LegalVIEW® Insights

Volume 2023-1:
Law firm rate increases

ELM Solutions

February 2023

Legal business publications in 2022 were replete with reports of huge hourly rate increase requests from firms that left buyers "surprised, angry, and dismayed."[1] This marked the end of a period of a decade or more where law firms had been content with relatively modest rate increases, and the topic of rate management had therefore become largely neglected. Unfortunately, corporate law firms are now paying the price for that neglect and finding that their rate management processes—to the extent they exist at all—suffer from grave design defects and generally lack the people, process, and technology required to combat the requests they are now faced with.

The flip side of the coin, however, is that the more klugey a process is, the greater the opportunity for improvement that it represents. The analysis to follow, based on data from the world's most sophisticated source of performance benchmarking for corporate law departments and insurance claims departments—LegalVIEW® Data Warehouse—shows that, while the situation is bad, it is nowhere near as bad as news accounts make it out to be and that there are also a number of opportunities for quick wins on rate management that require little upfront investment at all. Chief among these are shrinking the amount of work sent to the largest firms—either by moving to downmarket firms, insourcing, or ALSPs—and also by negotiating rate freezes on top legal matters, which often last years and years and therefore represent potential for savings that last years and years as well.

But not all the fruit will be low hanging. The last two years have shown that law departments were unprepared for something that was reasonably foreseeable: That demand would spike and trigger large rate increases from firms. The trouble may subside for now, but it will inevitably happen again. For their own good and for the good of the clients they serve, they cannot allow themselves to be caught unprepared again.

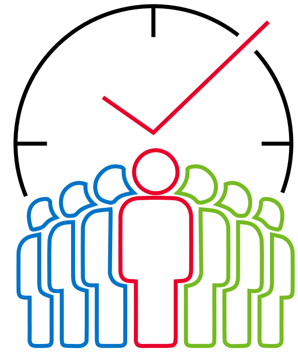
Nathan Cemenska

Director, Legal Operations/
Industry Insights
ELM Solutions

"There are a number of opportunities for quick wins on rate management that require little upfront investment at all."

1. 'Surprised, Angry, Dismayed': Legal Departments Vow to Fight Law Firms' Rate-Hike Plans, November 28, 2022, Corporate Counsel, by Hugo Guzman, Trudy Knockless, Maria Dinzeo, and Greg Andrews, available at: https://www.law.com/corpcounsel/2022/11/28/surprised-angry-dismayed-legal-departments-vow-to-fight-law-firms-rate-hike-plans/

Insight #1: The mean law firm rate increase was about 5.6% and the median 1.9%, but about 40% of timekeepers received no increase at all.

