact on the Relationship of Law Firm Dissolution, Contingent Fee Cases and the No Compensation Rule*, 33 Duq. L. Rev. 857, 885 (1995); *see* also *Jewel v. Boxer,* 203 Cal. Rptr. 13 (Cal. Ct. App. 1984).

[161] Epstein & Wisoff, *supra* note 146, at 1607.

[162] *Id*.

ment, the doctrine requires the fees to be split evenly among the partners of the old firm. Accordingly, all partners have an interest in income from the completion of the partnership's unfinished business."[163] However, this doctrine may be dealt with differently by the partnership agreement if the partners so choose.[164]

A second aspect of the winding up process involves the individual partners' responsibilities and rights. Although partners have the responsibility of completing the winding up process, they have no right to income from those efforts.[165] This requirement of the Uniform Partnership Act is aptly known as the "no compensation rule."[166] Except in the case of a partner's death, courts generally enforce the no competition rule to further what one commenter describes as, policy reasons.[167] These policy considerations include: "discouraging battles over cases and possession of files, preserving client choice, preserving freedom of contract, encouraging fiduciary duties among partners, and promoting judicial economy."[168]

Taxes are also a consideration that partners should take into account when law partnerships begin the dissolution process. LLP's are taxed using flow through taxation.[169] Like partnerships, LLP partners are taxed using flow through taxation instead of being double taxed like corporations.[170] However, unlike partnerships, LLP partners receive some liability protection from firm debts.[171] Nevertheless, when a firm partnership goes through dissolution or winds up, there are certain tax implications of which partners should be aware.[172] "For tax purposes, termination, rather than dissolution, is the critically important event."[173] This is because tax laws recognize termination differently than the Uniform Partnership Act (UPA).[174] The UPA places an emphasis on the dissolution while tax law recognizes actual termination as the critical event triggering a change in the payment of taxes.[175] Therefore, a partnership dissolved and terminated under the UPA might not be considered terminated under tax law. This can present a problem when the drafter of a partnership agreement focuses on the UPA without taking the relevant tax law into consideration. Like other financial

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[163] Hillman, *supra* note 147, at 42.

[164] *Id*.

[165] Weinstein, *supra* note 160, at 863.

[166] *Id*. & n. 30 (citing Unif. Partnership Act § 18(f)). *See* note 8 for court decisions which have defined the No Compensation Rule.

[167] Weinstein, *supra* note 160, at 863.

[168] *Id.*

[169] Adams, *supra* note 28, at 779.

[170] *Id*.

[171] *Id*.

[172] Hillman, supra note 147, at 36.

[173] *Id*. at 38.

[174] *Id*.

[175] *Id*. & n. 183 (citing I.R.C. § 708(a) (1982)).

considerations, taxes can play a role in the eventual survival or failure of a law firm whose partners have separated.

Another potential financial risk of the dissolving law firm is the potential for delayed malpractice suits. In his article on the ethical considerations of "grabbing and leaving," Hillman tells the story of one attorney who faced potential malpractice liability five years after he had left his previous firm.[176] According to the article, a client retained the services of a firm one year before one of the partners, Walters, withdrew, and the firm dissolved.[177] Before dissolving, one of the partners filed suit on behalf of the client.[178] After dissolution, the remaining partners continued to represent the client.[179] However, five years later, the client filed a malpractice suit against all of the original firm partners, including Walters, because they had failed to bring the case to trial within five years.[180] The California Court of Appeal found that the client had neither explicitly nor implicitly released Walters as his lawyer.[181] Thus, the suit could proceed against Walters despite the fact that he had never even met the client.[182]

This case illustrates the power that clients have in the process. Clients have the freedom to choose their legal representation.[183] Clients may choose to leave with exiting partners or stay with the firm.[184] Generally, courts have upheld an absolute power of the client to discharge an attorney at will.[185] Therefore, the firm has no power to prevent a client from going with a departing partner if the client so chooses.

Firm employees and partners are not the only individuals affected by the collapse or downsizing of large law firms. Third parties often have private contracts with the firm and are left out in the cold when the firm closes its doors. One such third party is the landlord of a firm's office space. When a large law firm collapses or downsizes, the firm is no longer in need of the office space that it has been leasing, sometimes for decades. Thus, the owner of that space is left with a large office space, which the lessor has modified to fit the needs of the firm, and now has no tenant. Landlords have an uphill battle to recover losses from a failed firm because landlords are almost always unsecured creditors.[186] When a firm fails, it is likely that the assets will be exhausted before the landlord gets its turn to collect.

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[176] Hillman, *supra* note 147, at 52 (citing *Redman v. Walters*, 152 Cal. Rptr. 42 (Cal. Ct. App. 1979)).

[177] Walters, 152 Cal. Rptr. at 43.

[178] *Id*.

[179] *Id*.

[180] *Id*.

[181] *Id*. at 46.

[182] *Id*. at 43, 46.

[183] Epstein & Wisoff, *supra* note 146, at 1604.

[184] *Id*.

[185] *Id*.

[186] *Id*.

Even when the partners receive considerable assets from the firm, landlords are left without a course of action because most law firms are hybrid business structures, such as LLPs, which provide partners with protection from personal liability.[187] According to one commenter, "[l]aw firms have evolved over the years into a measurable credit risk. . . ."[188] Because of this increased risk, many landlords have made changes in the way they conduct business with law firms.[189] For instance, many building owners now require letters of credit to secure leases.[190] Additionally, during lease negotiations, many landlords now study the law firm's financials and look at how long the partners have been with the firms.[191] If these talks involve renovations of the space, owners sometimes ask for full financial audits to be performed.[192] Despite the risks, law firms have remained attractive tenants for landlords of high-end office space.[193]

Another concern for the firm when a partner leaves is the liability of the firm towards the landlord. This concern is exaggerated when a firm suffers a large exodus of partners. Ordinarily, the firm remains liable for contracts that it has entered into with third parties unless one of the partners has placed a personal guarantee on the contract's performance. However, liability on the lease might be problematic if the firm's reduction in size is substantial. The firm may no longer need the same size office space that it is currently leasing. Additionally, a downsized firm may be working with significantly less capital and may no longer have the capability to pay for the same space.

Overall, there are many financial consequences associated with a law firm's failure or reduction in number of partners. Lawyers need to be aware of the risks associated with dissolution and winding up because law firms fail or make changes to their partnership association far more frequently than before. Attorneys no longer stay with the same firm for their entire careers. Additionally, there are differences in the way partnership laws and tax laws view the dissolution and winding up process of firms. There is a great risk of incurring additional financial expenses during a failure or change in partners because of taxes, lease implications, unfinished business, or conflicts regarding the division of assets. Thus, it is important for attorneys to understand these risks and plan accordingly.

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[187] *Id*.

[188] Randyl Drummer, *Dewey Collapse Gives Lenders Pause, But Landlords Won't Cease And Desist in Pursuing Law Firms*, Costar.com (May 30, 2014), http://www.costar.com/News/Article/Dewey-Collapse-Gives-Lenders-Pause-But-Landlords-Wont-Cease-And-Desist-in-Pursuing-Law-Firms/138888.

[189] *Id*.

[190] *Id*.

[191] *Id*.

[192] *Id*.

[193] *Id*. The author quotes executive vice president and San Francisco office branch manager for tenant representation firm Studley, Steve Barker, as saying that law firms "are still reputable, shiny tenants . . ." *Id*.

D. *Legal Project Management: The Attorney as Conductor*

Clients are focusing on value when they hire and retain law firms. "[C]lients are now choosing law firms based on their ability to apply a more systematic and disciplined approach to management that delivers more value, more quickly."[194] Value can be perceived in many ways, including how much a matter costs and the service a law firm provides.

Cost matters to clients. According to "a recent survey of General Counsel at 88 major companies," 74% of general counsel would be less likely to use a good lawyer at a pedigreed firm (e.g., AmLaw 20) for high stakes work compared to a good lawyer at a non-pedigreed firm when there was a 30% difference in overall cost.[195]

Service matters to clients, too. Another survey found that the top two reasons clients fired law firms from ongoing matters were the firms were either too expensive (19%) or provided poor service (17%).[196] In this regard, clients are looking at legal project management.

Legal project management involves managing the provision of legal services. It can increase efficiency and transparency, improve results, and reduce costs for the client while also increasing profits for the law firm. Legal project management is one of the top trends in 2014 for in-house legal departments.[197] In a 2012 survey, 60% of responding general counsel reported that the quality of a law firm's project management system was essential in the selection of counsel.[198]

Some commentators have argued that, with the unbundling of legal services allowing clients to hire multiple vendors for different stages of a matter, law firms must develop project management skills or risk becoming a services vendor managed by a general contractor.[199]

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[194] Jim Hassett & Jonathan Groner, *How Legal Project Management Is Changing the Way Services Are Marketed*, Bloomberg Law (Oct. 1, 2013), *available at* http://www.bna.com/how-legal-project-management-is-changing-the-way-services-are-marketed/.

[195] Dina Wang & Firoz Dattu, *Why Law Firm Pedigree May Be a Thing of the Past*, Harvard Business Review Blog (Oct. 11, 2013), *available at* http://blogs.hbr.org/2013/10/why-law-firm-pedigree-may-be-a-thing-of-the-past/.

[196] Kandy Hopkins, *Clients Hire Firms for Expertise, Fire for High Cost, Survey Finds*, Legal Executive Insights (Sept. 10, 2013), *available at* http://legalexecutiveinsights.com/clients-hire-firms-for-expertise-fire-for-high-cost-survey-finds/.

[197] *Ten Law Department Management Trends for 2014*, Huron Legal (2014), *available at* http://www.huronconsultinggroup.com/Insights/Perspective/Legal/~/media/Insights-Media-Content/PDF/ Legal/LC_TL_LawDeptTrends2014.pdf; *see also* Gabriella Khorasanee, *Top 4 2014 Trends in Legal Department Project Management*, In House Blog (Feb. 5, 2014 9:59 AM), *available at* http://blogs.findlaw.com/in_house/2014/02/top-4-2014-trends-in-legal-department-project-management.html.

[198] Susan Raridon Lambreth, *RFPs/Surveys Show Clients Are Demanding Legal Project Management*, LawVision, *available at* http://static1.squarespace.com/static/511be8cae4b0c9b5341e6c9a/t/515aefafe4b0e6ea87e2101f/1364914095505/RFPs+and+Surveys+Show+Clients+Demanding+LPM+-+LVG+Newsletter+Article.pdf.

[199] Currell & Henderson, *supra* note 82, at 26.

While lawyers currently are in the "driver's seat" to serve in the general contractor role, the commentators note that architects once were as well on construction projects. However, architects were replaced by a general contractor position that became more powerful and profitable than the architects.

This outline provides an overview of several different issues within legal project management, and how these issues can be addressed to benefit both the client and the law firm.

1. Managing Expectations

"[A]nything that has ever happened before is foreseeable," and "increasingly, clients are holding us accountable for foreseeing the foreseeable."[200] Because many clients now request and hold law firms to budgets for matters, development of a matter budget has taken on increased importance. Budgets are prepared by evaluating the case and listing the component tasks that are likely required. The analysis then should estimate the time for each task by each level of timekeeper: partners, non-partner attorneys, and paralegals. The dispositive motion estimate within a budget would include research, drafting, review, and editing of the original motion and any response motion, as well as time for oral argument.[201] Identifying the tasks in the budget development process also will assist in planning the case strategy. For example, the cost-benefit analysis may weigh against briefing and arguing a motion to dismiss with a low likelihood of success.

When preparing the budget, a law firm should work with the client to identify objectives for the matter. The best outcome for a client might not be a favorable jury verdict; publicity surrounding the case and the case's legal fees may result in an overall loss to the client. In other situations, the best outcome for a client might not be a quick settlement; that may encourage other plaintiffs' attorneys to file similar suits seeking their own quick pay-out. By working together early in the matter, the client and the law firm can identify these issues and determine strategies to obtain the outcome most favorable to the client.

The budgeting process does not stop after the budget has been sent to the client. Instead, the firm should constantly evaluate the matter's fees and costs against the budget projections to inform the client that the matter is within budget. The evaluation will be most helpful if it is done on a daily or weekly basis. Waiting for the monthly bill will not allow for mid-month adjustments to stay within budget. In addition, once the matter is concluded, the law firm should compare the budget with the outcome and determine what could have been done better in designing the budget's scope or assumptions.[202]

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[200] Samuel Goldblatt, *The Benefits of Legal Project Management and Advance Budgeting*, Inside Counsel (Feb. 10, 2014*), available at* http://www.insidecounsel.com/2014/02/10/the-benefits-of-legal-project-management-and-advan.

[201] Jason A. Copley and Kathleen Garrity, *Making Legal Project Management Part of Your Small to Mid-Sized Firm's Culture*, ABA Law Prac. Today (Mar. 2014), *available at* http://www.americanbar.org/content/newsletter/publications/law_practice_today_home/lpt-archives/2014/march14/making-legal-project-management-part-of-your-small-to-mid-sized-firms-culture.html.

[202] *Id*.

The law firm should send progress reports to the client. This will provide accountability in relation to the budget and matter accomplishments. It also will help avoid "scope creep," which can cause the budget to be exceeded.[203] If unforeseen case developments require work that was not contemplated by the budget, the law firm should inform the client and determine an approach to complete the work on terms that are agreeable to both parties.[204]

2. Managing Deadlines and Personnel

Poor planning can cause additional costs to be incurred. In some cases, last-minute fire drills could have been avoided by careful planning for known deadlines. Instead, due to a lack of planning, additional resources must be committed to complete a task. Insufficient planning also can reduce the likelihood of obtaining favorable results. Briefs or oral arguments that are prepared at the final hour may muddle or miss key arguments that a judge might find persuasive.

Legal project management involves first identifying all known deadlines. Once deadlines have been identified, action timelines can be created in which quality work product will be prepared and submitted by the deadline. Assignments can then be given for each task on the timeline.

The lead attorney on the litigation is ultimately responsible for the timely completion of each action item. This attorney likely will be best served by delegating oversight to another member of the team, who will be responsible for monitoring the progress of each action item. Junior lawyers can be involved in project management activities with training and software. Equipping these lawyers with legal project management skills will benefit the firm in the future, as these attorneys become more senior and directly provide legal project management benefits to their own clients. A law firm also can hire professional project management experts to assist the firm's attorneys.[205] No matter how a firm decides to address legal project management, what matters is that the firm has a plan in place.

Members of a litigation team should have defined responsibilities and assignments. These roles can be determined as part of the budgeting process, since who is performing what tasks will affect estimated cost. As the matter progresses and availability changes, these roles may change as well. To provide the best value for the client, the law firm should determine the most efficient manner to best complete each task. The goal should be to find the best match between the task and the level of timekeeper.

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[203] *See id.*

[204] *See id.*

[205] *See* Michelle Mahoney, *Embedding LPM – What Should You Focus On?*, ILTA Net (Oct. 17, 2013), *available at* http://connect.iltanet.org/blogsmain/blogviewer/?BlogKey=9c5c0a26-627b-4e9a-9d57-9b529f71a8d3.

Assignments should be managed to avoid duplicating efforts. In addition, assignments should be managed to build on previously acquired knowledge in the case. Just as it likely will not be most efficient to have two attorneys performing the same task, it likely will not be most efficient to have one attorney perform a follow-up on a project completed by a different attorney.

3. Managing Information

Refined internal knowledge management systems can improve efficiencies. Efficiency is especially important for firms operating under alternative fee arrangements, such as fixed fees. Sound knowledge management can avoid reinventing the wheel and provide consistency across matters. Law firms should consider whether they have the best knowledge management systems in place, and whether those systems are being utilized. Some firms may have outdated knowledge management systems that make it more time-consuming to retrieve information than to re-create it. Other firms may have cutting-edge knowledge management systems that few know about or use. Because of the efficiencies and other benefits that knowledge management provides, law firms should pay attention to the status and use of their knowledge management systems.

To improve their use of knowledge management, some firms have hired a "KM director" to oversee knowledge management and work directly with litigation teams. Some firms have hired knowledge management attorneys and created knowledge management solutions groups.[206] Knowledge management systems also allow for increased information available to and shared with the client. An executive at one firm's client enjoyed showing off the firm's custom tools on his iPad. The firm believed their custom tools had "absolutely won business. . . ."[207]

Real-time billing information can provide insight into where the matter stands against the budget. In addition, billing data can be stored and retrieved for preparation of future matter budgets. Finally, billing information can allow a law firm to "analyze the value it provides in very fine detail."[208]

Data also may provide analytical evidence to consider when determining case strategy and risk reduction. "Big Data" has revolutionized sports, marketing, and politics, and clients and law firms should consider how the power of data can be harnessed for the practice of

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[206] David Raths, *KM Helps Reshape the Practice of Law*, KM World (Jan. 31, 2014), *available at* http://www.kmworld.com/Articles/Editorial/Features/KM-helps-reshape-the-practice-of-law-94283.aspx.

[207] Igor Kossov, *4 Firms Using Tech Savvy to Win Over GCs*, Law360 (Apr. 26, 2014), *available at* http://www.law360.com/articles/530326/4-firms-using-tech-savvy-to-win-over-gcs.

[208] *See* Igor Kossov, *supra* note 207.

law.[209] Patent law already is exploring the use of data. Lex Machina and other subscription services allow litigators to evaluate statistics for a forum or a specific judge relating to motions, trial, settlements, and time to resolution.[210]

In summary, every law firm always should be looking for ways to provide better value. Legal project management is an important way to provide value. After a matter has concluded, past performance should be analyzed honestly to determine what could have been done better and more efficiently. Learning from the past will improve future services. Legal project management does not begin when a case is filed or end when a case is resolved. It should continue from matter to matter, client to client, always evolving and improving.

E. *The Billable Hour*

Billable hour rates continue to increase. According to a 2013 LexisNexis survey, a law firm partner's time cost $381 per hour on average across the United States, an increase of 2.7 percent from the previous year.[211] The current average rate is equivalent to charging $6.35 for every minute of the partner's time.

High billable hour rates are becoming more prevalent. According to its 2013 survey of the top 350 firms in the country, The National Law Journal reported that at least one partner at almost 20 percent of responding firms charged more than $1,000 per hour.[212] At $1,000 per hour, a partner is charging more than a quarter for every second of his or her time.

Cost was the number one reason a law firm was fired. A survey of general counsel found that when a law firm was fired from an ongoing matter, almost one out of five general counsel (19 percent) reported that the law firm was fired because it was too expensive.[213] Some firms that are too expensive may complete a matter, but may not be hired for future matters due to the high cost.

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[209] *See* James L. Michalowicz, *'Moneyball' for Litigators: Using Analytics and 'Big Data' to Improve Litigation Spend Management and Case Outcomes*, Legal Tech Newsletter (Feb. 2014), *available at* http://www.huronconsultinggroup.com/Insights/Perspective/Legal/~/media/Insights-Media-Content/ PDF/Legal/Moneyball%20for%20Litigators.pdf.

[210] Derrick Harris, *How New Tech Can Help Lawyers Rethink Their Jobs in the Big Data Age*, Gigaom (Dec. 31, 2013), *available at* http://gigaom.com/2013/12/31/how-new-tech-can-help-lawyers-rethink-their-jobs-in-the-big-data-age/.

[211] *Enterprise Legal Management Trends Report: 2013 Mid-Year Edition, The Rise of 'Large Enough' Law Firms*, LexisNexis 15-16 (2013), available at http://lexisnexis.com/counsellink/documents/Counsellink-ELM-web.pdf.

[212] Karen Sloan, *NLJ Billing Survey: $1,000 Per Hour Isn't Rare Anymore, Nominal Billing Levels Rise, But Discounts Ease Blow*, Nat'l L.J. (Jan. 13, 2014), *available at* http://www.nationallawjournal.com/id=1202637587261/NLJ%20Billing %20Survey%201000%20Per%20Hour%20Isnt%20Rare%20Anymore?mcode=0&curindex=0&curpage=ALL&slreturn=20140411090243.

[213] Kandy Hopkins, *Clients Hire Firms for Expertise, Fire for High Cost, Survey Finds*, Legal Executive Insights (Sept. 10, 2013*), available at* https://hildebrandtblog.wordpress.com/2013/09/10/clients-hire-firms-for-expertise-fire-for-high-cost-survey-finds/.

The increase in billable hour rates is not translating into equivalent profit increases. In a 2013 survey of 180 firms, billable hour rates increased by 3.7 percent, but law firm revenue increased by only 2.5 percent.[214] Revenue did not increase at the same pace as rates in large part because corporate clients are purchasing fewer billable hours.[215]

Clients are increasingly looking for alternatives to the billable hour. These materials provide an overview of alternative fee arrangements (AFAs) and how both clients and law firms can benefit from use of AFAs.

