

LITIGATION BOUTIQUES

A SPECIAL REPORT |

Boutiques experiencing an upside to the downturn

Litigation firms aren't immune to recession, but they may adjust to new conditions more readily.

BY GRAEME W. BUSH

As White House Chief of Staff Rahm Emanuel said, "A crisis is a terrible thing to waste." Boutiques, like all law firms, face many challenges from the economic crisis, and litigation boutiques face their own unique version of these challenges.

Law firms are scrambling to avoid harm from client reaction to the economic downturn. The interesting point for firms not overwhelmed by the crisis is the opportunity that the downturn presents. The crisis has created opportunities for litigation boutiques that they have not had in less turbulent times. The question is how not to waste the crisis.

Litigation boutiques, of course, are not immune from the downturn. Unlike in a more diversified firm, they lack other practices to tide them over if the litigation practice fails. Contrary to expectations, the litigation practices are not uniformly robust. The widely anticipated flood of crisis-related litigation, with exceptions in certain areas (like bankruptcy), has not materialized. Business clients appear to be avoiding commercial litigation to save money, because the uncertainties of recovery from financially troubled defendants do not justify the expense and distraction

that litigation inevitably creates. Although some high-profile government enforcement actions are in the news, enforcement litigation is not yet at the level that was anticipated in the market, since the new administration needs some time to set enforcement priorities and build cases.

PRESSURE BUILDS

Litigation boutiques also face pressures from clients to reduce legal costs. These pressures come via requests for reduced rates, freezes on rate increases, unbundling of legal services and increased scrutiny of bills. Litigation boutiques representing clients whose fees are paid by third parties under indemnification agreements or bylaws or by insurers also are facing a form of self-help, as the indemnitors and carriers unilaterally discount bills after the fact or delay payment by significant time periods. The damage to cash flow and profitability from these practices can be substantial.

So much for the bad news. What opportunities has the economic crisis created, and how are litigation boutiques uniquely situated to take advantage of them? Emanuel's comment was taken to mean that a crisis allows one to make the tough decisions that are easy to avoid when things are going well. Boutiques, and liti-

gation boutiques in particular, certainly have taken that admonition to heart by trimming staff, cutting costs and adjusting firm structures to better respond to the pressures.

Beyond defensive moves, firms can take steps that were not previously available to grow or strengthen practices. For example, partners with practices at large multinational firms who would not have given a moment's thought to moving to a boutique environment now may be more open to the idea if their practice is strong but their firm's overall profitability has been damaged by one or two underperforming practice areas. There is much talk about partners leaving large national firms to gain more flexibility to respond to rate, cost and staffing pressures from clients. Hourly rates and staffing at bigger firms have made it very difficult to respond to in-house counsel demands for reduced fees, and some partners see opportunities to better serve clients in a smaller boutique environment. It is critical for litigation boutiques to distinguish between a potential candidate with this profile and one who is leaving his firm because his own practice is falling off.

Related to the phenomenon of partners leaving bigger firms, the most significant opportunity arising from the crisis for smaller litigation-focused firms is in

addressing client pressures to reduce litigation expense. It is not always easy for firms to take advantage of the opportunity. First, there is so much noise about alternative fee arrangements, the mismatch of incentives created by the hourly-rate model, the evils of leverage and the like that one could be forgiven for thinking that the moment to take advantage of this opportunity has passed. In many instances this might be true, but for clients genuinely focused on working with outside counsel to reduce litigation costs, litigation boutiques are uniquely positioned to respond.

FEE ADVANTAGE

For example, simply by doing what they do now, litigation boutiques will almost undoubtedly cost less than a larger, multinational firm's litigation team on the same case. The hourly rates at litigation boutiques are very likely to be less than the rates for comparable attorneys at a larger firm. Litigation boutiques do not have the same leverage model as bigger multipractice firms, so staffing is leaner.

These obvious advantages do not automatically turn into new business from corporations dedicated to reducing their legal costs, however. The reasons include fear by general counsel of being second-guessed for a bad result in a case handled by a litigation boutique rather than a recognized big firm. This risk-averse attitude is misplaced on the merits—there is no reason that a prominent litigation firm will underperform a big firm. But the attitude is an obstacle to the most obvious way to achieve real litigation cost reduction.

Another impediment is that in-house departments often are focused on superficial metrics. It is harder for a general counsel to demonstrate that the overall cost of a case was less by using a litigation boutique than it is to say that the in-house attorney was able to negotiate a 10% discount on hourly rates or an alternative fee arrangement that capped annual litigation expenses for a basket of cases handled by a large-firm outside counsel.

ABLE TO ACT FASTER

An advantage to litigation boutiques is that they are more nimble and can offer a wider and more flexible variety of alternative billing arrangements than larger firms. For example, a litigation boutique should be able to evaluate the legal expenses incurred in different kinds of litigation handled by the firm and to structure a variety of fee arrangements that give general counsel a degree of certainty about anticipated litigation costs while at the same time rewarding the outside firm in ways that better match the incentives of the firm

“gotcha” borne by the law firm. Smaller firms' less hierarchical staffing structure means that a more senior attorney will be available to discuss choices with general counsel—choices like what depositions should be taken, what documents reviewed and what experts to hire.

For this process to contribute materially to a reduction in legal expense, the client must contribute as a true decision-maker, one with authority to make judgments about what to do and what not to do, with enough seniority or job security to make the decisions without fear that he or she will become the scapegoat for an adverse result.

These are some ways that litigation boutiques can take advantage of the economic crisis. The opportunities appear to be low-hanging fruit, but in reality the fruit is not so easy to pick. To realize the opportunities takes a commitment and focus from the firm to work with clients to reduce costs and develop a new way of working together on significant litigation.

The same commitment is required to build and strengthen the firm with new practices and high-quality laterals that were not previously available. Firms that have commitment and focus will come out of the crisis stronger and more competitive, without wasting the opportunity for change.

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and the client. Because smaller firms lack the same leverage beast to feed, alternative fee arrangements at these firms can place a premium on the efficient resolution of the disputes rather than tying the firm's outcome to the number of hours it can spend and collect.

Cutting litigation expenses largely involves making choices about how to conduct the litigation, and the client and outside counsel must share these decisions. The client must know and accept the risks of taking cost-savings measures. Those risks cannot simply be a malpractice

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