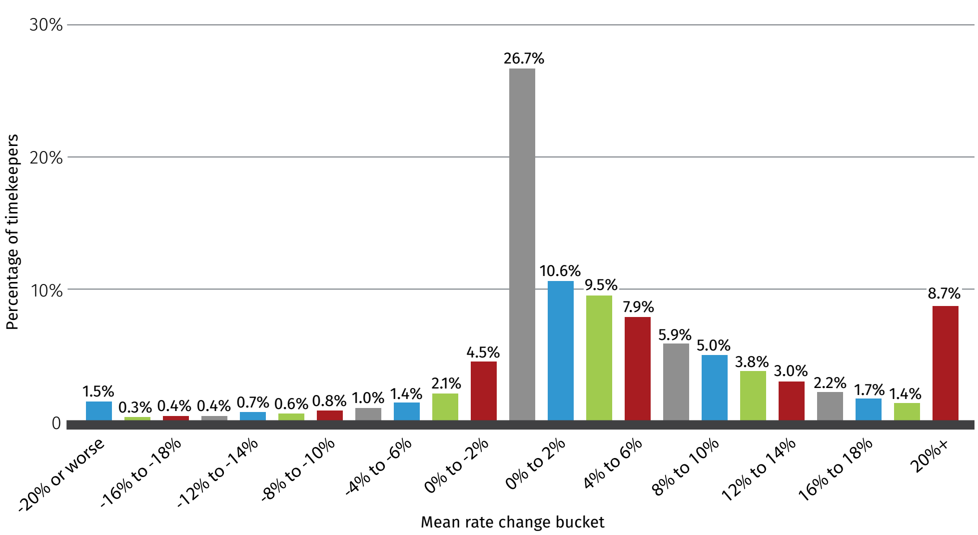


Based on talk going on in the legal ops community in the last year, law firms have been asking for (and often securing) astronomical rate increases. Indeed, LegalVIEW data shows that rate increases in excess of 10% were obtained by about 21% of timekeepers (see ***Figure 1*** below). However, the other half of the story is that 40% of timekeepers received no increase at all and that the mean and median increase, though not insubstantial, were hardly headline-making at 5.63% and 1.86%, respectively. This fact was acknowledged little, if at all, in industry discussions, and the unfortunate consequence was probably that some less savvy corporate law departments concluded that a rash of huge increases was sweeping across the globe, and they would have no choice except to go along with it, however reluctantly.

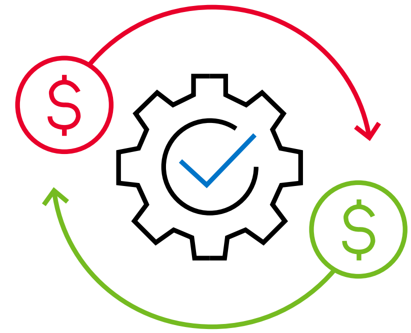
"A good number of timekeepers are willing to work for less than what some of their current clients are paying them."

In ***Figure 1*** below, we see that 26.7% of timekeepers did not change the average rate they charged across all their clients. You will also see that around 13% of timekeepers actually saw the average rate they charge across all clients decrease. In most cases, this is probably not because actual rates went down (they rarely do) but because that timekeeper lost a high-paying client or took on a lower-paying one, depressing the mean rate charged by that timekeeper. However, the information is still relevant because it shows that a good number of timekeepers are willing to work for less than what some of their current clients are paying them. If you work in a corporate law department and Timekeeper Joe is charging you $600/hour but has other clients where he does the same or similar work for $500/hour, that raises questions about whether you need to consider Joe's rate increase requests at all. In all probability, you could categorically deny any request from Joe, and he would continue working for you because he is still getting 20% more than what he has shown himself willing to settle for.

Figure 1: *Change in mean rate charged by timekeepers, 7/1/2021 to 6/30/2022*



Insight #2: Rate increases vary widely by industry.



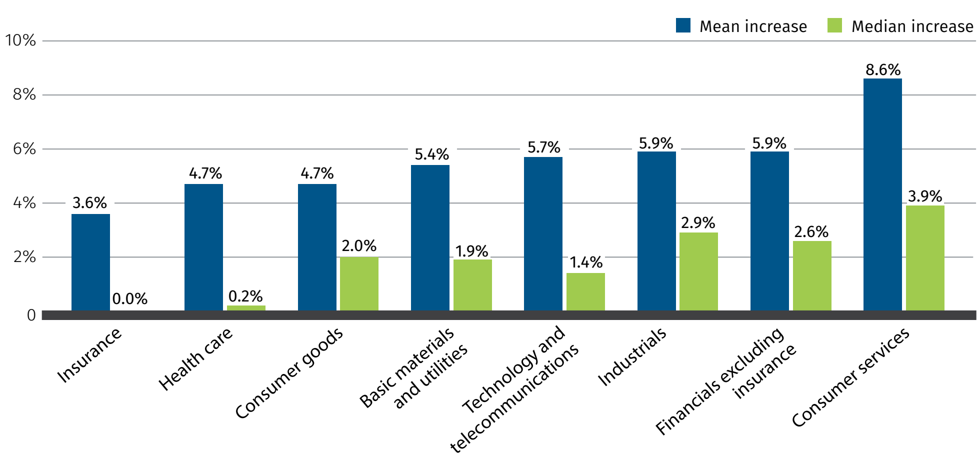
Wolters Kluwer data previously established that different industries pay different rates and that they experience different rate increases on top of those underlying rates as well. From 2021 to 2022, we see the disparities continue, with financial companies continuing to pay the highest rates of any industry, followed by tech and then consumer services (financial companies have long paid the highest rates, due in part to their tendency to use timekeepers and firms operating out of the most expensive market, New York City). The 2021-2022 rate changes appear to have exacerbated the disparity between those already-high rates and those charged to other industries: Timekeepers billing into financial corporate legal departments (CLDs) secured a mean rate increase of 5.9%, well over the 2.8% they obtained last year. To some extent, this may reflect a simple rubber band effect, where increases were kept fairly low in 2021 and had to be compensated for in 2022. Financial companies also have the reputation of using a high percentage of top firms—firms that, as a group, pushed more successfully for big rate increases in 2022 (see Insight #4). However, the mix of vendors used by the financials is actually pretty representative of the mix used by any big company, so the type of firm they use may not be a big factor in why their rates are going up more than most other industries.[2]