1. Background of Alternative Fee Arrangements

Most clients already are using AFAs, and expect the use of AFAs to only increase. In 2013, a reported 81% of corporate law departments used AFAs.[216] Approximately half of in-house counsel respondents (47%) in a 2013/2014 survey predicted an increase in their companies' use of AFAs during the next 12 months.[217] AFAs comprise a substantial percentage of some companies' legal budgets. Almost half of companies – 44% – used alternative fee arrangements for more than 20% of their outside counsel spending. One of ten companies used alternative fee arrangements for more than half of their outside counsel spending.[218]

Despite their increased use, AFAs still trail billable hours as a percentage of matters and billings. In total, from July 2012 to June 2013, AFAs were used in 10% of matters and 6% of billings.[219] However, given the expected increased use of AFAs, these numbers likely will continue to increase as well.

Fixed fee pricing is one type of alternative fee arrangement. The law firm receives a fixed fee for all work on a matter or docket. For example, a client hires a firm for $100,000 to handle a matter from start to finish. In one survey, the fixed fee was the most used type of AFA, used by 65% of respondents.[220]

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[214] Gretta Rusanow & Dan DiPietro, *Citi Report: Firms Saw Modest Growth in 2013*, Am. Lawyer (Feb. 5, 2014), *available at* http://www.americanlawyer.com/id=1202641665337.

[215] Aric Press, *Billing Survey Shows Rates Ticking Up as Demand Dips*, Am. Lawyer (Mar. 24, 2014), *available at* http://www.americanlawyer.com/id=1202648177671/Billing-Survey-Shows-Rates-Ticking-Up-as-Demand-Dips?slreturn=20140411093508.

[216] *Evolution of Alternative Fee Arrangements: From Simple to More Complex*, Huron Legal (Nov. 13, 2013), *available at* http://webcasts.acc.com/handouts/ACC_Nov_2013_LQH__Evolution_of_AFAs_from_Simple_to_Complex.pdf.

[217] *10th Annual Litigation Trends Survey Report*, Norton Rose Fulbright 24 (2014), *available at* http://www.nortonrosefulbright.com/us/knowledge/publications/115045/norton-rose-fulbrights-10supthsup-annual-litigation-trends.

[218] *Id*.

[219] *Enterprise Legal Management Trends Report: 2013 Mid-Year Edition, The Rise of 'Large Enough' Law Firms*, *supra* note 211.

[220] *10th Annual Litigation Trends Survey Report*, *supra* note 217.

In 2004, Tyco International hired Shook, Hardy & Bacon (SHB) to manage its entire product liability docket of 455 cases on a fixed fee arrangement. The annual fee is paid in monthly installments. Each year the fee has decreased, and SHB's profitability has increased.[221]

Task-based pricing is another type of alternative fee arrangement. Under this arrangement, the law firm receives a fixed fee for all work on a specific task or stage of litigation, such as document review or depositions. For example, a client hires a firm for $25,000 to complete all of the depositions in a case.

Yet another alternative fee arrangement is fee cap pricing. Under this arrangement, the law firm agrees to a not-to-exceed ceiling. For example, a client hires a firm and agrees to pay its hourly rates, so long as the total of the matter does not exceed $100,000. Slightly more than half of survey respondents used this type of AFA.[222]

With a contingency fee arrangement, the law firm receives a percentage of the recovery. For example, a client hires a firm to litigate a matter to resolution, and the firm receives 33% of any verdict or settlement. This type of AFA was used by 26 percent of respondents in one survey.[223] Under the blended rate pricing alternative fee, the law firm agrees to charge a single hourly price for all attorney work, whether partner or associate. For example, a firm agrees to charge a client $300 for all attorney work on a matter. Four out of ten respondents used this type of AFA.[224] Some have claimed that blended rates are not true AFAs because they are simply a variation of hourly pricing.[225]

Performance bonuses are yet another option. Under this system, the law firm receives a bonus if certain agreed-upon targets are achieved. This may include a bonus for obtaining successful outcomes (such as a defense contingency arrangement, which rewards a firm with a percentage of any savings below the expected verdict or settlement), for saving a certain amount or percentage of money, or for resolving a certain percentage of cases within a set period of time. More than one-third of survey respondents (35%) used this type of AFA.[226]

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[221] Paul Williams, *Chapter 13: Alternative Fee Arrangements – Can You 'Win-Win'?* in The Lawyer's Guide to AFAs and Value Pricing (Laura Slater ed., Ark Group 2014), *available at* http://www.shb.com/attorneys/WilliamsPaul/LawyersGuidetoAFA.pdf; *see also* Steven T. Taylor, *Positioned for Growth*, Law Practice Magazine (Nov./Dec. 2010) (on file with author).

[222] *10th Annual Litigation Trends Survey Report*, *supra* note 217.

[223] *Id*.

[224] *Id*.

[225] Kris Satkunas, *Alternative Fee Arrangements: Dispelling Six Misconceptions*, The Corporate Counselor (Aug. 2013), available at http://www.lexisnexis.com/counsellink/documents/AFAs-DispellingSix-Misconceptions-K.Satkunas-Aug2013.pdf.

[226] *10th Annual Litigation Trends Survey Report*, *supra* note 217.

Under the fee collar system, the client and law firm share savings if fees are below an agreed-upon range surrounding a fixed fee, but also share the loss if fees are above the range. For example, a client hires a firm to litigate a matter for $50,000 with a 10% fee collar. If the matter costs between $45,000 and $55,000, the firm is paid $50,000. If the matter costs less than $45,000, the firm shares in the savings. If the matter costs more than $55,000, the firm shares in the additional expense. A fee collar "allows both parties to share risk by creating a fee range for which the law firm assumes sole responsibility."[227]

There are a number of benefits to Alternative Fee Arrangements. One such benefit is cost certainty. The client has a greater level of predictability in the amount of its legal spending. According to Tyco's chief litigation counsel, "[W]hen I submit an annual budget, our business people can count on that number."[228] Another benefit is reduced costs to clients. Companies who have entered into AFAs have reported substantial cost savings. For example, Whirlpool saved 40% by hiring one firm to manage all of its class action defense work.[229]

Faster case resolutions are yet another benefit. The longer a case is active, the more expensive the case will be. Resolving cases quickly saves time and money for both the client and the law firm. After it entered into a fixed fee contract for a firm to manage its entire environmental docket, average resolution time for Unocal's environmental cases dropped from three years to one year. Settlement payments also decreased by about 50 percent.[230]

Not surprisingly, fewer cases being filed will likely lead to fewer costs. In its arrangement with SHB, Tyco has seen new case filings decline by more than 65%.[231] Whirlpool's outside counsel estimated that Whirlpool has saved millions of dollars by watching actions filed against competitors and making "preemptive strikes" to deter filings against Whirlpool.[232]

The client and law firm can both profit by resolving cases quickly and efficiently. The AFA also can reward the law firm for advice and activities that deter new cases from being filed. Reduced administrative issues are a necessary benefit of AFAs. In some AFAs, such as SHB's fixed fee arrangement with Tyco, the law firm hires and manages all vendors, local

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[227] Marie Woodbury & Matt Bohnen, *Partnering in Alternative Fee Arrangements*, Executive Counsel (Aug./Sept. 2010), *available at* http://www.shb.com/attorneys/WoodburyMarie/PartneringinAlternativeFeeArrangements.pdf.

[228] *Best Practices and Lessons Learned from ACC's 2012 Value Champions*, The Metropolitan Corporate Counsel (Sept. 2012), *available at* http://www.metrocorpcounsel.com/pdf/2012/ September/36.pdf.

[229] *Id*.

[230] Heather Smith, *The Fix Is In*, Litigation (2005), *available at* http://www.drystonecapital.com/pdf/fix_is_in.pdf.

[231] Salopek., *supra* 235.

[232] *Best Practices*, *supra* note 228.

counsel, and experts. This improves efficiency by allowing the party closest to the services, the law firm, to manage those services. It also allows for cost-savings by purchasing third-party services in bulk.[233] In addition, law firms and clients do not have to invest as much time in detailed invoice review.[234]

Clients increasingly would rather not pay to train new lawyers. Alternative fee arrangements could provide practical experience opportunities for associates that they otherwise might not have. These new experiences can boost associate morale.[235]

2. Making Alternative Fee Arrangements Work

An important key in making alternative fee arrangements work is to understand and define the project. Both sides need to fully understand what is contemplated by the fee arrangement. Understanding and defining the project's scope ensures the expectations of both sides are met in budgeting, costs, and deliverable work product.[236]

Another important component in making these arrangements work is to use data to make projections. Corporate legal departments are using advanced tools to analyze law firm bills and understand litigation costs better than could be done previously. A law firm should analyze prior matters it has handled, and when possible, that the client has faced with other firms, to understand how to price an AFA for a new matter or client.[237]

Providing clients with "a menu of offerings" is also a critical component in making these arrangements work.[238] For example, SHB offers clients this in its AFAs for privacy and data security work.[239] These services and the resulting AFA can be structured specifically to the client.[240]

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[233] Rachel M. Zahorsky, *Facing the Alternative*, ABA Journal (Mar. 2012), *available at* http://www.abajournal.com/magazine/article/facing_the_alternative_how_does_a_flat_fee_system_really_work/.

[234] *Evolution of Alternative Fee Arrangements: From Simple to More Complex*, *supra* note 216.

[235] Ben W. Heineman, Jr. and William F. Lee, *The Time Has Come*, Corporate Counsel (Sept. 2009), available at http://www.law.harvard.edu/programs/corp_gov/articles/Heineman-Lee_0909_CC.pdf; Joe Forward, *Post-Recession Gives Rise to New Law Firm Models*, Inside Track (Sept. 2013), *available at* http://www.wisbar.org/NewsPublications/RotundaReport/Pages/Article.aspx?ArticleID=11045.

[236] Julie Zeveloff, *5 Management Strategies Law Firms Should Adopt*, Law360 (Apr. 12, 2010), available at http://www.law360.com/articles/156440/5-management-strategies-law-firms-should-adopt.

[237] Christopher Petrini-Poli and Scott Springer, *Data Analytics: A New Approach to Profit Management in the Legal Business*, Accounting and Financial Planning for Law Firms (Feb. 2014), available at http://www.hbrconsulting.com/downloads/HBR_ALM_LJN_Account_and_Financial_Planning_2014_02_01.pdf.

[238] Allison Grande, *Privacy Attys Capitalize on Creative Fee Arrangements*, Law360 (July 22, 2013), available at http://www.law360.com/articles/458665/privacy-attys-capitalize-on-creative-fee-arrangements.

[239] *Id*.

[240] *Id*.

Helping to assist making AFAs work, some firms designate "alternative fee gurus" by practice area to assist with developing alternative fee proposals. At other firms, a partner serves as a resource for colleagues preparing alternative fee proposals.[241]

3. Implementing the Alternative Fee Arrangement

Communication is a key component to implementing an alternative fee arrangement. In this regard, the law firm should provide the client with an initial strategic plan when a case is filed and stay in constant communication with the client until the case is resolved. Keeping the client up to date on the matter will allow the case to stay on track, within budget, and meet the expectations of both the law firm and the client.

Through effective staffing, large law firms can provide superior service to clients and still turn a profit on AFAs. For example, SHB hired more lateral, non-partner track attorneys with eight to ten years of experience to handle Tyco's product liability docket. These attorneys brought significant experience and expertise, and because they were less costly than senior partners, allowed for greater profitability under the firm's AFA with Tyco.[242]

Law firms must select the right person to work on the case or perform the task to most efficiently achieve the best result. The firms also must train attorneys and paralegals to be efficient and effective under an AFA.[243] As discussed in the section on Legal Project Management, refined internal knowledge management systems can improve efficiencies. This is especially important when operating under AFAs. SHB captures summaries of depositions and court hearings.[244] SHB also logs and analyzes real-time financial and billing data to track expenses and costs.[245]

Trust is the name of the game with AFAs. When Tyco hired SHB to manage its entire product liability docket of 455 cases on a fixed fee arrangement, Tyco had not done work with SHB before.[246] With trust "the name of the game," Tyco and SHB have successfully worked together for almost a decade.[247]

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[241] Drew Combs, *All-Seeing, All-Knowing Alternative Fee Gurus Dispense Wisdom*, Am. Lawyer (Jan. 1, 2010), available at http://www.americanlawyer.com/id=1202437076876/All-Seeing,-All-Knowing.

[242] Rachel M. Zahorsky, *Facing the Alternative*, *supra* note 233.

[243] Paul A. Williams, *Wouldn't You Rather Be Partners?*, Corporate Counsel (June 7, 2010), available at http://www.shb.com/value/articles/CorporateCounsel-reprint.pdf.

[244] Rachel M. Zahorsky, *Facing the Alternative*, *supra* note 233.

[245] *Id*.

[246] *Id*.

[247] *See* Melissa Maleske, *A Matter of Time*, Inside Counsel (Feb. 1, 2010), available at http://www.inside-counsel.com/2010/02/01/a-matter-of-time.

In summary, AFAs are not the best fit for every client or every matter. That said, law firms should be creating and improving processes to better understand AFAs to which they already have agreed, as well as AFAs they might propose in the future. AFAs may never completely replace the billable hour, but they may be a preferred alternative for certain clients or types of matters. The law firms that best understand AFAs will be in the best position to get new business and profit from it.

F. *The Art of Succession: Letting the Millennials Lead*

In the context of generations, Millennials have a bit of an image problem. When people think of Millennials, the following stereotypes come to mind: entitled, attention seeking, lazy, tech savvy, social media craving, and trophy getting kids. If you are a Millennial lawyer, at first glance, you cannot be altogether pleased with the foregoing stereotypes. On the flip side, if you are a Baby Boomer shareholder, you might be worried about the legacy of your firm as you begin to consider the idea of succession. Rest assured, with a little understanding of what Millennials can bring to your firm and how shareholders can embrace that talent, the idea of letting the Millennials lead is not so daunting.

1. Who are Millennials? Understanding Their Strengths

Millennials are the "Internet generation." Ask anyone in this generation and one will be hard pressed to find a member of this generation who did not grow up with a computer, or a cell phone. They have grown up with social media, and flourish in it. Law firms should tap into that and allow Millennials to grow or even introduce your firm to a social media platform. While Baby Boomers and previous generations grew relationships out of shaking hands and face-to-face conversations, today we have access to millions through social media networks. Millennials easily connect with anyone and everyone — their next new relationship is just a text or "tweet" away. Let your Millennials lead and help your firm capture an audience that older generations have not yet tapped into.

More so than their predecessors, Millennials want a greater work-life balance; some interpret this as laziness—but that is far from the truth. Millennials are more prone to email and text than pick up the phone. By being more tech savvy than older generations, they are able to multitask and feel comfortable with all forms of technology. While most shareholders are still dictating deposition summaries, Millennials are concurrently taking the deposition and typing the deposition summary from their tablets. It is multitasking at its best and frees up time for the Millennial.

Understanding that Millennials seek a greater work-life balance, firms should create and foster opportunities for Millennials to have access to work remotely and with flexible hours. A firm will get a more productive and happy attorney doing so. In line with Millennials' need for a greater work-life balance, firms should create transparent tracks to both partnership and "of counsel" career paths. Part-time positions and contract attorney positions are becoming more and more available for those who want a greater balance, whether it be for more family time or even to launch a second career. Not everyone in this generation wants to or can become a partner, but hardworking, productive Millennial associates who seek a

greater work-life balance should know what options are available to them.

Millennials, unlike other generations, prefer teamwork. They learn through collaboration. Law firms can foster collaboration and let Millennials lead the way by overseeing projects with more junior associates or clerks. Millennials like feedback and allowing them to chair a team project will not only strengthen their management and leadership skills, but will also provide an avenue for them to receive feedback from their peers and supervisors.

2. Mentorship: Succession through Training

Understanding who Millennials are is the key to healthy succession. There is no better way to do that than through a mentorship program. For seamless succession, generational gaps need to be bridged. Partners in a firm should lead by example, demonstrating what they have learned through their many years in practice. They should teach younger generations what works, and what doesn't work. More experienced attorneys should show Millennials how their work makes a difference to their clients and to the community.

While mentorship programs usually occur in the context of a shareholder-associate relationship, they can exist outside of one's firm as well. Millennials may feel more comfortable asking questions and receiving feedback from a mentor who is not their "boss." Legal organizations or local bar associations provide great outlets to grow relationships with Millennial lawyers; some even specifically offer mentorship programs. Transitioning attorneys should keep their eyes out for young talent within their respective organizations and communities. What may start as an informal relationship could lead to a lateral Millennial hire.

Mentoring should take place both in and out of the courtroom. Clients need to know who will be trying their cases not only today, but tomorrow. Let Millennials second chair trials, assist in mediations, entertain clients, and attend conferences. Expose Millennial lawyers to trade associations and legal organizations. They are eager to help build a name for themselves, and the firm. While learning the skills inside the courtroom is extremely important, so is face time with clients and prospective clients who need to feel comfortable and confident in the young talent that will one day be trying their cases.

3. When to Think of Succession

Transitioning your firm in anticipation of retirement should be thought of well in advance, not when one foot is out the door. It should be a long term plan of any firm, no matter the size, looking at the talent under its own roof, in the community and evaluating where it wants to be in the next ten to fifty years. A firm should evaluate who its clients are now, and the health of the clients' industries. Will those industries be swallowed up by a new technology? What are emerging practice areas the firm can develop? Failing to ask Millennials their opinions on the subject matter and include them in development meetings is a mistake. Not only will they offer a fresh perspective to the conversation, but they will develop a vested interest in the firm that they may not have had before. After all, it will be *their* firm one day.

Transitioning current clients to a firm's Millennial lawyers should start well before a senior lawyer leaves a firm. When thinking of succession, the firm must evaluate its clients and how long they have been working with the firm and the partner who is considering retirement. Some clients may be amenable to working with a more junior attorney while others may be more dependent on the transitioning attorney and will need a prolonged period of time to gain confidence in the Millennial.

Just as transitioning clients to younger attorneys is important, firms should also transition its firm management to younger attorneys well in advance of the senior partners' departure. The firm's budget should be transparent, thus allowing Millennials the opportunity to educate themselves and ask questions while the senior attorneys are still there. Allow the younger attorney to participate in financial planning meetings or other special committees within the firm. Not only does it lead to collaboration (which the Millennial will love), ultimately it fosters a sense of ownership.

If a firm wants to expand its practice areas in the future, they should allow their Millennial lawyers to gain on the job experience and training in those other disciplines; encourage (and pay for) them to attend Continuing Legal Education courses. While there may be a steep learning curve initially, Millennials are eager to learn and connect.

Finally, get Millennials involved in recruitment. Let them participate in the hiring process of younger associates. One day they will be on the mentor side of the mentor-mentee relationship.

While Millennials may be more tech savvy than older generations, the law is a learned profession. Becoming a great lawyer is not taught in law school. It is accomplished by doing. Technology may alter the way we practice; however, the principles that guide our profession and create exceptional lawyers remain the same.

G. *Alternative Business Structures: The Non-Law Firm Law Firm?*

Rule 5.4 of the Model Rules addresses the professional independence of a lawyer. Rule 5.4(a) permits lawyers or law firms to share legal fees with nonlawyers in certain exceptional circumstances: payment of monies to a lawyer's estate or beneficiaries upon the lawyer's death.[248] payment of a purchase price to a deceased attorney's estate for the purchase of the business,[249] payment into a retirement plan for nonlawyer employee,[250] and the sharing of court awarded legal fees with a nonprofit organization that retained or recommended the attorney.[251] There are no other exceptions listed within the Model Rules regarding the sharing of legal fees between a lawyer and a nonlawyer.

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[248] *See* MODEL RULES OF PROF'L CONDUCT RULE 5.4(a)(1) (hereinafter "MODEL RULES").

[249] *Id*. at r. 5.4(a(2).

[250] *Id*. at r. 5.4(a)(3).

[251] *Id*. at r. 5.4(a(4).

After the noted exceptions, Model Rule 5.4 provides guidance to lawyers and law firms regarding the sharing of legal fees between lawyers and nonlawyers. Rules 5.4(b), (c) and (d) state:

(b) A lawyer shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law.

(c) A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.

(d) A lawyer shall not practice with or in the form of a professional corporation or association authorized to practice law for a profit, if:

(1) a nonlawyer owns any interest therein, except that a fiduciary representative of the estate of a lawyer may hold the stock or interest of the lawyer for a reasonable time during administration;

(2) a nonlawyer is a corporate director or officer thereof or occupies the position of similar responsibility in any form of association other than a corporation; or

(3) a nonlawyer has the right to direct or control the professional judgment of a lawyer.[252]

Rule 5.4(b) has become the subject of much discussion recently. All states that adhere to the Model Rules prohibit the association of lawyers and nonlawyers for the purpose of the practice of law.[253] The District of Columbia, however, which subscribes to the Model Rules, permits lawyers and nonlawyers to associate in a limited fashion for the purpose of the practice of law.[254] Specifically, the District of Columbia Rules of Professional Responsibility provide,

b) A lawyer may practice law in a partnership or other form of organization in which a financial interest is held or managerial authority is exercised by an individual nonlawyer who performs professional services which assist the organization in providing legal services to clients, but only if:

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[252] *Id*. at r. 5.4(b), (c) and (d).

[253] One author noted that due, in part, to large bank financing, certain non-lawyers already wield immense power over law firm business decisions. Joe Patrice, *Should Non-Lawyers Own Firms? Do They Already?,* Above the Law (Jan. 30, 2014), http://abovethelaw.com/2014/01/should-non-lawyers-own-firms-do-they-already.

[254] *See* Washington, D.C. Rules of Prof'l Conduct Rule 5.4(b).

(1) The partnership or organization has as its sole purpose providing legal services to clients;

(2) All persons having such managerial authority or holding a financial interest undertake to abide by these Rules of Professional Conduct;

(3) The lawyers who have a financial interest or managerial authority in the partnership or organization undertake to be responsible for the nonlawyer participants to the same extent as if nonlawyer participants were lawyers under Rule 5.1;

(4) The foregoing conditions are set forth in writing.[255]

Under these parameters, lawyers and nonlawyers may form a partnership or organization, based in the District of Columbia, for the purpose of providing legal services to clients. In the comments to the Rules, the drafters discussed the purpose behind liberalizing the rules noting that permitting the association allows nonlawyer professionals to work with lawyers in the delivery of legal services without being relegated to the role of an employee. Examples provided include permitting economists to work in a firm with antitrust or public utility practitioners, nonlawyer lobbyists to work with lawyers who perform legislative services, and certified public accountants to work in conjunction with tax lawyers or others who use accountants' services in performing legal services.[256]

In addition to discussing the types of associations permitted under its liberalized rule, drafters of the liberalized rule in the District of Columbia specifically commented on what is not permitted under the Rule. As noted in Comment 8, "Paragraph (b) does not permit an individual or entity to acquire all or any part of the ownership of a law partnership or other form of law practice organization for investment or other purposes. It thus does not permit a corporation, an investment banking firm, an investor, or any other person or entity to entitle itself to all or any portion of the income or profits of a law firm or other similar organization. Since such an investor would not be an individual performing professional services within the law firm or other organization, the requirements of paragraph (b) would not be met."[257]

Capitalizing on the liberalization of Rule 5.4(b) in the District of Columbia, Clearspire was founded in 2009. Clearspire had a law firm side made up of attorneys who were able to work remotely, and a management side, which provided support for the law firm. Clearspire was the subject of much publicity in recent years given the speculation surrounding the practice of law. Clearspire desired to take on big law and provide clients with top quality services at a much lower expense. Lawyers were hired under the notion that they would practice law and not be responsible for the management aspect of the practice;—a second

[255] *Id*.

[256] *Id*. at r. 5.4 cmt. 7.

[257] *Id*. at r. 5.4 cmt. 8.

side of the business entity would handle the management aspects. Despite announcements in 2013 relating to its growth, Clearspire exists no longer.

According to its website, prior to the closing of the legal service provider division of the company, Clearspire's goal was to offer legal services (and related technological and business advice) to clients in the most efficient manner possible consistent with maintaining a traditional attorney-client relationship and delivering high-quality work.[258] With a computer program, Coral,[259] central to its progress, Clearspire provided remote attorney workplaces designed to minimize overhead. Recognizing the needs of the traditional law firm, Clearspire also provided office space with full support staff for client interactions.[260] Coral provided Clearspire with analytics to provide a more efficient delivery of legal services. Under the Coral system, a project manager served as the legal architect and analyzed the problem at issue. The attorneys were then given a dashboard containing links to prior similar firm work, Lexis and Westlaw searches, and other public and nonpublic information to use in representing the client.[261]

Along with its novel case handling approach, Clearspire also had a novel approach on billing. Recognizing the perception that clients of Big Law were unhappy with fees being charged, Clearspire favored a fixed fee for services system where clients pay fixed fees, established at the beginning of the representation for services provided.[262] Clearspire functioned under the premise that "billable hourly fees are based upon an outdated, century-old system that is no longer viable or justifiable in today's economy."[263] Consistent with its being an alternative business model to Big Law, Clearspire did not have a partnership compensation system and most of its lawyers were salaried employees.[264]

Significant to this discussion, business related and non-law related matters were performed by the management division of Clearspire. Through the use of this model, clients "obtain[ed] the benefit of a multidisciplinary practice controlled by lawyers."[265] Thus, the Clearspire business model complied with the limitations set forth in Rule 5.4(b) of the District of Columbia Rules of Professional Conduct.

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[258] John S. Dzienkowski, *supra* note 75, at 3002.

[259] *Id*. at 3002, n. 63. For a detailed background on Coral and its development, *see* Steve Rosenbush, *How Clearspire Used IT To Reinvent the Law Firm*, WALL ST. J. CIO J. (Apr. 9, 2012, 4:56 PM), http://blogs.wsj.com/cio/2012/04/09/how-clearspire-used-it-to-reinvent-the-law-firm; Roy Strom, *Technology Transforms Pockets of the Legal World*, CHI. LAW. (Apr. 2012), http://www.chicagolawyermagazine.com/Archives/2012/04/Legal-Technology.aspx.

[260] Dzienkowski, *supra* note 75, at 3002.

[261] *Id.* at 3004 & n. 66*; see also* McGinnis & Pearce, *supra* note 139, at 3045-46.

[262] Dzienkowski, *supra* note 75, at 3004.

[263] *Id*. at 3004-05.

[264] *Id*. at 3005.

[265] *Id*.

While Clearspire addressed the lawyer and nonlawyer collaboration head-on, locating itself in the District of Columbia, "Axiom was formed as a nonlaw firm to provide advice and solutions to the world's largest corporations regarding their complex legal service needs."[266] Axiom's website clearly states "Axiom is not a law firm and does not provide legal representation or advice to clients. Axiom attorneys are independent and do not constitute a law firm among themselves."[267] Moreover, "[i]t prides itself as 'the world's largest and fastest growing non-traditional provider of legal services and the only sophisticated end-to-end (as opposed to point solution) provider of corporate legal services that is not a traditional law firm.'"[268]

Axiom offers both outsourcing and insourcing to its clients, often times at a significant discount. Axiom provides "managed services" to its clients which creates an efficient work flow required to provide high quality work in an efficient manner.[269] Nonlawyer professionals employed by Axiom to accomplish this task include project managers, systems engineers and information technologists.[270]

Where does Axiom's business model fit within Rule 5.4(b) of the Model Rules? Professor William Henderson describes Axiom as "a managed service provider who serves as a general counsel's outsourcing agent. Only clients with a general counsel can use Axiom as it uses this structure to comply with the rules of unauthorized practice and sharing fees with a nonlawyer."[271] Professor Henderson comments:

> I am sure that a state bar regulator, taking a very formalistic approach, can take issue with Axiom's construction of Rule 5.4, which prohibits profit-sharing between lawyers and nonlawyers from income generated from the practice of law. But the purpose behind Rule 5.4 is to preserve lawyer independence so that the quality of the underlying legal advice won't be compromised by the nonlawyer's pursuit of profit.[272]

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[266] *Id*. at 3008.

[267] *Id*. at 3008, n. 108.

[268] *Id*.

[269] *Id*. at 3010.

[270] *Id*. (citing Bill Henderson, *Is Axiom the Bellwether for Disruption in the Legal Industry?*, LEGAL WHITEBOARD (Nov. 10, 2013), http://lawprofessors.typepad.com/legalwhiteboard/2013/11/is-axiom-the-bellwether-for-disruption-in-the-legal-industry-look-what-is-happening-in-houston.html.).

[271] Dzienkowski, *supra* note 75, at 3036 n. 254 (citing Bill Henderson, *Is Axiom the Bellwether for Disruption in the Legal Industry?*, LEGAL WHITEBOARD (Nov. 10, 2013), http://lawprofessors.typepad.com/legalwhiteboard/2013/11/is-axiom-the-bellwether-for-disruption-in-the-legal-industry-look-what-is-happening-in-houston.html).

[272] Dzienkowski, *supra* note 271, at n. 255.

Thus, using the limitations imposed by Rule 5.4(b) of the District of Columbia Rules of Professional Conduct, when nonlawyers are providing services within a firm, the lawyers must "supervise this work and ultimately take full responsibility for the nonlawyer's involvement in the practice of law."[273]

With the Clearspire approach to meshing the work of lawyers and nonlawyers alike gaining attention, "[i]n 2013, the Commission on Ethics 20/20 completed its work on the revision of the Model Rules to accommodate practice in the 21st Century."[274] While modifications were made regarding the outsourcing of work to outside lawyers and nonlawyers and the need of lawyers to keep abreast of changes in technology, this issue of the association of lawyers and nonlawyers in a business arrangement was addressed. While the ABA maintains its steadfast position, the practice of law continues to evolve and modernize with no guidance being provided on that regulation.[275] Despite the ABA's position, concerned commentators have noted, "The regulatory structures of the legal profession should address, not ignore, innovations such as the development of alternative legal service providers that seek to represent Big Law clients."[276]

With the practitioners and innovators in the United States trying to figure out how to recognize the needs of corporate America and meld the nonlawyer professionals with the lawyer professionals, while at the same time complying with the Model Rules, foreign jurisdictions such as England, Canada, Australia[277] and Wales permit alternative business structures, including nonlawyer ownership.[278] A working group of the ABA Commission noted that MDPs (multidisciplinary practices) are permitted in Germany, the Netherlands (but not with accountants), and in Brussels (only with accountants but there must be separate billing).[279] "New Zealand permits incorporated law practices, but nonlawyers may only

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[273] *Id*. at 3036.

[274] *Id*. at 3039.

[275] *Id*. A very interesting commentary suggests that American regulators' decisions to allow Clearspire and Axiom Law to have nonlawyers raise capital and hire lawyers to deliver legal services may be a sign that the practice of law is already deregulated in the United States, *see* Toby Brown, *Is Practice of Law Already Deregulated?*, 3 geeks & l. Blog (Sept. 5, 2011 4:32 PM), http://www.geeklawblog.com/2011/09/is-practice-of-law-already-deregulated.html. Another commentator notes that he sees cracks in the U.S. regulatory structure, *see* Sam Glover, *Is It Time for Non-lawyer Ownership*, lawyerist (Sept. 24, 2013), http://lawyerist.com/time-for-non-lawyer-ownership/.

[276] Dzienkowski, *supra* note 75, at 3039.

[277] "Australia has adopted an expansive approach to ABS." Letter from ABA Commission on Ethics 20/20 Working Group on Alternative Business Structures to ABA Entities, Courts, Bar Associations (state, local, specialty and international), Law Schools, and Individuals (Apr. 5, 2011), *available at* http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/abs_issues_paper.authcheckdam.pdf.

[278] *See* ABA Commission on Ethics 20/20, p. 16. (2011).

[279] *See id*.

own non-voting shares. Only lawyers actively involved in providing the incorporated firm's regulated services can be directors."[280]

According to The Law Society, in the United Kingdom, an alternative business structure (ABS) is a "regulated organization which provides legal services and has some form of non-lawyer involvement. This involvement can either be at the management level [e.g.,] as a partner, director or member; or as an owner e.g. an investor or shareholder."[281] The Legal Services Act 2007 allows nonlawyers to own and invest in law firms.

Evaluating the benefits to ABS's, The Law Society commented that such an entity permits equity to be raised from a broader source of funds, without the need for nonlawyer involvement at the management level and provides the ability to diversify the range of legal services provided through the practice.[282] The impact of nonlawyer managers and/or owners on the culture of the firm is only one of the risks identified in forming an ABS. Getting nonlawyers to understand the culture and obligations of lawyers is also a potential risk.[283] Another important risk noted is the perception of the firm's risk profile by not only the regulatory agencies, but professional indemnity insurance companies.[284]

Perhaps the best argument against implementation of an alternative business structure similar to that implemented in the United Kingdom is the recognition by The Law Society that lawyers, subject to strict regulation, must examine if the owner's control could interfere with the firm's ability to act in the best interests of clients and, if so, how to mitigate the risk.[285] This concern is precisely "the purpose behind Rule 5.4, preserving lawyer independence so that the quality of the underlying legal advice won't be compromised by the nonlawyer's pursuit of profit."[286]

Along these lines, lawyers must consider whether offering certain services can conflict with that of a duty owed to a client. One example noted relates to the duty of auditors to disclose information while lawyers are required to keep information to clients confidential.[287] While it may be that the United Kingdom model does not provide all of the answers, the

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[280] *See id*.

[281] *Setting up an ABS*, The Law Soc'y (Oct. 31, 2012), https://www.lawsociety.org.uk/support-services/advice/articles/setting-up-an-abs/.

[282] *Alternative Business Structures*, The Law Soc'y (Jul. 22, 2012), http://www.lawsociety.org.uk/support-services/advice/practice-notes/alternative-business-structures/.

[283] *Id*.

[284] *Id*.

[285] *Id.*

[286] Henderson, supra note 270, *see also* Model Rules, *supra* note 248, at R. 5.4(b).

[287] See *Alternative Business Structures*, *supra* note 282.

solicitors and regulators of solicitors in the United Kingdom are much more forward thinking on the issue than in the United States. While innovators in the United States are moving along at a rapid pace as to virtual law firms[288] and non-law firms or alternative business structures, such as Axiom, the rules of professional conduct have not caught up with the progression, much to the chagrin of many members of the bar in the United States.

At its February 2011 meeting, the American Bar Association Commission on Ethics 20/20 examined alternative business structures in the United States. At the meeting, the Commission "decided that two options for alternative business structures – passive equity investment in law firms and the public trading of shares in law firms – would not be appropriate to recommend for implementation in the United States at this time, although both have been adopted elsewhere since July 2000."[289]

It remains clear that, at some point, the legal profession in the United States, will have to take affirmative steps on this issue. When, however, remains uncertain.

V.
The Corporate and Industry Perspective

Commentators believe that corporate law departments are under immense pressure with a focus on cost reduction and reducing external expenditures. There is a belief that such pressure is coupled with internal pressure to manage an increasing volume and complexity of work. "The dominant management preoccupation of most GCs (General Counsel) today is meeting the more-for-less challenge…. How can they deliver more legal service to their businesses at lower cost? ... (I)n house lawyers will come to the view … that the cost savings need cannot be secured simply by pricing differently. Rather, the challenge is to work differently."[290] The net result is that the role of in-house counsel and legal teams is expected to change.

Richard Susskind, author of "Tomorrow's Lawyers: An Introduction to Your Future" stated:

> Most General Counsel, the leaders of in-house legal teams, tell me that their principal job should be that of managing risk; that 'legal risk management' should be the core competence and service of in-house lawyers. . . Legal risk can be managed in many ways, but the emphasis is usually on preventing non-lawyers in businesses from inadvertently exposing their organizations to some kind of liability (such as might flow from a breach of some regulation or of an agreement). This control of legal risk can be achieved, for example, by increasing legal awareness, by introducing

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[288] Virtual Law firms include Potomac Law Group, VistaLaw, VLP Law Group, LegalForce, to name a few.

[289] Letter from ABA Commission on Ethics 20/20 Working Group on Alternative Business Structures, *supra* n. 278.

[290] Richard Susskind, Tomorrow's Lawyers: An Introduction to Your Future, 67-68 (2013).

> protocols or procedures, by using standard documents, or by involving lawyers more directly in the affairs of organizations. . . There is little question that tomorrow's in-house lawyers will become increasingly systematic and rigorous in their management of risk and will require sophisticated tools and techniques to help them. Strikingly, very few law firms have yet recognized the commercial opportunities here.[291]

One general counsel commented:

> . . . the demand for legal advice and review is increasing, as well as cooperation between the 'front office' and legal department. Since the business is expected to become more global and new types of business relations will arise due to new regulations, the lawyers need to be prepared to apply legal knowledge to new spheres. The business spectrum of the legal department will increase along with its importance in relation to other departments.[292]
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> Another went further, saying, 'in the next five years, the legal department's influence over other departments is expected to grow. Lawyers will need to have more acumen around new policies or products as well as a better understanding of the industries in which the products are to be promoted. This will allow them to advise on whether certain policies or products can be introduced.'[293]

Andrew M. Gilchrest, Counsel – Product Liability/Specialty Environmental for Exxon Mobile Corporation, describing his experience commented:

> From the in house perspective, the trend in the practice of law in the 21st century has been away from the pure practice of law to include duties such as leadership, management, finance and administration on large complex cases. Outside counsel are probably familiar with some of these changes, but not others. When I began my in house career we had file rooms, bankers boxes of documents, pleadings and discovery files and a law library. These have all gone the way of the tape cassette. They have completely exited the building. Now we have laptops, SharePoint sites and Westlaw. Obviously, technology has made things more convenient. I now read briefs on my laptop at home and answer emails or calls just about anywhere to my

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[291] *Id.*, at 62-63.

[292] *Beyond the Law: KPMG's Global Study of How General Counsel Are Turning Risk to Advantage*, KPMG (2012), *available at* http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/general-counsel-survey-2012v2.pdf [hereinafter "KPMG Survey"].

[293] *Id*.

> wife's chagrin. There is a lot less need to be in a traditional office. The workplace is everywhere. This has made things easier, but not always more efficient. A large portion of my day is spent dealing with obtaining and retaining electronic data. Hiring e-discovery vendors, understanding their billing structure, reviewing their bills and insisting they comply with their own rate structure is administrative work and not what many would consider the practice of law. Most cases now involve trying to catch the other side not producing some portion of its electronic data instead of focusing on the relevant issues in the case and how to bring a resolution to them. More attention to focusing counsel on the resolution of the case and providing the leadership to get there is required to avoid getting bogged down in irrelevant issues."

Gilchrest's experience is consistent with the results of a recent survey of general counsel. General counsel believe that their role is changing, to be a more strategic business adviser and a barometer for the business. Boards expect general counsel to be commercially aware and to combine this awareness with their legal knowledge and experience.[294]

Along those lines, technology has also effected the role of general counsel. According to Neal Winneg, Former General Counsel, of Jumptap, Inc.:

> It's not news that advances in technology over the last 20 years have created extraordinary opportunities along with concomitant challenges for virtually everyone, both in business and our personal lives. So, too, for in-house counsel . . .the days of one or two law firms handling most of a business's legal needs are over."[295]

This comment, premised upon the globalization of commerce, tells us that in-house counsel need to be prepared to learn new, technical areas of the law in addition to the areas where they are already strong.

According to Winneg:

> the number one factor on which clients focus in evaluating their counsel is responsiveness, and that is an area where in-house counsel have a leg up on outside counsel, in several respects."[296] Winneg asserts lack of outside counsel's minute-to-minute accessibility as one factor and familiarity with the business as a second factor in giving in-house counsel the leg up. Winneg notes that in-house counsel are "in a position to provide advice more quickly, needing less background information

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[294] KPMG Survey, *supra* note 292.

[295] Shep Davidson, *Tips From the Inside: Neal Winneg, Former General Counsel, Jumptap, Inc.,* The In-house Advisor (June 12th, 2014), http://www.in-houseadvisor.com/2014/06/12/tips-from-the-inside-neal-winneg-former-general-counsel-jumptap-inc/.

[296] *Id*.

> about how the business operates, because we already know it."[297] Richard Susskind, author of "Tomorrow's Lawyers: An Introduction to Your Future" observed, "In short, tomorrow's lawyers will need to be more in tune with tomorrow's clients…. In other words, (today) many law firms lack empathy. They fail to put themselves in their clients' shoes and see the business from the clients' perspective.[298]

A recent survey lends support to Winneg's beliefs. The Legal Marketing Association reported that more than half of the law firms surveyed did not have a client experience strategy in place.[299] According to Dave Galebenski:

> Senior business leaders are increasingly asking the legal department to do more with less to reduce the risk but accomplish this while being cost conscious. [Galbenski] finds increasingly that [general counsel] are focused on creating value and leveraging some of the new business models in legal services such as using alternative legal service providers, engaging in legal process outsourcing (LPO) or even shifting corporate legal work to 'large enough' law firms.
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> . . . Twenty years from now the acronym "GC" might more accurately define the top corporate legal role as a 'general contractor' rather than 'general counsel.'[300]

Susskind notes, "In house lawyers of the future will not only be more demanding on costs; they will be more discerning about the relationships they choose to cultivate with external firms."[301]

Gilchrest commented on this aspect of his work as well. "Corporations are much more sophisticated consumers of legal expertise in the 21st Century. Likewise, in house counsel have become more sophisticated in law firm management and utilization. There is now greater emphasis on vetting many different types of firms for work and getting the most competitive rates on every matter. Billing rates are tracked electronically and compared to other similar lawyers in the region or practice area. There is also the constant push to keep outside counsel fees flat or down. New technology has also made it easier to review bills and budget case expenses. Big cases are now staffed with virtual (multiple) law firms or teams. An in-house attorney's responsibilities include coordinating several firms in different geographic regions

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[297] *Id*.