"The 2021-2022 rate changes appear to have exacerbated the disparity between those industries with already-high rates and those charged to other industries."

Consumer services—a lot of which is storefront retail—experienced the largest increase overall, with a steep 8.6% increase in the mean rate paid and 3.9% increase in the median. However, in 2021, the industry only experienced a 0.3% mean increase, probably because they successfully made the argument that the pandemic severely impacted their business, and they needed some time to recover. However, law firms suffered during the pandemic as well, psychologically if not economically, and the consumer services industry can no longer point to lockdowns and slow business as a reason law firms need to share their pain.

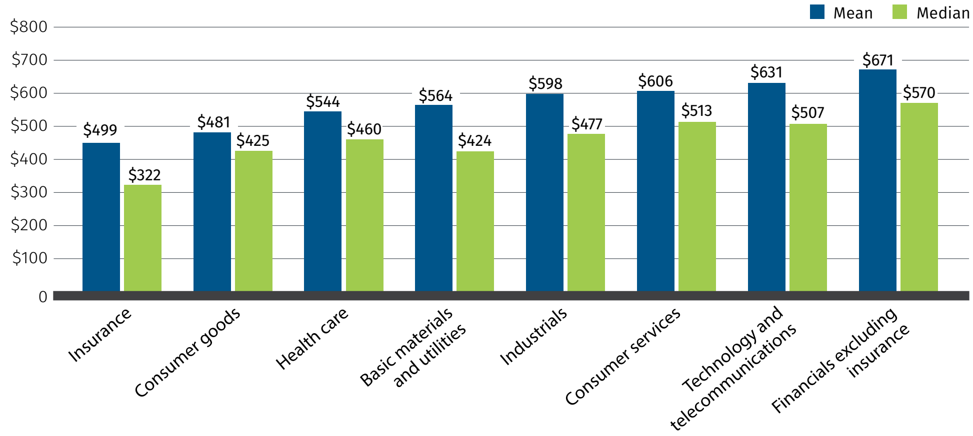
Insurance is consistently the lowest-paying industry to serve, primarily because much of that work is insurance defense, and a lot of insurance defense work has been commodified. Insurance companies kept mean rate increases at a mere 3.6%, and the median at zero. This is probably a reflection of the fact that a good deal of insurance defense work is done by smaller shops that either don't have strong pricing power or do not flex the power they do have. A median increase of 0% probably means many of those timekeepers didn't even bother to submit a rate increase request during our reference period. The larger law firms used by corporate law departments—most of which have substantial investments in people, process, and technology around rate management—can be counted upon to never neglect making such requests, making it harder for CLDs to contain rates.

Figure 2: *Average increase in timekeeper rate by Industry, All countries, 7/1/2021 to 6/30/2022*



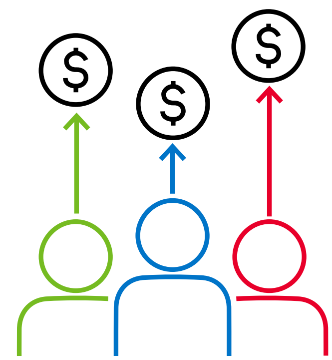
2. See ***LegalVIEW Insights, Volume 4: Finance Edition,*** available at: https://www.wolterskluwer.com/en/

Figure 3: *Average timekeeper rate by Industry, All countries, 7/1/2021 to 6/30/2022*



Insight #3: Rate increases also vary widely based on practice area.

Rate increases vary widely across practice areas, with increases in the most commodified work (insurance defense) over seven times lower than practice areas like government relations that tend to be pretty bespoke and handled by white-shoe firms. Part of the explanation probably resides in a spike in demand for lobbyists and other government relations assistance flowing from COVID economic stimulus, government spending on infrastructure, and other government activity that companies want to be involved in. However, other differences may not necessarily reflect supply and demand at all. For instance, is it really true that demand for insurance defense work is so anemic that timekeepers working in that area were only able to secure a 2.0% rate increase? Instead, the meager rate increases for this practice area might at least in part reflect that insurance claims departments have trained defense attorneys to not expect large rate increases in any environment. Therefore, those defense attorneys—most of whom work for smaller firms—may have failed to recognize an opportunity to press their advantage.



"Rate increases vary widely across practice areas, with increases in the most commodified work (insurance defense) over seven times lower than practice areas like government relations."

Figure 4: *Average rate increase by practice area, 7/1/2021 to 6/30/2022*

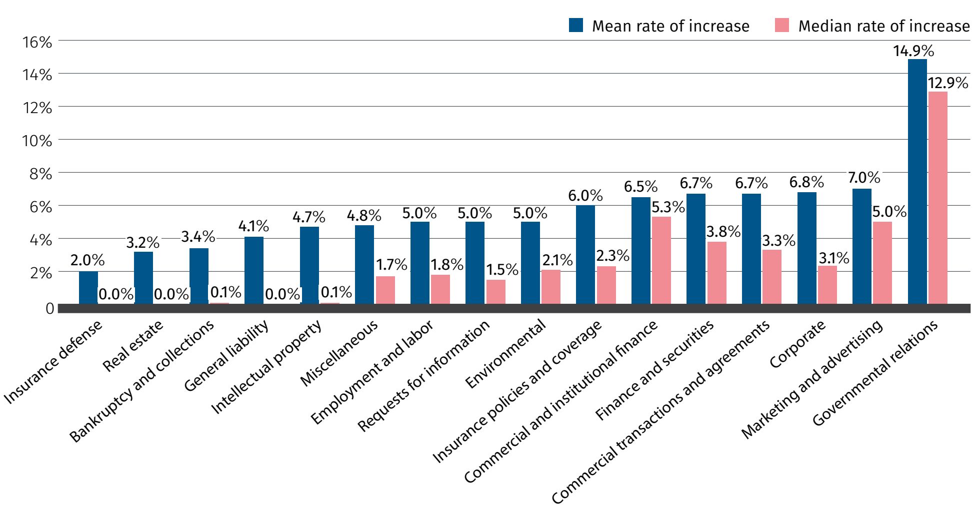
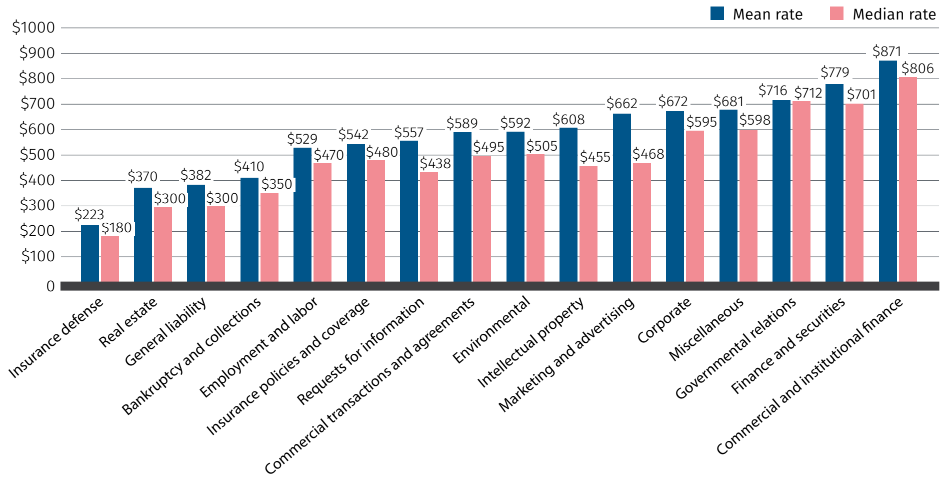
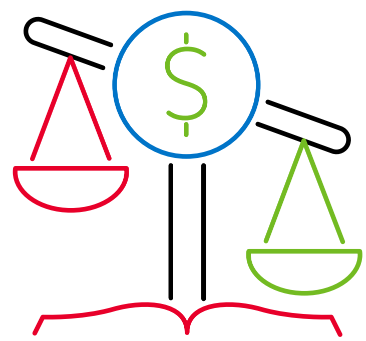