[298] *See* Susskind, note 290, p. 67-68.

[299] *One North Study*, Strategies: J. of Legal Marketing by LMA (May/June 2014), *available at* http://www.legalmarketing.org/strategies.

[300] Davidson, *supra* note 295.

[301] *See* Susskind, note 290, at 65-66.

who are handling different issues in the same lawsuit. Lawyers working on the same matter do not always see eye to eye and often have competing agendas and in house counsel must provide strong leadership and direction to take advantage of using virtual firms. The same is true of managing experts. There is more emphasis on hiring the best experts at the most competitive rates and requiring them to prepare and stick to a budget. Expert costs are also tracked electronically. Technology has made it easier to budget and track costs but there is no substitute for working one on one with outside counsel to achieve the best case result at a fair fee."

The future of the general counsel role was the study of a recent survey put together by the Association of Corporate Counsel (ACC). The survey found that: "84% of those surveyed said that legal management was among the top three values added to a company by the general counsel today, but that number dropped to only 64% that believed this would hold true in five to ten years."[302] According to the survey, "counselor-in-chief skills and strategy are expected to become even more important in the coming years."[303] In fact, "71% of general counsel surveyed" expect that "strategic decisionmaking will become a top three value-driver for legal department heads in the next five to 10 years. This means both legal strategy, which is already a key part of the game, as well as overall business strategy."[304] With cost concerns playing a major role in decision making, in house attorneys will manage with less internal resources, greater responsibility and less outside counsel input.[305]

Speaking from their perspective, in a recent survey, chief legal officers indicated on a scale of 0 to 10 that law firms are at a 3 in being serious about changing their legal service delivery model to provide greater value to clients as opposed to simply reducing rates, with zero indicating the firm is not serious at all and ten indicating the firm is doing everything that it can.[306] Law firm leaders, when presented with the same question, using the same scale, weighed in with a median of five.[307]

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[302] Matt Faustman, *What the Future Holds for General Counsel*, Upcounsel (Jan. 29, 2014), http://blog.upcounsel.com/general-counsel-of-the-future/.

[303] *Id*.

[304] *Id*.

[305] Shep Davidson, *Tips From the Inside: Keith Wexelblatt, Associate General Counsel, Reebok International Ltd*., The In-house Advisor (Apr. 3, 2014), http://www.in-houseadvisor.com/2014/04/03/tips-from-the-inside-keith-wexelblatt-associate-general-counsel-reebok-international-ltd/#.U7rxxXYaXZc.

[306] Thomas S. Clay & Eric A. Seeger, *2014 Law Firms in Transition: An Altman Weil flash Survey,* Altman Weil (2014), *available at* http://www.altmanweil.com/dir_docs/resource/f68236ab-d51f-4d81-8172-96e8d47387e3_document.pdf.

[307] *Id*.

Within the same survey, 34.4% of law firm leaders viewed corporate law departments as the most likely change agent in the legal market over the next ten years.[308] Other noted change agents include technological innovations (31.6%), non-firm providers of legal services (15.4%), law firms (10.2%) and Gen X lawyers (8.4%).[309] While the 34.4% was the comparison of law firms of all shapes and sizes, 62.5% of law firm leaders in law firms with over one thousand attorneys believed that corporate law departments would be the most likely change agent, compared with only 21% of law firm leaders in firms between fifty and ninety-nine lawyers.[310]

VI.
Conclusion

The legal profession is not going to become extinct. Lawyers provide valuable services and skills with a host of methods in which to provide those services. Much like any profession or industry, lawyers, law firms, and the legal profession as a whole must evolve to meet their client's needs. As John F. Kennedy stated, "Change is the law of life. And those who look only to the past or present are certain to miss the future." Contrary to the thought process of some, lawyers and corporations are not at odds with one another and evolution into the 21st Century practice should not be considered adversarial. Instead, law firms and their clients must work together to develop innovative and effective solutions that make the relationship not only workable, but beneficial to each other.

Included within the evolution, however, so must go the regulation. The ABA and the state bar associations must examine the permitted use of alternative business structures and develop a strategy to regulate the structures. As history has taught us, the law firm structure was not created overnight. It took time to develop the internal structure of the law firm and it will take time to develop the regulations to go along with the ever-changing structure, practice and client expectations. Nonetheless, the time is now. Law firms must face the problems head on and develop strategies that allow the practice to grow, perhaps not by numbers, but by strength. The legal profession might take advice from one of the most successful athletes of all time, Michael Jordan, "I believe greatness is an evolutionary process that changes and evolves era to era." In this regard, lawyers, often compared to many animals, should choose to be like the cockroaches and crocodiles, existing for millions of years by changing with the times.

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[308] *Id.*

[309] *Id.*

[310] *Id.*

Three Rules for the 21st Century Lawyer– A View from Two Worlds

Timothy Pratt

I. Introduction

What is the state of the relationship between in-house and outside counsel? Has it truly changed over the last few decades? There is no doubt that both sides need each other. Law firms need clients. And corporate clients need quality services from outside counsel more now than ever. Though there may have been some dip in demand for legal services in the recessionary years, the fact is that there now are more deals, more government investigations, more litigation, more compliance and employment-related matters, and more changes in the law within the United States and beyond. However, this higher demand for legal services has intersected with the growing pressure to reduce legal costs. Therein resides the tension of competing objectives.

In the face of this escalating demand, corporate clients are searching for imaginative ways to achieve more predictable and efficient mechanisms to pay for these services. Alarmists in the crowd will proclaim that this has changed the practice of law in revolutionary ways. But that is the overly-strident view. The core feature of the attorney-client relationship has remained intact—a client hires a lawyer to represent its interests in a matter, and the goal is to achieve an outcome in the best interests of the client for a reasonable cost. That has been true since lawyers were paid with sacks of potatoes for the legal work they did.

For law firms, seeking and retaining clients is the critical aspect of success. There has always been an ebb and flow in business as clients replace old firms, add new ones and shift allegiances when new leadership comes into legal departments. No doubt, the trend has been for clients to use fewer firms to do their legal work. Some of that is cost-driven. Providing more work to a single law firm creates opportunities for volume discounts, and that law firm is incentivized to provide more cost reductions when a significant amount

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of work is involved. Furthermore, for the in-house legal department, managing fewer law firms is easier than managing many because the corresponding burden is decreased for its litigation managers. It is also helpful and cost-effective in some instances for a single outside law firm to oversee related litigation or transactional work across certain geographies. Finally, because knowledge of the client's business and personnel is important, having that institutional knowledge invested in fewer firms inures to the best financial and strategic interests of the client.

Despite the trend to have fewer firms handle the bulk of their legal matters, most corporate clients hire new lawyers on a regular basis. There are always new matters in areas where local representation is required or desired. Some clients are reluctant to become too dependent on a few firms who then have the leverage to push their own interests in the negotiations regarding compensation. In other words, opportunities exist for law firms that do not represent a particular client to acquire business from that client. The burning question is how might they get under the tent and make a play for that client's work?

To begin with, you have to be pretty darn good at what you do. Amidst all the angst and debate about the future of the practice of law, there is one abiding principle—quality counts. And quality is measured by accomplishments and performance. Good lawyers get more business than bad ones. That will not change.

Another truism is that costs count. Great lawyers can price themselves out of most of the legal market. During the recessionary years, many companies faced challenges to their top revenue line as demand and prices were reduced. That, in turn, put pressure on expenses. As part of the annual planning process, every corporate function, including the legal department, faced budgetary constraints. The legal department had to find ways to control outside counsel spend to meet its budgetary commitments. That created a tightened

squeeze on law firms, many of whom responded by providing cost concessions. For many companies, outside counsel legal spend did go down. Some of that may have been attributed to cost-reduction agreements with outside law firms, but much of it was attributed to reduced merger/acquisition activity, improved internal management of outside firms and an increased tendency of companies to settle cases earlier rather than incur significant attorneys' fees and discovery costs. Today, costs continue to be a factor in any decision whether to hire or retain an outside law firm. That has long been an historical fact, but recessionary years made it a strategic imperative for corporate clients.

Rather than dwell on history, let's look to tomorrow and into the 21st Century. Though some things have remained the same and some have changed over the past several years, the successful law firm of the 21st Century must know how to market itself to potential clients and get new business. There is no magic elixir. It is important for law firms to understand that many disparate factors drive hiring decisions. The caveat here is that no company is like all others, and different considerations come into play for various companies. However, as noted, the same general considerations predominate as much now as they have for an eternity—every client wants a lawyer who can achieve an outcome in the best interests of the client for a reasonable cost. The rest is all about details.

And finally, remember this—the old adage that clients hire lawyers and not law firms is as true now as it ever was. With the growing consolidation of law firms, many clients will work with a tiny fraction of a law firm's attorneys. The reputation of the law firm means nothing to the client if its attorney is doing a poor job on the assigned matters. The successes of the law firm on other clients' matters mean nothing unless the outside counsel you hire was instrumental in those successes. Law firms need to get over the notion that they can attract and retain a particular client's business by glorifying everything that the law firm can do. Effective law firm marketing is segmented so that the qualities and characteristics of the relevant individual lawyers predominate. Fancy, colorful law firm brochures may serve as an introduction but are never the vehicle for hiring decisions.

So, yes, some things have changed and other things have remained the same. That will continue to be true. With all the vicissitudes and uncertainties in the practice of law, what will it take for a lawyer to thrive in the 21st Century?

II.
Three Rules for the 21st Century Lawyer

A. *Rule #1—Figure out a better way to get paid for the services you provide.*

The billable hour system has not been around forever, but most lawyers practicing today grew up in that system. The ethical setting of a reasonable fee over the years has implicated a number of factors, but the amount of time a lawyer spends on a matter became the most critical factor in the 1960's when many law firms were billing clients on an hourly basis.[1]

[1] A.B.A. Commission on Billable Hours Report 2001-2002, 3 (2002), available at http://ilta.personifycloud.com/webfiles/productfiles/914311/FMPG4_ABABillableHours2002.pdf.

As time passed, law firms expected their attorneys to bill more hours per year and the hourly rate moved inexorably higher. Clients demanded to know who did their work, what they did and how much time they spent. That led to detailed statements incorporating scrupulous timekeeping by outside counsel and significant review by in-house counsel. Even before the 2008 recession, clients were clamoring for a better way to pay for legal services, seeking to mitigate the ever-escalating legal costs and thirsting for consistency and predictability.

And lawyers themselves were joining the chorus. In a 2007 article in the American Bar Association Journal, noted novelist and attorney, Scott Turow, authored an article entitled, "The Billable Hour Must Die." The thesis of the article was that the billable hour system rewards inefficiency, creates client suspicion and may be unethical. In the last paragraph, Turow states:

> If I had only one wish for our profession from the proverbial genie, I would want us to move toward something better than dollars times hours. We have created a zero-sum game in which we are selling our lives, not just our time. We are fostering an environment that doesn't provide the right incentives for young lawyers to live out the ideals of the profession. And we are feeding misperceptions of our intentions as lawyers that disrupt our relationships with our clients. Somehow, people as smart and dedicated as we are can do better.[2]

This damning indictment of the billable hour highlights why it is so pernicious—it has become a foundational element of the practice of law. Not only is it used to measure how much a client should pay, it is being used to track how hard lawyers are working and to set law firm compensation. Those who cannot "keep up" are often punished financially or forced out of the practice of law without regard to their talents as lawyers. If the billable hour disappears as a measure of producing revenue, how can law firms determine how much to pay their lawyers?

With all the acclaim that the billable hour must die, law firms and clients alike have been grasping at a whole host of "alternative" options, from contingent fee arrangements, alternative fee arrangements, fixed and flat fees, to blended rates. Some of these arrangements have been successful and extolled by clients and outside counsel alike because they carry no remnant of the hourly rate, and predictability in legal costs is achieved. However, many of these alternative arrangements have at their core some semblance of the persistent billable hour. For example, law firms need to know how much to charge the client so they figure their "alternative" fee by estimating how much work is expected to be done, who will do it, how much each attorney charges per hour under the internal rates, and multiply all of those numbers. This sounds a lot like "dollars times hours." But clients compound the problem. They want proof that the law firm is actually putting in the work to justify the fee,

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[2] Scott Turow, *The Billable Hour Must Die*, A.B.A. J., Aug. 1, 2007, *available at* http://www.abajournal.com/magazine/article/the_billable_hour_must_die.

so they may insist on receiving "shadow bills," which look very much like the traditional statements for hourly rate work. In-house resources are then expended in the review of these shadow bills. And if you add a collar, it begins to look and feel like the good old days because the amount paid to a law firm is driven by statements reflecting how much hourly work is done by the law firm.

Changes have been demanded. The Association of Corporate Counsel (ACC) has championed its "Value Challenge," which it describes on its website as follows:

> The ACC Value Challenge is an initiative to reconnect the value and the cost of legal services. Believing that solutions must come from dialogue and a mutual willingness to change, the ACC Value Challenge is based on the concept that law departments can use management practices that enhance the value of legal service spending; and that law firms can reduce their costs to corporate clients and still maintain strong profitability. The ACC Value Challenge promotes the adoption of management practices that allow all participants to achieve their key objectives.[3]

There is nothing here that suggests a billing system based on hourly rates. The key is calculating "the value of legal service spending." Value is not reliably determined by the amount of time that lawyers spend on a matter. Value is measured by outcomes, expediency and a host of things disconnected from how many lawyers spend how many hours on a client matter.

One problem with the hourly rate is that it does not correspond to the language of corporate clients. Corporations are in the business of providing value to shareholders, which means they must deliver profitable returns at least consistent with forward-looking guidance. In determining profits, corporations look at their total revenues and expenses, and they then calculate their profit margins and operating income in that bridge between what they bring in and what they pay out. None of their expenses incorporate an hourly rate for the work they do. They pay employee salaries and show that as part of a line-item expense, but they do not apply an internal hourly rate calculation for any purpose. For most of their outside vendors, they pay flat fees that cover an entire project and are not tethered to hourly rates. Incentives are provided for early and successful completion of the project. So, when law firms propose an hourly rate structure or an alternative fee arrangement that is largely founded on a "dollars times hours" algorithm, it just doesn't resonate with corporate clients.

Let's apply that to the in-house law department context. In-house litigation management attorneys spend their days working with outside counsel, reviewing documents, editing briefs, discussing strategy and attending depositions, hearings and trials. Working side-by-side with outside counsel, the in-house attorneys do many of the same things as outside counsel. Yet, in-house counsel "value" is not connected in any way to hours billed. Their compensation

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[3] ASSOCIATION OF CORPORATE COUNSEL, http://demo.acc.com/valuechallenge/about/index.cfm (last visited Apr. 21, 2015).

is fixed and set early in the year, hence it is predictable. It is based on the attorney's past and expected performance as well as peer comparisons. That is the measure of "value" to which the company assigns a dollar amount calculated by base pay, bonus and equity. Let's do a little math. If an in-house counsel's total compensation packet is worth $250,000 and we assume the equivalent of 2,000 hours of work per year, that translates into an hourly rate of $125. Most in-house litigation attorneys work far more than 2,000 hours. The same calculation could be done for in-house attorneys doing merger/acquisition work, employment counseling, internal investigations and the like.

Of course, outside counsel is not employed by the client so the concept of employee compensation is not a perfect match. However, the determination of what constitutes "value" is not dramatically different. A win is a shared accomplishment by in-house and outside counsel. How dramatically different is the compensable "value" assigned to these roles?

The premise here is not that outside counsel should be billing in the sub-$200 an hour range. Rather, it is to display the disconnect over how value is differentially defined by in-house and outside counsel. The billable hour is an inefficient, archaic and dis-incentivized way to reward value for outside counsel. Clients want and expect their outside counsel to make a profit off of the value they deliver. The issue is how much and how do you define that value. Let's assume a sole practitioner wants to earn $1 million a year in total compensation. And let's assume that the overhead or cost structure for that firm is $200,000 a year. With a fair degree of conviction, let's assume that a client's work was going to take half of that lawyer's time. Wouldn't it be fair for the client to pay the lawyer $600,000 throughout the course of the year, representing half of the lawyer's desired income and overhead, a sum unrelated to an hourly rate or whether that lawyer works 2,000 or 3,000 hours a year? If that lawyer had an associate and the client needed 25% of that associate's time, couldn't a similar calculation be done? Once the baseline is determined, adjustments could be made if the workload assumptions proved inaccurate. Alternatively, outside counsel could calculate a fee arrangement that delivers profits the way to which corporations are accustomed—after factoring in all expenses, how much revenue must the firm bring in to achieve a predetermined profit margin without factoring in an "hourly rate" value for employees?

This "top down" approach to setting fees is often unworkable because lawyers do not go into each year with a preconceived notion of how much money they want to make. And the impediments are even greater for larger law firms where expense allocation is difficult to predict or to set. But that is not the point of the analogy. The point is that how much a lawyer/law firm makes should not be driven by the hours they put into a matter divided by an arbitrary hourly rate. It should be driven by more realistic and efficient concepts of value that permit the lawyer/law firm to achieve a reasonable profit margin in the context of outcomes delivered. That is how corporations do it.

Over time, the reference to hourly rates in the context of fee negotiations will inevitably be eliminated. It may be a slow death, but death is assured. Clients do not like the algorithm based on "dollars times hours." Nor do they like reviewing bills—whether real or shadow—because that takes time and makes in-house lawyers less efficient. The successful 21st Century lawyer will come up with something better, and clients will reward that lawyer

for that. For example, the financial relationship between outside counsel and the client could be constructed in this fashion:

1. There should be early discussions about how much work the case is expected to take and who in the law firm should do it. Perhaps the case will require a large team or, in some instances, a single associate. A preliminary strategy must be discussed, based on certain assumptions and expectations.

2. Distinctions should be drawn between the various tasks that law firms are expected to perform. At the purest level, clients want the time, attention, strategic input and performance of experienced attorneys. But think about all the things that law firms are asked to do—review and analyze documents, conduct legal research, prepare legal memoranda, draft correspondence, analyze problems, engage in strategic planning and handle depositions, hearings and trials. How many of these tasks are commoditized and do not require years of experience? In other words, all the things that law firms are asked to do are not created equal. A client might be willing to pay for the hours a senior, experienced lawyer spends on a significant matter, but why should commoditized work be valued on an hourly rate basis? In this instance, one size does not fit all, and the law firms of the future will submit proposals where the commoditized work, and even the high-level strategic work, becomes completely divorced from the "dollars times hours" construct.

3. Create a baseline flat-fee arrangement that fairly reflects the "value" expected to be delivered by the law firm for all of the tasks the law firm is expected to perform. There should be no discussion of hourly rates, and any presumed hourly rates for the lawyer(s) doing the work should not be a factor. And here is the heart of it—there will be enough trust in the relationship that adjustments can be made in the event the early assumptions prove to be in error.

4. There should be no monthly budgets or bills. Instead, the law firm would provide the client with a monthly report of who did what (without hours or other details), what went well or not, and any recommended changes in the strategy going forth. This monthly report would reassure the client that its matter is getting appropriate attention by the key players in the law firm. The report also would promote constant collaboration between in-house and outside counsel on the work that should be done and whether the strategic approach to the matter should be modified.

5. The law firm and client should determine in the first instance how value is defined. If the goal is to resolve the matter quickly, that outcome should be rewarded. If the expectation is that the matter will have to be tried, but it is resolved earlier in a satisfactory way, that outcome should be rewarded. Just as general contractors are compensated for completing construction projects earlier than planned, so too should law firms be incentivized to deliver earlier successful outcomes. In other words, we should financially incentivize efficiency and early wins rather than long, dragged-out battles.

At the end of the day, true "value" is not determined by the anachronistic notion of how many hours law firm personnel apply to a case. It is determined by outcomes and the speed at which a matter is resolved. It may be counter-intuitive that the most valued law firms get rid of matters quickly, but those firms will continue to get more work because of the value

they deliver. It is time for greater imagination on behalf of both law firms and clients. There is a better way to do this. And the law firms that crack the code of defining their value and putting a mutually satisfying price tag on it will thrive in the 21st Century.

B. *Rule #2—Be true strategic partners with the client.*

Lawyers are, by trade, exceptional tacticians. That is what is expected of them. You give them a matter, and they will figure out how to navigate the whitewater straits to an acceptable ending. They will dig into the details, understand the law, apply their legal learnings to the facts of the matter, and execute well to a successful outcome.

When you look at the intersection of in-house and outside counsel, you see common features. Both participate in the strategy discussions on how to handle a matter. They jointly "manage" the matter, making midcourse adjustments and watching resources and costs. They work together to get the facts, from internal and external sources, to enable informed decisions. So, whether negotiating a deal, overseeing litigation or managing an intellectual property portfolio, the in-house and outside counsel are in regular contact and hopefully synchronized on the strategic course and tactical details needed to accomplish the desired outcome.

However, at some point, their roles diverge in marked ways. Let's take litigation as an example. Most corporate law departments have experienced litigation managers. What are the key attributes of an effective in-house litigation manager? Here are some of them: (1) know the business; (2) understand the strategic objectives of the company; (3) look out for the best interests of company employees by minimizing disruption to the commercial engine of the company; (4) ensure that litigation is managed in a way that mitigates risks and protects the reputation of the company; (5) be legal advisors to senior management and the board of directors; (6) set appropriate litigation reserves; (7) control litigation costs; and (8) win. The in-house litigation manager has to be a skilled litigator but must also wear a business hat because that is the environment in which he or she operates.

What are the primary attributes of outside litigation counsel? Among them are: (1) know the case; (2) understand how the client defines "success" on a particular matter; (3) get as much information as you can from internal sources, like employees and documents, so your advice is adequately informed; (4) do what is necessary to protect the business and reputational risks of the company; (5) answer questions from in-house counsel on costs, risks, reserves and the like; (6) handle discussions with opposing counsel; (7) conduct legal research and document reviews; (8) take depositions; (9) handle hearings and trials; and (10) win. The outside counsel typically wears much more of a litigation hat than a business hat.

The disconnect and, in some instances, the duplication between what in-house and outside counsel do has driven some companies to in-source their legal work. In other words, they create their own internal law firm. They hire lawyers into the law department to try their cases and, on their own, handle deals, employment claims and other matters typically referred to outside law firms. FedEx Corporation, for example, maintains a staff of in-house litigators who handle cases directly from start to trial. There are several reasons why a company might do this. One, of course, is efficiency. If you can create a team of hybrid business/litigation

lawyers by merging all of the above roles of in-house and outside counsel into a group of internal lawyers who can be managed as a single unit, you are getting the best of all worlds under one umbrella. Another reason is to save costs. You can cap, or at least better predict, your legal spend if you have salaried employees handle most of the legal matters on a non-hourly rate basis. This model is also helpful because in-house counsel know the business, the substantive legal principles at issue, and the key internal players. This saves money because the company does not have to educate outside counsel on the statutes, regulations, laws and internal structures that in-house counsel deal with every day. And shifting strategic courses can be readily identified, discussed and pursued rather than conveyed to outside counsel for execution. There is no "transition" required from in-house to outside counsel because the corporate law department is serving as its own outside counsel.

Despite the advantages, there are disadvantages to creating your own internal law firms. There is often an ebb and flow to the legal work that a company must handle. When you rely on a law firm, you can more easily accommodate changing demands for legal services—you use them for however long you need them and stop when you don't. If the company hires internal resources, it is harder to calibrate the resources to the often unpredictable demand. Variable costs become fixed costs. And, no matter how much legal work is in-sourced, you will likely still require outside local counsel to advise and assist on certain matters, which adds to the internal costs.

What does all of this mean for the 21st Century lawyer? It means that an outside lawyer needs to think more like an in-house counsel, to know what in-house counsel knows and be as attuned to the business strategies as he/she is to the legal strategies. The 21st Century lawyer should read what in-house counsel reads—company press releases, proxy statements, annual reports, SEC filings and analyst reports. Know the business of your client. Go beyond "know the case" and move into a place where one broadly "knows the client." The 21st Century lawyer should know more about what in-house counsel does—setting reserves, applying accounting principles, figuring out what must be publicly disclosed and when, and managing reputational issues. That will allow outside counsel to think like an in-house counsel and provide knowledgeable legal support to the company. The 21st Century lawyer must be acutely aware of the pressures that in-house corporate counsel are facing—budgetary constraints, managing disruption and crisis management. By thinking and acting like an in-house counsel, the 21st Century lawyer will become a true "strategic partner" to in-house counsel.

"Strategic Partner." That has a nice ring to it. One of the common themes of law firm marketing is the capacity to "partner" with clients. That's what clients want as well. What does that mean? According to Merriam-Webster, one definition of "partner" is "to join or associate with another."[4] So, what does that mean? Simply put, in the legal context, it means that outside counsel is a natural and seamless extension of the in-house law department. There is a significant blurring of the roles between in-house and outside counsel.

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[4] MERRIAM-WEBSTER, http://www.merriam-webster.com/dictionary/partner (last visited Apr. 21, 2015).

Here is the essential lesson for the successful 21st Century lawyer—become that natural and seamless extension of the in-house legal department. Think and be like an in-house counsel. Look after the long-term interests of the company, beyond an individual matter. Be keenly attuned to advancing the commercial and business interests of the client and seek to minimize disruption. Manage costs as though you were managing a law department budget rather than just a legal matter. You will elevate your standing in the eyes of the client. You will make the life of the in-house counsel easier. You will distinguish yourself from those lawyers who are mere tacticians. That builds a relationship that endures. And enduring relationships are the key to success in the 21st Century practice of law.

C. *Rule #3—Be a leader, not just a lawyer.*

The responsibility of law schools is to devise a curriculum to develop the lawyers of tomorrow. Because the lawyers of tomorrow will be handling legal matters, the historical focus of law schools has been on the development of legal skills—learning to research and analyze cases, mastering various substantive areas of the law, understanding the processes and procedures that lawyers need to navigate, and incubating practical skills like taking depositions, handling trials and arguing cases. Law firms then advance those skills by exposing associates to deposition and trial training programs and providing them practical experiences. All of this lays the foundation for young lawyers to become better lawyers over time and handle cases more successfully. That is important to clients because the ability to handle cases and win is a critical component of the attorney/client relationship. That has been true since the dawn of legal time.

However, there are lawyers all over the world who can take a case and do a workmanlike job handling it. As noted, it has been argued by some that the practice of law has become commoditized, and that is certainly true when it comes to more routine matters. On the important strategic matters that experienced lawyers are often asked to address, there is no doubt that some lawyers are better than others. However, the range of good legal advice one gets from various experienced outside counsel does not have a huge standard deviation. Any incremental advantage in that regard is difficult for the "better" lawyer to prove and market.

What will be the key differentiator in the 21st Century? It is something often under-emphasized by law schools and under-valued by law firms. It has less to do with what lawyers do than what they are. It requires measuring the attorney not just as a lawyer but also as a person. It focuses on how that lawyer treats people, carries himself/herself and inspires respect. It is about approaching challenges with humility and operating with an "us" rather than a "me" mentality. It is a simple concept with life-changing potential. It is called leadership.

There is significant interaction between outside counsel and in-house counsel, and only a small proportion of that interaction takes place in the courtroom where the outside counsel display critical legal skills. Most of the interaction takes place during phone calls, informal meetings and the day-to-day strategic management of a case. It is in that setting where impressions are formed and relationships are built. It is undeniable that, in selecting

or retaining outside counsel, performance counts. But equally weighted are the intangibles like connectivity, likability, and all the other things that go into building a personal and professional relationship. In other words, is that person just a lawyer or also a "lawyer leader?"

So, what is leadership? Leadership eludes definition, despite the thousands of books and courses that purport to describe it. There are few resources that paint a clear picture of what makes a lawyer an effective leader. It is clearly more than law school performance and the number of jury trials or deals completed. It is far more intangible. But what are those intangibles? Here are five important leadership criteria that the 21st Century lawyer should aspire to achieve:

1. *Display executive presence and communicate well.* "Executive presence" may be as hard to define as the word "leadership," but you know it when you see it. It is the ability of a person to walk into a room and command attention. It is not the loudness of the voice or the sharpness of the outfit. It is an effortless presence manifested by engaging others, showing an easy conversational style and unexpected humility, listening attentively to others, sharing ascendant insight and exuding a quiet confidence. It is not just charisma because it is far more substantive. Others enjoy being with people like this. Colleagues in the law firm want to work with such a leader. Prospective clients want to hire outside counsel who have executive presence. Executive presence also implicates the ability to communicate effectively. It is axiomatic that great trial lawyers communicate well in the courtroom—with jurors, the judge and even witnesses. However, lawyers communicate far more often outside the courtroom than in it. They attend meetings, give presentations, participate in conference calls and interact with others in all types of settings. True leaders have mastered the art of impressive and persuasive communication. It involves listening as well as speaking. It is an easy, unforced conversational style untethered to PowerPoint slides and notes—getting to the point without belaboring it, speaking with inflection and pace, using movement and hand gestures to emphasize points, and sprinkling in illustrative examples and, yes, even some humor. Leaders, in their communications, sell their points and themselves. Clients notice. Cast aside the notes, slides, ponderous speech style and unprepared chatter. Make listeners go "wow!" and leave them with an indelible impression.

2. *Be accountable and calm in crisis*. The practice of law does not take place in a perfect world. Not everything will go as planned. There will be unexpected successes and more than a few disappointments. And the disappointments sting. Outside counsel must understand that there is an internal accountability within corporate law departments. Senior management relies on the strategic judgment and assurances of in-house litigation managers, just as in-house litigation managers rely on the considered judgment of outside counsel. Outside counsel needs to subscribe to the litigation strategy and accept the consequences of its failure. The accountable leader shares successes with the team but personally and singularly accepts responsibility for failure. This is equally appreciated by the internal law firm team and in-house counsel. In those chaotic moments when things look dim, the leader slows things down and comforts others, inspiring a sense that despite the setback, everything will work out without engendering false optimism. Nothing is more discouraging to a team or client than a leader who has lost hope or run out of ideas. It is in those moments when true

leaders inspire others to the possibility of better things to come by their demeanor, tone of voice and calmness of purpose. Anyone can lead in the good times. It is the true leader who excels when things do not go as well as expected. In challenging times, the leader builds excitement about the successes of tomorrow. Be that leader.

3. *Be courageous*. No one wants to fail. For lawyers, failure may mean loss of business, revenue and reputation. The fear of failure may provoke conservatism where risk discomfiture is traded for the safe and easy way out. That is a bad trade-off for the client. The antonym of courage is timidity, and who wants a timid lawyer? One cannot live life in fear of bad things happening. Most fears are not realized, though they seem so real in the darkness of night. For lawyers, courage means the case does not get worse for the client every day it gets closer to trial. It means sharing with clients an imaginative and potentially game-changing strategy that may work or not. The 21st Century lawyer is willing to take measured risks in consultation with the client, is aware, but not fearful, of consequences, and displays an easy confidence that things will work out just fine. Leadership means one is not wedded to the status quo or the safe way out. One needs to take chances and inspire the team—including the client—to follow. It is as true in the law as it is in the military, politics, academia, business and all aspects of life. Be smart and courageous.

4. *Be a team-builder*. There is little we can do alone—in the law or in all walks of life. It is important for lawyers to build teams that perform together and achieve great outcomes despite the stress and uncertainty of the moment. The leader has to be surrounded by others with passion and talent. The job of the leader is to bring them together and make them excel. True leaders have the ability to attract talent. People want to work with them. True leaders retain talent. Once people are on the team, they feel valued and enjoy what they do. True leaders inspire others to places once thought unattainable. That requires broad strategic thinking, empowerment of team members, sharing successes, and a strong fabric that knits people together. The 21st Century lawyer must have the capacity to build strong internal teams in the law firm. Without that, the lawyer is destined to fail. But, think about the broad team that outside counsel must deal with while handling a legal matter. It includes opposing counsel, the judge, in-house litigation managers, outside consultants and experts, and non-legal staff at the law firm and the corporate law department. The 21st Century lawyer/leader is able to build personal relationships with all of these individuals, be respected, calm emotional conflicts, collaborate and persuade others to the wisdom of his or her viewpoints. Those are defining characteristics of the legal leaders of tomorrow.

5. *Be professional and civil*. Being professional is not optional for attorneys. It is an abiding requirement that, in many fronts, is honored in the breach. Too many attorneys approach litigation as warfare where "opponents" are seen as "enemies" and extending courtesies is perceived as "weakness." That mindset instills a culture of disharmony, one-upmanship, churlishness, confrontation and wasteful battles on matters unrelated to the merits at hand. That culture drains one's satisfaction in the practice of law.

There are ways to reign in unprofessionalism and incivility. Sanctions may help, but that is like trying to stop speeding by issuing more tickets. There is another more powerful

deterrent—clients. Corporate law departments, who send substantial legal business to law firms, should take a blood oath not to hire unprofessional lawyers to represent their interests. And, if a retained lawyer engages in unprofessional conduct, he or she should be fired. Period. Such an approach would advance the overarching interest of maintaining high professional standards for the practice of law, an important but only incidental benefit. The fact is that clients cannot afford unprofessional lawyers. They cost money with unnecessary motions, hearings and petty arguments with the other side. They compromise the client's relationship with the judge. They are generally unpleasant to work with in their own right, exhibiting a dearth of leadership skills. However, and perhaps more importantly, such lawyers interfere with the client's best interests and end game strategy. With only a fraction of filed cases being tried, it is likely that the client will have to sit down with the opposing party and seek to resolve a matter amicably. The odds of that process working are increased if there is a good relationship between the client's outside counsel and the opposing counsel. A history of anger, retribution and ill-will between them will sabotage the process to the client's disadvantage. It is a no-win proposition for the client, who expects its outside counsel to rise above the provocations and surpass the highest standards of good behavior.

The 21st Century lawyer is the paragon of professionalism and civility. That not only builds respect, but also a reputation. In-house lawyers want to work with outside counsel who make them proud and represent all that is good for this storied profession. We need to eradicate unprofessionalism. If we want to promote professional behaviors, it's time to do so by rewarding those who exemplify what we expect rather than just punishing those who don't. Corporate law departments have an important role in that regard.

These leadership criteria and all the rest of them—intellect, passion, work ethic, perseverance—can truly differentiate outside counsel. These comprise the buffet of characteristics that impress in-house counsel, or not. These build the critical relationships that become stronger over time, or not. And these make up the intangibles that convince clients to hire you as their lawyer, or not. The degree of bonding between an outside counsel and the client can be enhanced if the outside counsel displays true leadership capabilities. If outside counsel does not display those capabilities, the decision to separate from that counsel becomes monumentally easier. If you want a lot of legal work, learn how to be a leader and be one.

III.
Conclusion

The successful 21st Century lawyer will exhibit the skills to be an exceptional lawyer and so much more. The lawyer will focus less on historical accomplishments and more on what he or she is and can do. The lawyer will be a true strategic partner with the client. The lawyer will also be a good leader and person. The determining factor for clients is not simply "we can win with this person," but "this is a person who will help us win, and one we trust and who knows our business, is a leader with whom we are proud to associate and who requires minimum management." If all of that is there, the costs will take care of themselves.

Handle With Care: Bad Faith in the Absence of Coverage

Frank H. Gassler
G. David Godwin
Stephen J. Bagge

I.
Introduction

Insurers have often relied on the assumption that, absent coverage, there can be no extra-contractual liability (i.e., liability beyond that defined by contract). This so-called "general rule" may arguably constitute no rule at all. Recent case law and legislation have provided policyholders with a number of stepping stones on a path to extra-contractual recovery even where their claim is not covered by the policy.

The viability of such extra-contractual claims varies by jurisdiction; however, in a growing number of states, courts are allowing extra-contractual claims to proceed based on insurers' alleged failures to properly respond to and handle claims. The trend appears to generally involve one of the following types of claims:

- Failure to promptly and fairly investigate and adjust first party claims;
- Failure to properly respond to a request for a defense of a third party claim; and
- Violations of fair claim handling practices, statutes, and regulations.

This article focuses on how improper claim handling may create liability in the absence of coverage. The first part explores recent case law and regulations impacting an insurer's exposure to extra-contractual liability for errors in the adjustment of first party claims and in the investigation and defense of third party claims. The second part addresses how policyholders may pursue claims against agents and brokers where the policy does not cover the claim under certain circumstances.

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II.
Insurers May Face Extra-Contractual Liability Even For Uncovered Claims

An insurer risks liability beyond that defined in its policy of insurance where its acts or omissions in handling and adjusting a claim amount to bad faith or result in an argument of waiver or estoppel. Some courts have held such liability may be imposed even where the claim is not covered by the policy. Moreover, some states which require a claim to be covered before bad faith liability can be pursued may nevertheless find liability where the insurer has waived coverage defenses or is otherwise estopped from raising valid defenses.

A. *Breach of the Covenant of Good Faith and Fair Dealing as a Basis for Liability Absent Coverage*

Implied in all contracts, including insurance policies, is the covenant of good faith and fair dealing ("the implied covenant"). The obligations imposed by the covenant are not defined in the contract; rather, they are imposed by law. The covenant of good faith and fair dealing governs the manner in which contractual obligations are fulfilled (such as the obligations to defend and indemnify, or to pay a loss). In the insurance context, this covenant is often said to require the insurer to not place its own interests equal to or above those of its insured.[1]

[1] *See*, *e.g.*, Comunale v. Traders & General Ins. Co., 328 P.2d 198, 200 (Cal. 1958); see also Rawlings v. Apocada, 726 P.2d 565, 569 (Ariz. Ct. App. 1986).

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To understand how a breach of this implied covenant could exist absent a covered claim, it is useful to review the types of obligations imposed on insurers by the implied covenant of good faith and fair dealing.

1. Obligations Imposed By the Implied Covenant

In the first-party context, the implied covenant requires a thorough and prompt investigation of the claim as well as payment of policy benefits without unreasonable delay.[2] In the third-party context, the implied covenant requires: (1) a reasonable and prompt investigation of the claim; (2) a defense of the insured where a potential for coverage exists; and an attempt to settle the claim within policy limits whenever there is a substantial likelihood of a recovery in excess of those limits.[3] Particularly relevant is the obligation to promptly investigate a claim, which according to some courts is a separate obligation not necessarily tied to whether the claim is covered. In contrast, the duties to defend and settle implicitly, if not directly, require either a potential for coverage or actual coverage.

Consequently, in first-party and third-party contexts, the insurer must conduct prompt and reasonable investigations of claims as part of its obligations under the implied covenant of good faith and fair dealing. The issue then becomes whether errors in the investigation of a claim give rise to liability outside the policy of insurance.

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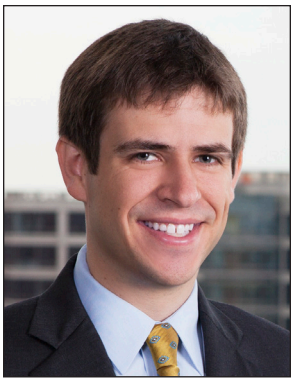
[2] *See*, *e.g.*, Cal. Shoppers, Inc. v. Royal Globe Ins. Co., 221 Cal. Rptr. 171, 200 (Cal. Ct. App. 1985).

[3] *See*, *e.g.*, Egan v. Mutual of Omaha Ins. Co., 620 P.2d 141, 145-146 (Cal. 1979); Johansen v. California State Auto. Assn. Inter-Ins. Bureau, 538 P.2d 744 (Cal. 1975).



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2. The General Rule" Requires a Covered Claim Before a Bad Faith Action May Proceed

Many state courts have said no. For example, courts in California have held that "[t]he covenant of good faith is read into contracts in order to protect the express covenants or promises of the contract, not to protect some general public policy interest not directly tied to the contract's purposes."[4] For this reason, if there is no breach of the contract of insurance, there can be no breach of the implied covenant of good faith and fair dealing.[5]

Many other states require a claim to be covered before extra-contractual liability may arise.[6]

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[4] Foley v. Interactive Data Corp., 765 P.2d 373, 394 (Cal. 1988).

[5] Jordan v. Allstate Ins. Co., 56 Cal. Rptr. 3d 312, 324 (Cal. Ct. App. 2007) ("An insurer's failure to investigate, upon which Jordan's claim of bad faith entirely rests, is *not* separately actionable if there is no coverage.); *see also* Waller v. Truck Ins. Exch., Inc., 900 P.2d 619, 639 (Cal. 1995).