Figure 5: *Average rates by practice area, 7/1/2021 to 6/30/2022*



The large, white-shoe firms of the Am Law 100, in contrast, have clearly not been trained to expect meager rate increases, and as of this writing, their clients seem more afraid of them ending the relationship, rather than the other way around. This despite the fact that it is almost certainly true that clients fire or discontinue relationships with law firms far more often than law firms fire their clients.

Insight #4: The top Am Law firms implemented the greatest rate increases, while firms outside the Am Law 200 charged more modest ones. However, even among the Am Law 100, 32% of timekeepers received no increase at all.



The biggest, most elite law firms in the world clearly have more pricing power than smaller firms, and that is reflected in the rate increase numbers for 2022. The mean rate increase granted to an Am Law 100 timekeeper was 7.2%, and the median was 3.7%. While these numbers might not sound outrageous, keep in mind that we are talking in averages, and some of the individual rate increases were somewhat shocking at the high end. The Am Law Second Hundred experienced a 6.2% mean increase and a median increase of 1.9%—only about half of the median for the first hundred. Unranked firms experienced a mean increase of 3.4% vs. a median of zero.

"The biggest, most elite law firms in the world clearly have more pricing power than smaller firms, and that is reflected in the rate increase numbers for 2022."

The small rate increases obtained by smaller firms, combined with the fact that those increases work on a lower hourly rate to begin with, mean that the savings opportunities in smaller firms may be limited. For instance, the mean rate charged by a firm outside the Am Law 200 in 2021 was $417/hour. In 2022, the typical timekeeper at this type of firm increased their rate 3.4% to $431.[3] A crack rate management program might have reduced the rate increase by one-third to about 2.25%. What is saved? The end rate is $426. Five dollars per hour are saved.

3. Note that the $431 figure differs somewhat from the figures presented in *Figure 7*, because the calculations are different: *Figure 7* is about the mean and median rates in 2022. The other calculation is taking the 2021 rate and increasing it to reflect the median rate increase experienced by a timekeeper from 2021-2022-- a slightly different concept, but one that focuses on what happened to the typical timekeeper as opposed to rates as a whole.

Compare those five dollars to the savings generated by curbing Am Law 100 rate increases by the same 33%. The mean rate charged by timekeepers in this tier in 2021 was $701, but the typical timekeeper got an increase of 7.2% off their prior base, so the typical timekeeper's rate would grow to $753. If that 7.2% increase had been curbed by one-third, the year's increase would come down to 4.8%, and the final rate for 2022 down to $735. This saves about $18 per hour or about 3.6X the savings generated by an equivalent 33% reduction in the rate of rate increase in smaller, more modestly priced firms. This line of thinking may indicate there is a lot more money to be saved by tight management of rates at the biggest firms, rather than spending too much time worrying about the smaller ones.