[6] **Alabama** – White v. State Farm Fire & Cas. Co., 953 So.2d 340,348-49 (Ala. 2006); **Connecticut** – Capstone Bldg. Corp. v. Am. Motorists Ins. Co., 67 A.3d 961, 987 (Conn. 2013); **Delaware** – Cassan v. Nationwide Ins. Co., 455 A.2d 361, 369 (Del. Super. Ct. 1982); **Georgia** – BayRock Mortg. Corp. v. Chicago Title Ins. Co., 648 S.E.2d 433 (Ga. Ct. App. 2007); **Idaho** – Robinson v. State Farm Mut. Auto. Ins. Co., 45 P.3d 829 (Idaho 2002); **Iowa** – Johnson v. Farm Bureau Mut. Ins. Co., 533 N.W.2d 203 (Iowa 1995); **Kentucky –** Wittmer v. Jones, 864 S.W.2d 885, 890 (Ky. 1993); **Louisiana** – Clausen v. Fidelity & Deposit Co. of Md., 660 So.2d 83 (La. Ct. App. 1995); **Minnesota** – *In re* Hennepin Cnty. 1986 Recycling Bond Lit., 540 N.W.2d 494 (Minn. 1995); **Mississippi** – McCain v. Nw. Nat'l Life Ins. Co., 484 So.2d 1001, 1002 (Miss. 1986); **New Mexico** – Charter Servs, Inc. v. Principal Mut. Life Ins. Co., 868 P.2d 1307, 1313 (N.M. Ct. App. 1994); **Rhode Island** – Bartlett v. John Hancock Mut. Life Ins. Co., 538 A.2d 997, 1000 (R.I. 1988); **Texas** – Republic Ins. Co. v. Stoker, 903 S.W.2d 338 (Tx. 1995); **Vermont** – Serecky v. Nat'l Grange Mut. Ins., 857 A.2d 775 (Vt. 2004); **Virginia** – A&E Supply Co. v. Nationwide Mut. Fire Ins. Co., 798 F.2d 559 (4th Cir. 1986); **Wisconsin** – Brethorst v. Allstate Prop. and Cas. Ins. Co., 798 N.W.2d 467 (Wis. 2011). Even in states where the existence of a covered claim is a predicate to bad faith liability, an insurer may nonetheless be held liable absent coverage under some other tort theory such as fraud, negligent misrepresentation, intentional infliction of emotional distress, or invasion of privacy. These types of claims are outside the scope of this article.

3. Recent Trends Suggest Extra-Contractual Claims are Not Dependent Upon the Existence of Coverage

In contrast, a growing number of courts and some state legislatures have recently allowed insureds to pursue bad faith claims even after the court determines that the claim is not covered under the policy. Courts allowing such claims typically reason that an insurer may be liable for bad faith where the insurer denies the insured the security of knowing it will be dealt with fairly and in good faith. Specifically, the cases usually involve the determination that the insurer has acted so egregiously in the handling or adjustment of an insured's claim as to constitute bad faith regardless of whether the claim is actually covered under the policy. While there seems to be a common thread between most of the "bad-faith-absent-coverage" cases, the courts' analysis often differs depending upon the context of the insured's bad faith claim.

a. Conduct Prior to Denial of Coverage

In the first-party context, courts that have allowed insureds to pursue bad faith actions absent coverage have uniformly done so under a tort theory. These cases generally involve allegations that the insurer acted wrongfully in the investigation, handling, or denial of the insured's first-party claim. While the rationale for some decisions is unclear, various courts appear to suggest that the insured should be compensated for the emotional distress or insecurity sustained during the claims handling process.

The Arizona Supreme Court's decision in *Deese v. State Farm Mutual Automobile Insurance Co.,*[7] provides a good example of the courts' reasoning in these cases. In Deese, the insured made a claim for medical expenses with State Farm after she suffered serious injuries in an automobile accident. After an independent investigation, State Farm agreed to pay only a portion of the medical bills, forcing the insured to pay the remainder. The insured filed suit, alleging breach of contract and bad faith. The jury found in favor of State Farm on the breach of contract action but in favor of the insured on the bad faith claim and awarded her $75,000 in punitive damages. State Farm appealed.

The appellate court agreed with State Farm and found that the insured was required to establish a breach of an express policy term as a prerequisite to a bad faith claim. The Arizona Supreme Court disagreed, however, explaining that a breach of the implied covenant of good faith and fair dealing could arise absent coverage where the insurer's conduct effectively denies the insured the "security of knowing that she will be dealt with fairly and in good faith."[8] Because it was determined that there was no coverage under the policy for the insured's claims, the court's opinion suggests insureds can be compensated solely for emotional distress associated with the denial of a claim. Critics of Deese argue such a result is unsound as emotional distress may be experienced by an insured in any denial situation.

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[7] 838 P.2d 1265 (Ariz. 1992).

[8] *Id*. at 1269.

The Supreme Court of South Carolina relied in part on *Deese* in holding that breach of contract is not a predicate to a bad faith claim. In *Tadlock Painting Co. v. Maryland Casualty Co.,*[9] Tadlock operated an industrial painting company and was insured under a general liability policy issued by Maryland Casualty Company ("Maryland"). During one of its operations, overspray landed on dozens of cars. Claims were made against Tadlock for the damage caused by the overspray. Those claims were tendered to Maryland which initially agreed to attempt to settle the claims but reserved the right to apply a deductible against each payment made to a claimant.[10] Tadlock objected, and Maryland withdrew from all settlement efforts. Tadlock proceeded to settle all the claims on its own and brought a bad faith suit against Maryland.[11]

Maryland argued that the bad faith claim must fail absent a breach of an express contract provision. The Supreme Court of South Carolina disagreed, ruling that the benefits due an insured are not limited solely by those expressly set out in the contract but also include the obligation to deal with the insured fairly and in good faith.[12] It allowed the claim to proceed despite the fact that all the settlements were for amounts under the deductible. The court noted that "whether [the] insurer is liable for bad faith must be determined by the evidence before it at the time it denied the claim; evidence arising after denial [is] irrelevant to propriety of insurer's conduct at the time of refusal."[13]

There is similar precedent in Ohio, where courts have found that "the tort of bad faith is an independent claim which does not necessarily rely on a breach of contract claim for its existence."[14] Bad faith may "be asserted 'when an insurer breaches its duty of good faith by intentionally refusing to satisfy an insured's claim where there is either (1) no lawful basis for the refusal coupled with actual knowledge of that fact; or (2) an intentional failure to determine whether there was any lawful basis for such refusal.'"[15] Under this second basis for liability, the policyholder need only establish that the insurer intentionally failed to determine whether its denial of coverage had a valid basis.[16]

Arguably analogous to an insurer's failure to determine a valid basis for denial is where an insurer fails to rely on a valid defense to coverage. In *Vining v. Enterprise Financial Group, Inc.,*[17] the court ruled that under Oklahoma law "a plaintiff may bring a bad faith

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[9] 473 S.E.2d 52 (S.C. 1996).

[10] *Id. at 53.*

[11] *Id.*

[12] *Id*. at 54.

[13] *Id*. at 55 (citing Howard v. State Farm Mut. Auto. Ins. Co., 450 S.E.2d 582 (1994)).

[14] Bullet Trucking, Inc. v. Glens Falls Ins. Co., 616 N.E.2d 1123, 1127 (Ohio Ct. App. 1992).

[15] *Id*. (citing *Motorists Mut. Ins. Co. v. Said*, 590 N.E.2d 1228-36 (Ohio 1992)).

[16] *Id*.; *see also* Poneris v. Pa. Life Ins. Co., 2007 WL 3047232 (S.D. Ohio 2007); Essad v. Cincinnati Cas. Co., 2002 WL 924439 (Ohio Ct. App. 2002); *but see* Hahn's Electric Co. v. Hartford Cas. Co., 2002 Ohio App. LEXIS 5031 at 24 (Ohio Ct. App. 2002).

[17] 148 F.3d 1206 (10th Cir. 1998).

cause of action even though a legitimate defense to a breach of contract claim exists if the defendant did not actually rely on that defense to deny payment under the policy."[18] The plaintiff in *Vining* demonstrated that the insurer had a deliberate, systematic practice of rescinding life insurance policies as soon as claims were made. The court found that such evidence constituted bad faith regardless of whether the insurer could have relied on a coverage defense because in fact the insurer did not expressly contest coverage on that basis.[19]

b. Voluntary Assumption of the Defense

Where an insurer voluntarily assumes the insured's defense (i.e., a defense is provided gratuitously) but mishandles the case and causes harm to the insured, some courts have held the insured can pursue a bad faith claim even though the insurer did not have a duty to defend in the first place. The reasoning in these cases is that once the insurer assumes the insured's defense, the covenant of good faith and fair dealing requires the insured to act reasonably and not leave the insured in a worse position than it would have been had the insurer not defended the case at all.

A good example of the reasoning behind this line of cases is *Delmonte v. State Farm Fire & Casualty Co.*[20] In *Delmonte*, the Supreme Court of Hawaii held that a carrier had a duty to conduct a defense in good faith even though there was no actual duty to defend. Specifically, the court held, once an insurer assumes the defense of its insured, it is obligated to not mishandle the defense; it must even pay for the costs of an appeal where reasonable grounds for the appeal exist. In an earlier third-party bad faith case, the Hawaii Supreme court explained that breach of the express covenant to pay claims is not the *sine qua non* for an action for bad faith: "The implied covenant is breached, whether the carrier pays the claim or not, when its conduct damages the very protection or security which the insured sought to gain by buying insurance."[21]

Another case providing additional insight into the courts' reasoning in these third-party cases is *Lloyd v. State Farm Mutual Automobile Insurance Co.*[22] In *Lloyd*, the insured purchased a personal auto policy from State Farm. The insured did not obtain coverage for a go-cart, which it also owned. Apparently, the insured knew the go-cart was uninsurable. A third-party brought suit against the insured after being struck by the go-cart. The insured failed to respond to the complaint and the third-party filed an application for default. The application for default was sent to the insured and State Farm. The insured testified that upon receiving a copy of the application for default he called the claims department and was told State Farm would "take care of it."

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[18] *Id*. at 1213.

[19] *Id*.

[20] 975 P.2d 1159 (Haw. 1999).

[21] Best Place, Inc. v. Penn Am. Ins. Co., 920 P.2d 334 (Haw. 1996) (internal citations omitted).

[22] 943 P.2d 729 (Ariz. App. 1996).

After a default was entered against the insured for $10 million, State Farm hired defense counsel to represent the insured. Defense counsel filed an answer and a motion to set aside the default. Soon thereafter, State Farm sent the insured a reservation of rights letter. In addition to reserving the right to deny coverage, the letter also stated State Farm would begin its investigation into whether coverage existed and warned of the possibility of a judgment in excess of limits.

During State Farm's investigation, the third party made a settlement demand for policy limits of $50,000, which State Farm rejected two days prior to the offer's expiration. At the same time it rejected the settlement, State Farm sent a letter to the insured advising there was no coverage under the policy, that it was withdrawing from the defense, and that the insured should obtain its own counsel. The insured received State Farm's letter after the expiration of the $50,000 settlement demand and, unfortunately for the insured, the court denied its motion to set aside the default.

In the ensuing coverage action, State Farm maintained that it could not be liable for the assumption of a duty to defend in the absence of an insurance policy covering the accident. The trial court granted summary judgment for State Farm. The appellate court reversed. While the court recognized that an insurer need not defend when the complaint does not trigger a duty to defend, it held a carrier could be held liable for bad faith in the absence of coverage:

> [State Farm's] assumption [of the defense] was "gratuitous" because, as it turns out, the policy does not cover the accident. The fact that State Farm gratuitously assumed the defense does not mean that the duty to defend is unconnected to the policy. Rather, that term was used because under the circumstances the policy itself did not require State Farm to assume the defense.
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> The core of the duty of good faith and fair dealing is that the insurer act reasonably towards its insured. We grant that security from financial loss is a primary goal motivating the purchase of insurance. That security flows from the express covenants of the insurance agreement. However, the insured also is entitled to receive the additional security of knowing that she will be dealt with fairly and in good faith. That security comes not from the express contractual terms, but from the implied covenant of good faith and fair dealing.[23]

The *Lloyd* court's reference to State Farm's "gratuitous assumption" of the insured's defense is similar to another line of cases that holds an insured can pursue a bad faith action in the absence of coverage when the insurer is estopped from denying coverage.[24]

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[23] *Id*. at 736 (emphasis in original).

[24] *See* section I.B. below.

c. Violation of Statutes or Regulations as a Basis for Extra-Contractual Liability

All states have enacted some form of unfair insurance practices laws. These laws are typically enforced by the state insurance commissioners. However, some states allow for a private right of action.[25] The conditions and limitations on recovery vary by state, but some states afford the right to recover for statutory violations even where there is no coverage for the claim at issue.

For example, in *St. Paul Fire and Marine Ins. Co. v. Onvia, Inc.,*[26] the Supreme Court of Washington addressed a certified question from the United States District Court for the Western District of Washington regarding whether an insured, absent any coverage obligation, has a bad faith cause of action against its liability insurer for violation of the Washington Administrative Code or the Washington Consumer Protection Act (CPA). The underlying claim involved a class action against the insured for "fax blasting" in violation of state law. The action was tendered to the insured's liability carrier. The insurer did not respond to the notice of claim until nine months later, denying coverage and a defense. The insured defended itself and eventually agreed to a stipulated judgment and assignment of insurance rights to the plaintiff with a covenant not to execute against the insured.

In the ensuing coverage action, the federal district court granted the insurer's motion for partial summary judgment on all coverage issues.[27] The court certified the remaining claims for common law procedural bad faith for violation of the CPA to the Washington Supreme Court. The Supreme Court first noted that under Washington law in the third-party insurance context, an insurer can be held liable for bad faith even in the absence of a covered claim.[28] It found that, under Washington law, "every insurer has a duty to act promptly, in both communication and investigation, in response to a claim or tender of defense. [citing various Washington statutes].[29] The court concluded that the insurer's failure to promptly respond could form the basis of a bad faith claim, because the duty to promptly investigate and respond to claims is read into every contract of insurance.[30]

For more information on state consumer protection laws, various helpful resources exist.[31]

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[25] *See* Ostrager & Newman, Handbook on Insurance Coverage Disputes (Aspen Publishers, Inc., 16th ed. 2013) at §12.02[c], p. 1044-46.

[26] 196 P.3d 664 (Wash. 2008),

[27] *Id*. at 667.

[28] *Id*. at 668 (citing Kirk v. Mt. Airy Ins. Co., 951 P.2d 1124 (Wash. 1998).

[29] *Id*.

[30] *Id*. at 669.

[31] *See* PropertyCasualty360*, Claims-Handling Guidelines, available at* http://www.propertycasualty360.com/pages/claims-guidelines.php; Carolyn L. Carter, Consumer Protection In The United States, A 50-State Report on Unfair and Deceptive Acts and Practices Statutes, 2009 National Consumer Law Center, Inc., http://www.nclc.org/images.pdf.udap/report_50_states.pdf.

B. *Waiver as a Basis for Liability Absent Coverage*

Courts have also held an insurer can effectively waive its right to a coverage defense when the insurer is found to have failed to raise or rely upon a coverage defense. Some commentators suggest these cases provide insureds with at least a basis to argue that an insured can pursue extra-contractual recovery despite there being no coverage by virtue of the insurer's waiver. The typical elements of waiver are (1) the existence at the time of the waiver of a right, privilege, advantage, or benefit which may be waived; (2) the actual or constructive knowledge of the rights; and (3) the intention to relinquish the right.

For example, in the first-party context, a Florida court in *Johnson v. Life Insurance Co. of Georgia,*[32] held that an insurer waived its coverage defense by acting inconsistently with that defense.[33] The court found the insurer's acceptance of premium with constructive knowledge of the coverage defense constituted a waiver.[34] Generally, however, constructive knowledge is insufficient to support waiver.[35]

Waiver may also be found in the third-party context where the insurer fails to effectively reserve its rights when undertaking the defense of its insured. In *World Harvest Church, Inc. v. GuideOne Mutual Insurance Co.,*[36] two individuals set up a Ponzi scheme involving an automobile title lending business. One million dollars from the scheme was donated to the World Harvest Church.[37] An SEC investigation of the church donations revealed the source and brought a civil enforcement action to recover these funds from the church.[38] The church tendered the defense of this case to GuideOne, the church's commercial general liability insurer.[39] An affiliate of GuideOne responded with a written reservation of rights letter and eventually denied coverage.[40]

After the original enforcement action was dismissed for lack of personal jurisdiction, a second enforcement action was brought against the church in its home state of Georgia. The church again sought a defense from GuideOne. GuideOne assumed the defense without issuing a reservation of rights but later denied coverage and withdrew the defense. The church undertook to defend itself, and the court entered summary judgment against the church. The case settled for one million dollars, and the church brought suit against GuideOne for breach of the duties to defend and indemnify. The trial court rejected the church's argument that

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[32] 52 So. 2d 813 (Fla. 1951).

[33] *Id*. at 815.

[34] *Id*. at 815-16.

[35] *See*, *e.g.*, United Servs. Auto. Ass'n v. Clarke, 757 So. 2d 554, 556 (Fla. Dist. Ct. App. 2000) (holding no waiver when there was no "deliberate disregard of information for information" by the insurer).

[36] 695 S.E.2d 6, 8 (Ga. 2010).

[37] *Id.*

[38] *Id.*

[39] *Id.*

[40] *Id.*

GuideOne's failure to issue a reservation of rights estopped it from denying coverage; the court entered summary judgment for GuideOne, finding the church was not prejudiced by GuideOne's defense of the action and later withdrawal.

On appeal, the Eleventh Circuit certified three questions to the Georgia Supreme Court:

(1) Does an insurer effectively reserve its right to deny coverage if it informs the insured that it does "not see coverage," after the insured had received a written reservation of rights from the insurer's sister company in a similar lawsuit in another jurisdiction, or is a written or more unequivocal reservation of rights required?

(2) When an insurer assumes and conducts an initial defense without notifying the insured that it is doing so with a reservation of rights, is the insurer estopped from asserting the defense of noncoverage only if the insured can show prejudice, or is prejudice conclusively presumed?

(3) If the insured must show prejudice, do the facts and circumstances of this case show it?[41]

As to the first point, the Georgia Supreme Court held that a written reservation is not required so long as an insurer fairly informs the policyholder of the insurer's position. The court found that GuideOne's statement that "it did not see coverage" did not satisfy the requirement that the specific basis for reservations be provided to the insured.[42] The court also found that the prior reservation of rights letter was not sufficient since it referred to a predecessor policy.[43]

The Supreme Court then held that, when an insurer undertakes to defend its insured without issuing a reservation of rights, prejudice is conclusively presumed, and "the insurer is deemed estopped from asserting the defense of noncoverage regardless of whether the insured can show prejudice."[44] Consequently, GuideOne was held liable for the church's losses despite the fact that the claim was not covered.[45]

Similarly, the Missouri Supreme Court in *Brown v. State Farm Mutual Automobile Insurance Co.,*[46] announced that "[i]t is the insurer's unequivocal conduct, knowingly contrary to the claim provisions of its contract, that betrays the insurer's purpose to relinquish its right

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[41] 695 S.E.2d at 9.

[42] *Id*. at 10.

[43] *Id*. at 11.

[44] *Id*. at 12.

[45] *Id.; see also* Hoover v. Maxum Indem. Co., 730 S.E.2d 413, 418 (Ga. 2012) (insurer waived the late notice defense by its outright denial of the claim).

[46] 776 S.W.2d 384, 387 (Mo. 1989).

to rely on the contractual language."[47] The court was careful to note that "the insurer must first announce a specific defense and subsequently seek to rely instead on an inconsistent theory."[48] Only where the announcement of a specific defense to coverage "lulls the insured into relying to his detriment and subsequent injury" on the stated position is estoppel an issue.[49]

C. *Estoppel as a Basis for Liability Absent Coverage*

While the doctrines of waiver and estoppel are similar in that they bar the insurer from asserting a defense, they nonetheless differ. The rule of estoppel as relates to insurance contracts arises from the inequity resulting from an insured's *detrimental reliance* on an insurer's superior knowledge in purchasing a policy of insurance, which deprives him of the opportunity to purchase desired coverage elsewhere. On the other hand, waiver is commonly described as the voluntary or intentional surrender of a known right, or, at least, conduct which demonstrates an inference of such relinquishment.

Numerous states have held that an insurer can be estopped from asserting an otherwise valid defense if it defends without notifying the insured of a reservation of rights. The Washington Supreme Court, for example, has held that a bad faith action could be maintained in the first-party context under an estoppel theory even when coverage was ultimately found to be non-existent. In *Coventry Assoc. v. American States Insurance Co.,*[50] the insurer denied coverage after performing a brief and admittedly inadequate investigation. While the insured was building the apartment complex, a retaining wall collapsed, damaging the property.[51] After the insured submitted its claim, the insurer's adjuster briefly investigated the site. The adjuster only looked at two of the six forms comprising the insured's policy and denied coverage because the policy contained an exclusion for damage to the retaining wall.[52]

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[47] *Id.*

[48] *Id*. at 388.

[49] *Id*. at 389; *see also* U.S. Fidelity & Guar. Co. v. Cntry. Club*,* 458 S.E.2d 734 (N.C. Ct. App. 1995) (Despite the existence of a liquor exclusion that barred the claim, coverage may be found by the doctrines of waiver and estoppel where the insurer knew that its insured provided alcohol to guests); *but see* Ulico Cas. Co. v. Allied Pilots Assn., 262 S.W.3d 773 (Tx. 2008) ("[T]here is no 'right' of noncoverage that is subject to being waived by the insurer, even by assumption of the insured's defense with knowledge of facts indicating noncoverage and without obtaining a valid reservation of rights or non-waiver agreement.); Wisconsin in Maxwell v. Hartford Union High School Dist., 814 N.W.2d 484 (Wis. 2012) (An insurer which defends without reserving the right to deny coverage has not waived its ability to rely on coverage clauses in the policy allowing for such a denial).

[50] 961 P.2d 933 (Wash. 1998).

[51] *Id*. at 934.

[52] *Id.*

In a rare turn of events, the insurer admitted that this investigation was in bad faith, but argued the insured had suffered no harm because it was not entitled to coverage in the first place. The court disagreed, pointing out that an insurer owes a duty of good faith that is separate from its contractual obligations.[53] The court found that the insurer forced its insured to hire experts and investigators to determine whether it should have covered the claim, thus committing an unfair trade practice and denying the insured the full benefit of its insurance contract. It concluded that a bad faith action is permissible against an insurer regardless of whether the insurer was ultimately correct in determining the absence of coverage.[54]

Courts in Ohio have likewise applied the doctrines of waiver and estoppel to extend liability for a claim not otherwise covered in certain situations. In *Turner Liquidating Co. v. St. Paul Surplus Lines Insurance Co.,*[55] the insurer agreed to defend the insured under a policy providing coverage for products liability claims. Approximately a year later, the insurer withdrew the defense.[56] The insured initiated a suit claiming that the insurer was estopped from denying coverage as no reservation of rights was ever made.

The appellate court surveyed the law of waiver and estoppel in the insurance context and noted that, while the general rule might be that coverage cannot be created by waiver or estoppel, there are a number of exceptions. It found that estoppel may be appropriate where an insurer's misrepresentation made at the policy's inception prevented the insured from procuring the desired coverage.[57] The court further concluded that, in cases in which the insurer represents the insured without a reservation of rights, the insured may be prejudiced by the legal strategy adopted by the insurer.[58] It held that "[p]roviding a defense for nearly one year without reserving its rights may give rise to a claim of estoppel preventing St. Paul from raising the lack of coverage in this case."[59]

The Illinois Supreme Court went so far as to establish a protocol for insurers to avoid a finding of coverage by estoppel. In *Employers Insurance of Wausau v. EHLCO Liquidating Trust,*[60] the court restated the general rule that:

> an insurer which takes the position that a complaint potentially alleging coverage is not covered under a policy that includes a duty to defend may not simply refuse to defend the insured. Rather, the insurer has two options: (1) defend the suit under a reservation of rights; or (2) seek a declaratory judgment that there is no coverage.

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[53] *Id.* at 937-938.

[54] *Id*.

[55] 638 N.E.2d 174 (Ohio Ct. App. 1994).

[56] *Id*. at 179.

[57] *Id.*

[58] *Id*.

[59] *Id*. at 180.

[60] 708 N.E.2d 1122 (Ill. 1999).

> If the insurer fails to take either of these steps and is later found to have wrongfully denied coverage, the insurer is estopped from raising policy defenses to coverage.[61]

The Illinois Supreme Court went on to note that estoppel does not apply where there was no duty to defend in the first instance.[62]

D. *Summary*

Many courts continue to link coverage with the viability of any bad faith or extra-contractual claim; however, a number of recent decisions have weakened this "general rule" in the context of adjusting, investigating or handling claims. These decisions either separate the obligations related to the response and handling of a claim from the duty to indemnify or rely on the doctrines of waiver or estoppel to impose liability absent coverage. Some state legislatures have also imposed claim handling obligations on insurers that may be used by policyholders as a basis of extra-contractual liability against insurers. But insurers are not alone. Adjusters, agents and brokers may also have reason for concern as Part II explores.

III.
Agent and Broker Liability in the Absence of Coverage

A. *General Rule Concerning Bad Faith Claims Against the Agent or Broker*

1. Defining Terms

As an initial matter, the terms "agent" and "broker" are often used interchangeably and sometimes incorrectly by courts. Insurance brokers are generally independent contractors who procure insurance on behalf of insureds.[63] While a broker is typically considered the agent of an insured, a broker could be an agent for an insurer for certain purposes.[64] A broker can be an agent for an insurer if the insurer gives the broker the authority to act on its behalf or if there are acts from which a broker's authority to represent the insurer may be fairly inferred.[65] In other words, a broker can in some circumstances be a dual agent for both an insurer and an insured.[66]

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[61] *Id*. at 1134-35.

[62] *Id*. at 1135.

[63] *See, e.g.,* Secura Ins. Co. v. Saunders, 227 F.3d 1077, 1080 (8th Cir. 2000); *see also* Alverson v. Am. Nat. Ins. Co., 30 F. App'x 491, 496 (6th Cir. 2002).

[64] 227 F.3d *at* 1080.

[65] *Id*.

[66] *See, e.g.,* Nat'l Prop. Owners Ins. Co. v. Wells, 304 S.E.2d 458, 459 (Ga. Ct. App. 1983).

In contrast, individuals generally described as "agents" generally work for an insurer and not for an insured. An agent could be an employee of an insurer, or could simply be someone who writes insurance policies on behalf of an insurer.[67] Independent claims adjusters are generally considered agents of an insurer.

2. Liability of Adjusters, Agents and Brokers Generally

Brokers and agents can face liability under any number of theories including, but not limited to, failure to procure insurance, negligent misrepresentation, and fraud.[68]

a. Failure to Procure Insurance

Brokers and agents are liable to insureds if they negligently fail to procure insurance.[69]

b. Advice Regarding the Amount of Coverage

While brokers and agents do not have a general duty to advise customers about their particular insurance needs or the types and amounts of coverage that may be available and do not have an obligation to explain policies, brokers and agents do have a duty to obtain the coverage that an individual requests.[70] If insurance coverage is not available, an agent or broker must provide an explanation.[71]

c. Liability to Insurer for an Unauthorized Extension of Coverage

An agent or broker is liable for negligently failing to procure insurance, and an agent is liable to an insurer for an unauthorized extension of coverage.[72] Because an insurer, as a principal, can be bound by an agent's act,[73] an insurer can have a cause of action against an agent who extends coverage to an insured without authorization.

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[67] *See, e.g.,* Benner v. Farm Bureau Mut. Ins. Co., 528 P.2d 193, 195 (Idaho 1974).

[68] *See*, *e.g.*, Liberty Surplus Ins. Corp., Inc. v. First Indem. Ins. Servs., Inc., 31 So. 3d 852, 857 (Fla. Dist. Ct. App. 2010) (holding that broker could be liable to insurer under negligent misrepresentation theory); Flamme v. Wolf Ins. Agency, 476 N.W.2d 802, 807 (Neb. 1991) (stating that it is well established that brokers or agents can be liable to insureds under negligent misrepresentation); Von Hoffmann v. Prudential Ins. Co. of Am., 202 F. Supp. 2d 252, 263 (S.D.N.Y. 2002) (holding that it was appropriate for insured to bring fraud claim against insurance broker).

[69] *See generally Liability of Insurance Broker or Agent to Insured for Failure to Procure Insurance*, 64 A.L.R.3d 398 (1975).

[70] Busey Truck Equip., Inc. v. Am. Family Mut. Ins. Co., 299 S.W.3d 735, 738-39 (Mo. Ct. App. 2009).

[71] Haynes v. Edgerson, 240 S.W.3d 189, 195 (Mo. Ct. App. 2007).

[72] *See, e.g.*, Benner v. Farm Bureau Mut. Ins. Co., 528 P.2d 193, 195 (Idaho 1974).

[73] *See* Mfrs. Cas. Ins. Co. v. Martin-Lebreton Ins. Agency, 242 F.2d 951 (5th Cir. 1957); Restatement of Agency, § 401.

d. Failure to Properly Adjust the Claim

There is currently a split of authority as to whether it is permissible for insureds to sue independent adjusters for the improper adjustment of a claim. In *Charleston Dry Cleaners & Laundry, Inc. v. Zurich Am. Ins. Co.,*[74] the court explained that the majority of jurisdictions do not permit an insured to sue an independent adjuster for negligence because there is no relationship between an adjuster and an insured, and thus no duty to use due care.[75] These courts recognize imposing a legal duty on independent adjusters to insureds would "thrust the adjuster into what could be an irreconcilable conflict between such duty and the adjuster's contractual duty to follow the instructions of its client, the insurer."[76]

Those jurisdictions permitting negligence claims an against insurance company's agents point out that there is a foreseeability of harm to insureds if a claim is not properly adjusted.[77] In *Morvay*, independent insurance investigators were hired by an insurance company to investigate a plaintiffs' claim after a fire damaged their home.[78] Although the court recognized that the independent investigators were not in privity with the plaintiffs, the court reasoned that the investigators were fully aware that the plaintiffs could be harmed financially if they performed their investigation in a negligent manner and rendered a report to insurer that would cause the company to refuse payment to the plaintiffs.[79] The court held that the plaintiffs stated a cause of action in negligence against the independent insurance investigators.[80]

e. Liability for Bad Faith

Regardless of the existence of coverage, the general rule is that insurance agents cannot be liable for bad faith damages to third parties as there is no contract between the agent and the third party, and the duty of good faith and fair dealing arises out of contract. Similarly,

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[74] 586 S.E.2d 586, 588 (2003).

[75] *See* Meineke v. GAB Bus. Servs., Inc., 991 P.2d 267 (Ariz. Ct. App.1999); Sanchez v. Lindsey Morden Claims Servs., Inc., 84 Cal. Rptr. 2d 799 (Cal. Ct. App. 1999); King v. Nat'l Sec. Fire and Cas. Co., 656 So.2d 1338 (Fla. Dist. Ct. App. 1995); Velastequi v. Exch. Ins. Co., 132 Misc.2d 896, 505 N.Y.S.2d 779 (N.Y.City Civ.Ct. 1986); Dear v. Scottsdale Ins. Co., 947 S.W.2d 908 (Tex. Ct. App. 1997); *see also* Troxell v. Am. States Ins. Co., 596 N.E.2d 921, 925 n. 1 (Ind.Ct.App. 1992); Wolverton v. Bullock, 35 F. Supp. 2d 1278 (D. Kan. 1998); Grossman v. Homesite Ins. Co., No. FSTCV075004413S, 2009 WL 2357978 (Conn. Super. Ct. 2009).

[76] GAB Business Services, Inc., 991 P.2d at 271.

[77] *See, e.g.*, Morvay v. Hanover Ins. Cos., 506 A.2d 333 (N.H. 1986).

[78] *Id*. at 334.

[79] *Id*. at 335.

[80] *Id.; see also* Continental Ins. Co. v. Bayless & Roberts, Inc., 608 P.2d 281 (Alaska 1980); Brown v. State Farm Fire and Cas. Co., 58 P.3d 217 (Okla. Ct. App.2002); Bass v. Cal. Life Ins. Co., 581 So.2d 1087 (Miss. 1991) (allowing claim for gross negligence).

insurance brokers who procure insurance on behalf of insureds are not liable to an insured for an insurer's bad faith; rather, they are only liable if they act in bad faith in their dealings with an insured. Accordingly, bad faith damages are only generally recoverable from an insurer. This rule applies to agents, brokers and independent adjusters.

(1) Insurance Agents

The general rule that agents cannot be held liable for bad faith is exemplified in *Butler v. Nationwide Mut. Ins. Co.*[81] In *Butler*, the defendant agent was described as a "career agent" who exclusively wrote insurance policies on behalf of Nationwide for a specific geographic region in Mississippi. The plaintiff attempted to assert a bad faith claim against both the agent and Nationwide. In dismissing the claim against the agent, the court explained that the agent was not party to the insurance contract and therefore could not be "sued for bad faith refusal to pay nor [could he] be subjected to an implied duty of good faith and fair dealing."[82]

Courts outside of Mississippi have followed the rationale in *Butler* and have refused to extend bad faith liability to agents because agents are not parties to the insurance contract between the insurer and the insured.[83]

(2) Insurance Brokers

An insurance broker, like an agent, is not liable for an insurer's bad faith in handling a claim.[84] Like an agent, a broker is not a party to the insurance contract between the insurer and the insured.[85] However, a bad faith claim against an insurance broker could be viable if there is evidence that a broker had itself committed bad faith in its dealings with an in-

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[81] 712 F. Supp. 528, 529 (S.D. Miss. 1989).

[82] *Id*. (citing Griffin v. Ware, 457 So. 2d 936 (Miss. 1984)).

[83] *See*, *e.g.*, United Adjustment Servs., Inc., v. Prof. Insurors Agency, LLC, 307 P. 3d 400, 405 (Okla. Ct. Civ. App 2013) (stating that Oklahoma law is clear that an insured cannot bring a bad faith claim against an independent insurance agency or its agents because they are not parties to the insurance contract); Gruenberg v. Aetna Ins. Co., 510 P.2d 1032, 1039 (Cal. 1973) (holding that agents of an insurer cannot be held liable for bad faith because they are not parties to the insurance contract); Goins v. Stewart, No. 08CA002, 2008 WL 3856297, *6 (Ohio Ct. App. 2008) (affirming summary judgment granted to insurance agent for bad faith damages when insurer allegedly acted in bad faith, but noting that "an agent can be liable for the agent's own bad faith"); McNeil v. Currie, 830 P.2d 1241, 1245 (1992) (holding that independent insurance agent could not be held liable in tort for bad faith to purchaser of insurance). *See also* Griggs v. State Farm Lloyds, 181 F.3d 694, 700 (5th Cir. 1999) (holding that an insurance agent not in a contractual relationship with an insured cannot be liable to the insured for breach of contract); J. Smith Lanier & Co. v. SE Forge, Inc., 280 Ga. 508, 510 (Ga. 2006) (stating that under Georgia insurance code bad faith claims are only available between insureds and insurers).

[84] *See*, *e.g.*, Mark Patterson, Inc. v. R.M. Stephens & Co., Inc., 232 A.D.2d 178, 179, 647 N.Y.S.2d 760, 761 (N.Y. App. Div. 1996).

[85] *See id*.

sured.[86] For instance in *Tiara*, the court affirmed summary judgment to a broker on a bad faith claim not because the broker was not an insurer, but because there was no evidence that the broker itself had acted in bad faith or had committed intentional misconduct.[87] In those circumstances, the bad faith claim would presumably arise out of the interaction between the broker and the insured, and not out of the insurance contract between the insurer and the inured.[88]

(3) Insurance Adjusters

The general rule that agents cannot be held liable for the bad faith of insurers has been applied in a claim brought by an insured against an independent claims adjuster.[89] In *Natividad*, the plaintiff was injured twice during the scope of her employment.[90] She eventually filed suit for breach of duty of good faith and fair dealing against her employer, the workers' compensation carrier and an independent claims adjuster. The plaintiff settled her claims against all parties except for the independent claims adjuster.[91] The trial court granted summary judgment to the adjuster. This decision was reversed on appeal by an intermediate appellate court.[92] On appeal to the Texas Supreme Court, the court reversed the lower court's decision and held that summary judgment was appropriate to the claims adjuster because there was no relationship between the adjuster and the plaintiff, and thus no duty of good faith and fair dealing.[93] The court explained that the duty of good faith and fair dealing arises out of contract, which gives rises to a special relationship between the contracting parties. Because there was no contract between the adjuster and the plaintiff, there was no special relationship, and thus the adjuster had no duty to the plaintiff handle the claim with good faith.[94]

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[86] *E.g.*, Tiara Condo. Ass'n, Inc. v. Marsh & McLennan Cos., Inc., 607 F.3d 742, 747 (11th Cir. 2010) *certified question answered*, 110 So.3d 399 (Fla. 2013) (granting summary judgment to insurance broker on claim for breach of implied covenant of good faith and fair dealing on the basis that there was no evidence that broker had intentionally or in bad faith committed errors).

[87] *Id.*

[88] *Id.*

[89] *See*, *e.g.*, Natividad v. Alexsis, Inc., 875 S.W.2d 695, 698 (Tex. 1994).

[90] *Id*. at 696.

[91] *Id*.

[92] 833 S.W.2d 545.

[93] *Id.* at 697-98.

[94] *Id.* at 698.

Case law regarding the independent adjuster's liability to insurers is scarce.[95] One reason may be that damages to an insurer could be speculative in the context of bad faith claims handling. To find an agent a legal cause of an insurer's damages in the context of bad faith, a jury would have to speculate that had the insurer not settled an underlying claims in excess of policy limits, the claimants would have recovered judgments in excess of policy limits and the insurer's insureds would have successfully sued it for bad faith.[96] Consequently, an agent's liability to insurers arising out of bad faith could be limited to situations where an insured has suffered an excess verdict.[97]

Finally, the general rule that the majority of states follow makes sense simply because, in the context of bad faith, an insurer, as principal, is liable for the acts of its agents.[98] Thus, in the event of bad faith claims adjusting, an insured has a remedy – it can sue an insurer who will be liable for the acts of its agents.[99]

B. *Exceptions Permitting Claims for Bad Faith or Breach of Fiduciary Duty*

1. Breach of Duty to Insureds

In Colorado, independent adjusting agents have a duty of good faith and fair dealing to claimants, even though the agent is not a party to an insurance contract.[100] In *Johnson*, the court considered whether an independent adjusting service to a self-insured employer had a duty of good faith and fair dealing to workers' compensation claimants. While the court pointed out that there was a lack of privity between the independent adjuster and claimants, the court was concerned that without an obligation to deal in good faith and fairly, claims adjusting services could create obstacles to payment of claims.[101] The importance of speedy payment of claims in the workers' compensation system was also important to the court.[102]

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[95] N.H. Indem. Co. v. Prof'l Claim Servs, Inc., No. D051230, 2008 WL 5115084 (Cal. Ct. App. 2008) ("There is a dearth of legal authority pertaining to an insurer's claim against an independent adjuster for damages.").

[96] *Id*.

[97] *See, e.g.*, Crawford & Co., 890 So.2d at 1188-89.

[98] *See generally* Charleston Dry Cleaners & Laundry, Inc. v. Zurich Am. Ins. Co., 586 S.E.2d 586, 589 (S.C. 2003).

[99] *Id*.

[100] Scott Wetzel Servs., Inc. v. Johnson, 821 P.2d 804, 812 (Colo. 1991).

[101] *Id*. at 812-13.

[102] *Id.*

[103] *See, e.g.*, Taylor v. Nationwide Mut. Ins. Co., 589 S.E.2d 55, 61 (W. Va. 2003); Blanchard v. State Farm Lloyds, 206 F. Supp. 2d 840, 846 (S.D. Tex. 2001).

Other states have employed consumer protection laws to impose liability upon adjusters.[103] For instance, in *Taylor*, the court held that a plaintiff could sue an adjuster and an insurance company under a West Virginia consumer protection law that provided for a private cause of action against persons who commit unfair trade practices.[104] Similarly, in *Blanchard*, an insurance adjuster was sued under a Texas statute governing claims handling.[105]

2. Breach of Duty to Insurers

Some cases have found that independent adjusters can be sued by insurers for claims arising out of bad faith. That was precisely what occurred in *Home Ins. Co. v. Crawford & Co*.[106] In *Home*, an insurer sued an independent adjuster on the grounds of breach of fiduciary duty and breach of contract because the adjuster's actions resulted in a lost opportunity to more favorably settle a third party suit against an insured. While the court affirmed a directed verdict for the adjuster on the breach of fiduciary duty count, the court held that an insurer's damages against an independent adjuster for the lost opportunity to more favorably settle a third party suit against the insured were not speculative, although the insured had suffered a judgment substantially in excess of its deductible.[107]

C. *Summary*

The "general rule" that there is no extra-contractual liability absent coverage appears much stronger for agents and brokers than for insurers. However, there remains a limited number of circumstances, primarily involving adjusters, that could give rise to extra-contractual liability. These claims typically involve the adjusting and handling of claims where courts are concerned with the prompt and fair disposition of claims.

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[104] *Id*. at 589 S.E.2d at 62 (2003).