One might object that the pricing power of the big firms is so great they are immovable, and there are no savings to be had with them by negotiating rates. But the data suggests this just isn't the case. Even in the Am Law 100, approximately 32% of timekeepers got no rate increase at all in the reference period. Rate increases are not, as the defeatists would argue, always inevitable and always inevitably high, although they are more likely to be both in the case of a buyer with a lackadaisical approach to rate management.

"One might object that the pricing power of the big firms is so great they are immovable, and there are no savings to be had with them by negotiating rates. But the data suggests this just isn't the case."

Yet, there are indications that corporate law departments aren't interested in saving money on the largest firms. Their leaders, including GCs, routinely make remarks that, when it comes to "bet the company matters," "it costs what it costs." While that may be true, having your department head proclaim from the rafters is probably not a rate management best practice, as it basically signals to law firms that you will accept any increase proposed.

Figure 6: *Mean and median rate increase, by Am Law tier, all countries, 7/1/2021 to 6/30/2022*

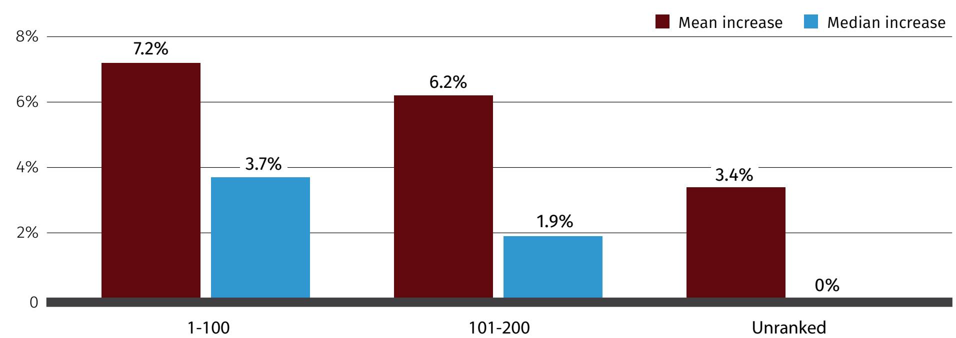


Figure 7: *Mean and median rates charged by Am Law tier, 7/1/2021 to 6/30/2022*

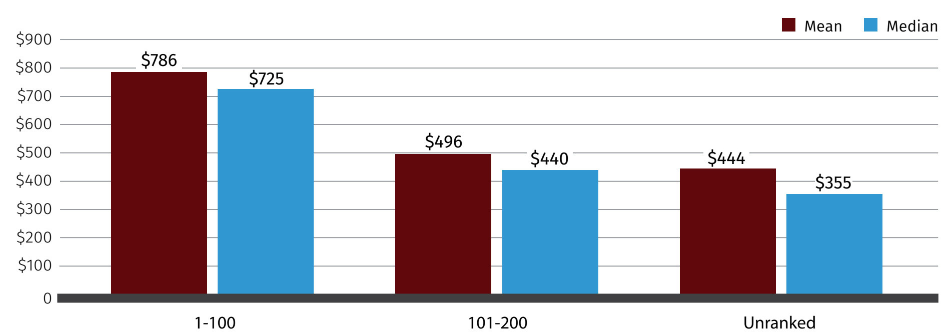
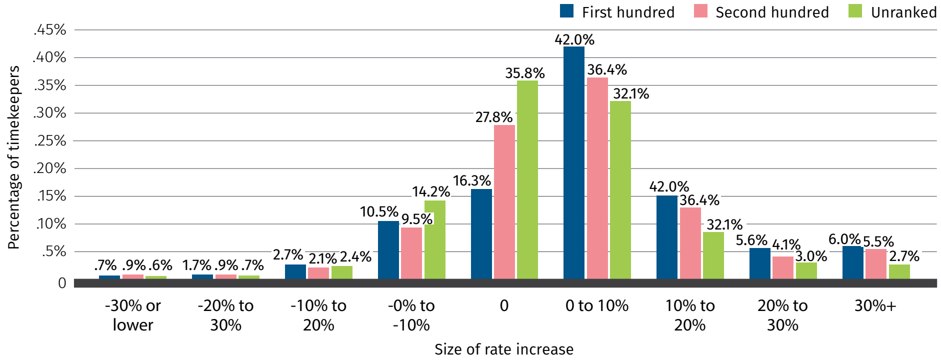


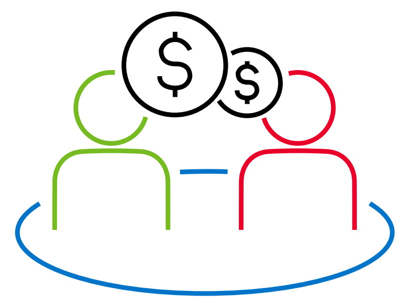
Figure 8: *Size of rate increases by Am Law tier, 7/1/2021 to 6/30/2022*



Thus, corporate law departments may have substantial pricing power over both small and large firms but are willing to flex it only where it matters least: In smaller, less expensive firms where both rate increases and the underlying rate tend to be lower, limiting opportunities for savings. As long as corporate law departments continue to stand in awe of their largest firms and steer away from the application of any serious pressure to rates at the biggest firms, hourly rate increases at those firms will compound year over year and inevitably become outrageous by any definition. However, the pattern of agreeing to huge increases from Big Law is what it is, and legal ops might do better to look for other opportunities to save money. In particular, consider moving as much work as reasonably possible out of Big Law to ALSPs, the Big Four, mid-market firms, and other vendors that don't necessarily feel entitled to large rate increases (off an already sizeable base) year after year. You will still lose the rate game with big firms, but it won't matter as much because you shrunk their pie.

> *"Consider moving as much work as reasonably possible out of Big Law to ALSPs, the Big Four, mid-market firms, and other vendors that don't necessarily feel entitled to large rate increases year after year."*

Insight #5: Associate rate increases far exceeded those of partners.



The fact that associate rate increases tend to be greater than those of partners is no secret. However, beyond published statistics on the average rate increase for associates and partners YoY, details are hard to come by.

Below you will find three histograms showing the spread of rate increases broken out by partner, associate, and paralegal for the period of 7/1/2021 through 6/30/2022. These charts help the reader see that, although the mean rate of increase among partners was 4.8%, that figure oversimplifies the rich variety of rate increases occurring within the partner category. About 6.7% of partners negotiated rate increases of 20% or more, while 26.5% experienced a rate increase of zero, and another 13.0% actually saw the mean rate they were charging across all their clients decline.[4] Just looking at the headline 4.8% figure and benchmarking rate increases off that or—even worse—benchmarking against sensationalistic legal industry news accounts hurts the buy side by obscuring the fact that their peers are getting away with $0 increases 40% of the time, even in a bumper year for firms.

The mean associate rate increase was 62% higher than the rate increase for partners (7.8% vs. 4.8%). Paralegal rate increases lagged behind both.

	Partner	Associate	Paralegal
Median	1.8%	2.8%	0.5%
Mean	4.8%	7.8%	4.6%

4. Again, note that this is probably not because individual rates charged to individual clients declined. Rather, the timekeeper gained a new, lower-paying client or lost an old, higher-paying one.