[105] *Id.*

[106] 890 So.2d 1186 (Fla. Dist. Ct. App. 2005) *abrogated on other grounds by* Westgate Miami Beach, Ltd. v. Newport Operating Corp., 55 So. 3d 567 (Fla. 2010).

[107] *Id*. at 1188-89.

Satisfying a Self-Insured Retention or Deductible in a Third Party Claim

Thomas R. Newman

When a commercial policyholder assesses its risks in protecting against third-party claims, it will often determine that it is not financially advantageous or necessary for it to purchase liability insurance in an amount large enough to cover its entire potential exposure. It may elect to retain some portion of the risk and "self-insure" for a fixed dollar amount, purchasing liability insurance that attaches only above that amount. The amount of the exposure retained by the policyholder and not covered by the purchased insurance policy may be a "deductible" or a "self-insured retention" ("SIR"), also referred to as the "retained limit."

This article discusses the differences between a "deductible" and a "SIR" and considers why policyholders may choose one instead of the other, even if the dollar amount may be the same. Next, the article looks at whether an SIR may be satisfied by "other insurance" that provides coverage to the policyholder, either as the named insured or as an additional insured. Finally, the article addresses how a deductible may be satisfied and whether defense costs may erode the SIR.

The difference between an SIR and a deductible

An SIR is not a deductible. A deductible is that portion of the damages which the policyholder must pay before the policy's indemnity coverage attaches. Unless otherwise agreed,[1] a deductible, regardless of amount, does not pertain to defense costs; even when the policy contains a deductible, the insurer must pay the defense costs if there is a potentially

[1] *See*, *e.g.*, Northbrook Ins. Co. v. Kuljian Corp., 690 F.2d 368, 370 (3d Cir. 1982) ("The deductible amount stated in the Declarations shall be applicable to each single claim and shall include loss payments and claims expenses, whether or not loss payment is made").

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covered claim. The trade-off is that the insurer gets to control the investigation of the claim and defense of the suit, including the selection of defense counsel.

However, in those cases in which indemnity is owed, the amount of the deductible will be subtracted from the policy limits, thereby reducing the available coverage.[2] When the coverage is written above an SIR, the insured generally assumes responsibility for handling the claims and paying the defense costs. Once the retention has been satisfied, the full insurance policy limits will be available to pay a judgment or settlement. A policy may contain both, with a deductible to be satisfied after exhaustion of an SIR[3] or, in a tower of coverage, the primary policy may have a deductible while one of the excess policies may have an SIR. Policyholders may choose to purchase coverage excess of an SIR where they believe that they are better equipped than the insurer to handle the defense of claims. This approach may be more economical for the policyholder, since the insurer can be expected to build the cost of defense into its premium. Generally, it is large companies, sophisticated in risk management and claims handling, that will purchase coverage above an SIR because, until the SIR is exhausted, the policyholder will be responsible for the investigation, defense, settlement and payment of claims. The policyholder may do this on its own or it may retain the services of an independent adjusting firm.

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[2] *See*, 2 Barry R. Ostrager & Thomas R. Newman, Handbook on Insurance Coverage Disputes § 13.13[a] (17th ed. 2015).

[3] *In re* September 11th Liability Ins. Coverage Cases, 333 F. Supp. 2d 111, 124 n. 7 (S.D.N.Y. 2004) ("Zurich's Binder provided a $100,000 self-insured retention and a $150,000 deductible in excess of that retention for a total retention of $250,000 per occurrence").

Where the coverage is written above an SIR, the policy's notice of claim provision, generally will require the policyholder to report to the insurer only enumerated categories of claims[4] or those it considers likely to impact upon the insurer's policy. After the SIR is satisfied, the insurer will assume full responsibility for the defense of all pending and future claims and suits.

An SIR may be used with a primary liability policy or it may be underlying to the coverage provided by an excess or umbrella policy. When in a primary policy, the "SIR endorsement effectively transforms what is labeled a primary policy into an excess policy covering only amounts in excess of the amount of the SIR."[5]

Other insurance

An issue that frequently arises is whether a policyholder under a policy issued by Insurer A, which contains an SIR, may satisfy its retention by payments made on its behalf as an additional insured under a policy issued by Insurer B. The answer to this question will depend on the language in the SIR provision or endorsement. Generally, a policyholder "may purchase other insurance to cover the SIR *unless the policy clearly requires* the insured itself, not other insurers, to pay this amount."[6]

In *Vons Cos. v. United States Fire Insurance Co*.,[7] Vons was sued in a bodily injury action arising out of an accident that occurred outside a Vons store in the common area of a shopping center owned by its landlord, Long's Drug Stores.[8] As part of its lease with Long's, Vons was named as an additional insured under Long's CGL policy issued by National Union Fire Insurance Co. of Pittsburgh, Pa. ("National Union"), and the National Union policy contained a $500,000 per occurrence SIR.[9] Vons was also insured under its own policy issued by United States Fire Insurance Co. ("U.S. Fire"), with a $1,000,000 SIR endorsement expressly making it "subject to" all of the policy's terms and conditions which remained unchanged.[10] Among the conditions in the U.S. Fire policy was an "Other Insurance" provision that made the U.S. Fire policy excess over any valid and collectible other insurance, whether primary, excess, contingent or on any other basis.

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[4] *E.g.*, where the injury results in death, brain damage, quadriplegia or hemiplegia, amputation of major limbs or blindness, or sex organs, or where a reserve has been set at 50% or more of the retention.

[5] General Star Nat'l Ins. Corp. v. World Oil Co., 973 F. Supp. 943, 949 (C.D. Cal. 1997).

[6] Forecast Homes, Inc. v. Steadfast Ins. Co., 105 Cal. Rptr. 3d 200, 207 (Cal. Ct. App. 2010), (citing Vons Cos., Inc. v. U.S. Fire Ins. Co., 92 Cal. Rptr. 2d 597, 600-601 (Cal. Ct. App. 2000)).

[7] 92 Cal. Rptr. 2d 597 (Cal. Ct. App. 2000).

[8] *Id.* at 599.

[9] *Id*.

[10] *Id*.

The underlying bodily injury claim was settled for $1,539,905.[11] National Union issued a $1,000,000 check to Vons as an additional insured under Long's policy.[12] Vons funded the remainder of the settlement. Vons and U.S. Fire disagreed on whether the $1,000,000 SIR in the Vons policy was exhausted by National Union's payment on Vons' behalf. U.S. Fire refused to reimburse Vons for the amount it contributed toward the settlement, and Vons sued it for declaratory relief on the issue.[13]

The trial court ruled in favor of Vons, finding that "the Vons policy did not limit the source of the $1 million SIR in any way and did not require Vons to pay the SIR exclusively from its own pocket."[14] The Court of Appeal affirmed, explaining that while "the SIR standing alone would ordinarily make the Vons policy excess," the subject provision was expressly made subject to policy terms which stated that U.S. Fire's insurance was excess if any other valid insurance was available for the same occurrence.[15] The court concluded that "the most reasonable construction of this provision" permitted payment of the SIR amount through other valid and collectible insurance.[16] The court found the SIR ambiguous on this point and stated that "if USF wanted to make it clear that Vons was required to pay the SIR amount, it should have said so."

> Nowhere does the SIR expressly state that Vons itself, not other insurers, must pay the SIR amount. Because the SIR was subject to the other insurance provisions, which also made the Vons policy excess if there were another policy covering the accident, Vons as a reasonable insured could read the policy as permitting the use of other insurance proceeds to cover the SIR amount.[17]

Although Long's National Union policy was not before the court for determination, the court found the policy wording to be in "stark contrast to the SIR in the Vons policy."[18] Instead of stating that the SIR endorsement "was subject to the other policy terms and conditions," National Union's policy simply stated that the SIR endorsement "formed a part of the overall policy."[19] In addition, National Union "appears to have tackled the issue of other insurance, stating: 'In the event there is any other insurance, whether or not collectible, applicable to an 'occurrence', claim or suit within the Retention Amount, you will continue to be responsible for the full Retention Amount before the Limits of Insurance under this policy apply.'"[20]

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[11] *Id*. at 600.

[12] *Id*.

[13] *Id*.

[14] *Id*. at 600.

[15] *Id*. at 604-605.

[16] *Id*. at 605.

[17] *Id*.

[18] *Id*. at 605 n. 4.

[19] *Id*.

[20] *Id*.

The SIR endorsement at issue in *Forecast Homes, Inc. v. Steadfast Insurance Co.*,[21] was even more explicit in requiring the named insured to "make actual payment" of the SIR amount; it stated, "Payments by others, including but not limited to additional insureds or insurers, do not serve to satisfy the self-insured retention."[22] Despite this clear language, Forecast argued that the insurer was required to specifically list who was precluded from paying the SIR out of their own pocket and could easily have inserted language to the effect that only the named insured may pay the SIR, or specifically precluding payment by other insurance or any additional insured.[23] The court rejected Forecast's argument, finding instead that "Steadfast could not have been clearer, without being repetitive. It was not necessary to envision, and then create, a list of who possibly *could not* satisfy the condition precedent."[24]

In *Virginia Surety Co. v. Lexington Insurance Co.*,[25] Virginia Surety sought equitable contribution from Lexington for defense and indemnity costs relating to a construction defect lawsuit brought against their common insured Galletti & Sons, a concrete subcontractor on a construction project.[26] Lexington insured Galletti from November 1, 2003 to November 1, 2004, under a CGL policy that contained a SIR endorsement of $25,000 requiring Galletti to "assume" the retained limit and "exhaust" it before Lexington would be required to provide coverage.[27] Virginia Surety insured Galletti under a CGL policy from November 1, 2004 to November 1, 2005, and the CGL policy contained a $25,000 deductible.[28]

Galletti tendered the defense and coverage of the action to both Lexington and Virginia Surety. Virginia Surety accepted the defense and incurred $75,523 in defense costs and paid $620,000 damages in settlement of the action. Lexington denied coverage, claiming that Galletti had not "satisfied" the $25,000 SIR in its policy. Virginia Surety's position was that, by paying the $25,000 deductible in its policy, Galletti satisfied the SIR and triggered coverage under Lexington's policy.[29]

The court began its analysis by noting, "courts in California have held that an insurer cannot 'stack' SIRs by requiring an insured to exhaust all SIRs in multiple policies that potentially provide coverage before being liable under its own policy."[30] However:

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[21] 105 Cal. Rptr. 3d 200 (Cal. Ct. App. 2010).

[22] *Id*. at 205.

[23] *Id*. at 209.

[24] *Id*. at 210 (emphasis in original).

[25] No. C 10–02751 SI, 2011 WL 2653374 (N.D. Cal. Jul. 6, 2011).

[26] *Id*. at *1.

[27] *Id*.

[28] *Id*.

[29] *Id*.

[30] *Id*. at *3 (citing *California Pacific Homes v. Scottsdale Ins. Co.*, 83 Cal. Rptr. 2d 328 (Cal. Ct. App. 1999).

> . . . the question here is not whether Lexington is requiring Galletti to pay other, additional SIRs or deductibles in other policies before it can be liable under its own policy, but whether Virginia can claim that Galletti's payment of the $25,000 deductible to Virginia Surety satisfies the $25,000 SIR under the Lexington policy.

The court found "there is nothing in the SIR or case law to support" Lexington's argument.[31]

The court pointed out that:

> The SIR endorsement also provides that the Retained Limit can be met by the insured's payment of Allocated Loss Adjustment Expenses [ALAE] . . . [The ALAE] are defined as fees and costs 'reasonably chargeable to the investigation, negotiation, settlement or defense of a loss or claim or 'suit' against you.' Virginia Surety subm[itted] evidence that its $25,000 deductible, required from Galletti, was due for coverage of fees and defense costs incurred by Virginia Surety on Galletti's behalf to defend [the actions].[32]

Thus, it was a payment of ALAE expressly contemplated by the SIR endorsement.

In *Intervest Construction of Jax v. General Fidelity Insurance Co.*,[33] General Fidelity insured Intervest Construction of Jax and ICI Homes, Inc. (collectively "ICI") under a liability policy that contained an SIR endorsement providing, in relevant part, that the insurer had no duty to defend or indemnify "unless and until the amount of the 'Retained Limit' is exhausted by payment of settlements, judgments, or 'Claims Expense' *by you*," and that "[t]he 'Retained Limit' will *only* be reduced by payments made *by the insured*."[34]

ICI contracted with Custom Cutting, Inc. to install attic stairs in a residence that ICI was building.[35] The homeowner, Ferrin, fell while using the attic stairs and sustained serious injuries.[36] She sued ICI, which sought indemnification from Custom Cutting under the terms of the subcontract. Custom Cutting maintained a CGL policy with North Pointe Insurance Company, but ICI was not an additional insured under that policy.[37] Ferrin's claim was settled at mediation for $1,600,000.[38] North Pointe paid ICI $1,000,000 to settle its indemnification claim against Custom Cutting and ICI paid that amount to Ferrin.[39] A dispute arose as to whether ICI or General Fidelity was responsible for paying Ferrin the remaining $600,000.[40]

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[31] *Id*.

[32] *Id*.

[33] 133 So.3d 494 (Fla. 2014).

[34] *Id*. at 498 (emphasis in original).

[35] *Id*. at 495.

[36] *Id*.

[37] *Id*. at 496.

[38] *Id*.

[39] *Id*.

[40] 133 So.3d 494, 496 (Fla. 2014).

The district court granted General Fidelity's motion for summary judgment, finding its policy "terms to be unambiguous and required ICI to exhaust the SIR by payment of its own funds, not by application of the indemnification funds."[41] The Florida Supreme Court, on a question certified to it by the Eleventh Circuit, followed the California decisions in *Vons* and *Forecast Homes* and held that the policy's SIR could be satisfied by payments made on the policyholder's behalf by another insurer, notwithstanding the seemingly clear policy wording that required payment to be made "by you", i.e., the named insured. The court found the General Fidelity policy wording differed from that in the California cases as follows:

> The language of the instant policy states that the retained limit must be paid by the insured, but does not specify where those funds must originate. Requiring payment to be made from the insured's "own account" is not necessarily the same as requiring that it be paid "by you."
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> . . . .
>
> The contract between Custom Cutting and ICI, which included the right to indemnification, was entered into six years before the General Fidelity policy was purchased by ICI. ICI paid for the indemnity protection in the purchase price of the Custom Cutting subcontract and therefore hedged its retained risk in this manner. ICI bargained for and paid for this right to indemnification and, without an express policy provision to the contrary, should be able to use it to satisfy the SIR.[42]

Satisfying a deductible

In *Hartford Accident & Indemnity Co. v. U.S. Natural Resources, Inc.,*[43] Hartford issued a broad form CGL policy with a $250,000 deductible to the "named insured," USNR and its affiliates.[44] The policy provided that:

> [t]he company may pay any part or all of the deductible amount to effect settlement of any claim or suit and, upon notification of the action taken, the named insured shall promptly reimburse the company for such part of the deductible amount as has been paid by the company.[45]

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[41] *Id*. at 499.

[42] *Id*. at 504; *see also*, Continental Cas. Co. v. N. Am. Capacity Ins. Co., 683 F.3d 79 (5th Cir. 2012); *and see* Coffeyville Resources Refining & Mktg., LLC v. Liberty Surplus Ins. Co., 748 F. Supp. 2d 1261 (D. Kan. 2010) (holding that where the policy does not explicitly require the insured to pay the self-insured retention amount itself, payments by other insurers may serve to satisfy the SIR).

[43] 897 F. Supp. 466 (D. Or. 1995).

[44] *Id*. at 469.

[45] *Id*. at 473.

USNR entered into a contract with Temple-Eastex for the sale and installation of certain machinery at a sawmill under construction.[46] The contract contained an indemnity provision whereby USNR would indemnify Temple-Eastex for all liability claims for actions for injuries sustained during the installation, but excluding liability arising out of the sole negligence of Temple-Eastex.[47] USNR was also required to maintain certain insurance on which Temple-Eastex was to be named as an additional insured.[48]

Marvin Richardson sued Temple-Eastex for injuries he sustained while working at the sawmill when he fell from an allegedly defective ladder that belonged to USNR.[49] An investigation revealed that a USNR employee was supervising Richardson while he was using the ladder.[50] Defense of the claim was tendered to both Hartford (as insurer) and USNR (as indemnitor). Both entities declined to accept the tender on the ground that the indemnity clause of the USNR/Temple-Eastex contract did not require USNR to defend or indemnify Temple-Eastex for its sole negligence.[51]

Temple-Eastex's liability insurer, Highlands, settled Richardson's claims for $ 1.1 million.[52] After reevaluating its position and concluding that Temple-Eastex was a "person insured," Hartford contributed $ 550,000 toward the settlement and then sought reimbursement of the $250,000 deductible from USNR. When USNR refused to pay, Hartford sued.[53]

The court found that USNR, not Highlands or Temple-Eastex, was obligated to reimburse Hartford for the deductible, stating that "the plain language of the CGL policy imposes the burden of reimbursing the deductible on the party qualifying as 'named insured, as defined, and not on those qualifying as 'persons insured,' 'insured,' or 'additional persons insured – required by contract' as defined elsewhere in the contract."[54]

In *Northbrook Ins. Co. v. Kuljian Corp.*,[55] a professional liability policy named two related but separate entities as the named insured, H.A. Kuljian & Company and The Kuljian Corporation, making both responsible for the $25,000 deductible under unambiguous policy terms.[56] H.A. Kuljian & Company was named as one of the defendants in two actions to recover damages arising from the allegedly negligent design and/or construction of the roof of a school building. The Kuljian Corporation was named, but not served, in one of the ac-

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[46] *Id*. at 468.

[47] *Id*.

[48] *Id*.

[49] 897 F. Supp. 466, 469 (D. Or. 1995).

[50] *Id*.

[51] *Id*.

[52] *Id*.

[53] *Id*.

[54] *Id*. at 473.

[55] 690 F.2d 368 (3d Cir. 1982).

[56] *Id*. at 370.

tions as an additional defendant; it was stipulated at trial that The Kuljian Corporation had no contractual relationship with the school district and was in no way liable in the lawsuits.[57]

The school district settled the action; H.A. Kuljian & Company's share of the settlement was $20,000. That company, however, was part of a virtually insolvent estate and unable to pay the deductible amount. Northbrook then paid that amount and sued The Kuljian Corporation for payment of the deductible.[58] The Kuljian Corporation argued that on a proper construction of the policy the obligation of the insured to pay the deductible must mean the insured against whom there was a claim and on whose behalf the insurer afforded a defense. A divided Third Circuit (2-1) affirmed the district court and rejected this argument, stating that The Kuljian Corporation "points to no language in the policy under which the obligation of one of the Named Insureds to pay the deductible is limited to the situation when there is a claim against that Named Insured, and we are not free to so rewrite the policy."[59] The majority also said, "Even if we were free, in the face of the clear language, to consider appellant's equitable argument, we would reject it. It was the appellant, through its President, which applied for the insurance policy covering both entities. Northbrook performed its obligation to defend, and even paid the settlement contribution in the first instance to insure that settlement would be effected. Appellant has offered no equitable argument as to why it should not be held to the letter of its contract."[60]

Defense costs

Where the insured purchased a policy with an SIR and is also an additional insured under another policy that has paid the insured's defense costs, a question may arise as to whether payment of the defense costs may be applied toward satisfaction of the SIR. The outcome will depend on the terms negotiated and the policy wording. Defense costs within the retained limit will decrease the insured's exposure, fixing it at no more than the amount of the retained limit. On the other hand, where defense costs are not within the SIR, it will prolong exhaustion of the retention and the point at which the insurer's obligations for defense and indemnity are triggered. Generally, unless altered by agreement of the parties, defense costs do not erode the SIR.[61]

Conclusion

When a policyholder or its broker or risk manager is negotiating for the purchase of a policy of insurance with a self-insured retention endorsement it is important that it clarifies

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[57] *Id*. at 370-371.

[58] *Id*. at 371.

[59] *Id*. at 373.

[60] *Id*.

[61] *See* Forecast Homes, 105 Cal. Rptr. 3d at 204 where the court found that the policy wording "permitted SIR damages and defense costs to be used separately or in tandem to satisfy the per occurrence" retention amount.

[i] whether the amount of the retained limit must be paid solely by it or whether the SIR may be satisfied by payments from third-parties, i.e., other insurers or indemnitors, and [ii] whether defense costs are to be within or outside of the retained limit. Clear contract wording is necessary to avoid disputes and coverage litigation. Courts will not rewrite the parties' contract for the parties.

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The FEDERATION OF DEFENSE & CORPORATE COUNSEL QUARTERLY, published quarterly through the office of publication by the Federation of Defense & Corporate Counsel, Inc., 11812 North 56th Street, Tampa, FL 33617.

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