The fact that associate rate increases exceed those of partners makes sense because experience, though valuable, has diminishing returns. Having 10 years of experience in a practice area is many times more valuable than having only one, but previous Wolters Kluwer analysis has shown that partners with more than 21 years of experience are only able to charge about 18% more per hour, on average, than partners with less than 21 years of experience.[5]

However, there are probably other, more structural reasons why associate increases tend to exceed those of partners as well. As we have seen, rate increases tend to get bigger as the firm requesting them gets bigger (see ***Insight #4***). Those firms also happen to be the most leveraged, with the Am Law 50 billing about 50% of all hours through associates, compared to the more partner-heavy Am Law Second Hundred, where associate hours represent only about 35% of all hours billed.[6] In other words, while the second hundred partners are making a lot of money based on their own work, partners at the biggest firms are making even more money by working smarter and optimizing associate leverage, hours, and rates to juice margins. The high leverage works, but it would also make margins highly sensitive to associate rate increases and whether they can be sustained. Thus, while all firms obviously want to raise rates as much as they reasonably can, the biggest firms—where rate increases are more likely to come from—have a bigger incentive to drive associate rates higher and higher.

This interpretation would also explain the somewhat anemic increases seen in paralegals. Paralegals can have a high profit margin for firms, but in absolute terms, both the number of paralegal hours[7] and the associated rates (median $216/hour as of this writing) are quite low. No matter what rate increases firms could obtain for paralegals, paralegal work will rarely generate much revenue, so there is no incentive to push. Better to concentrate negotiating power on associate rates, followed by those of partners.

"While the second hundred partners are making a lot of money based on their own work, partners at the biggest firms are making even more money by working smarter and optimizing associate leverage, hours, and rates to juice margins."

Figure 9: *Change in mean rate charged by individual partners, CLD spend only—excludes insurances claims rates, US rates only, 7/1/2020 to 6/30/2021 compared to 7/1/2021 to 6/30/2022*

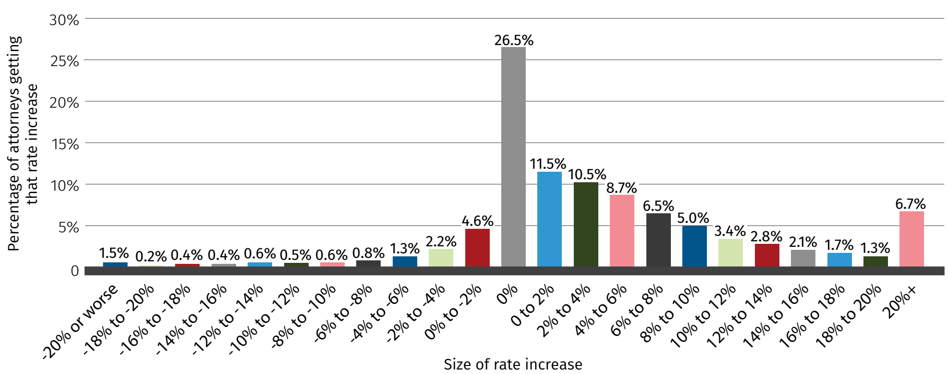
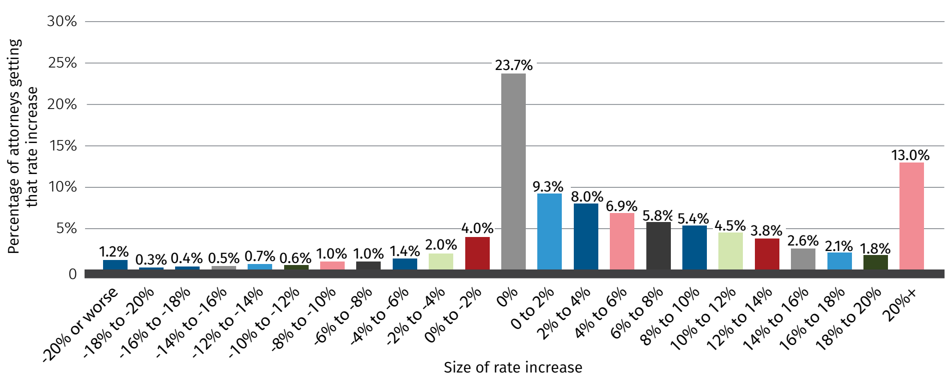


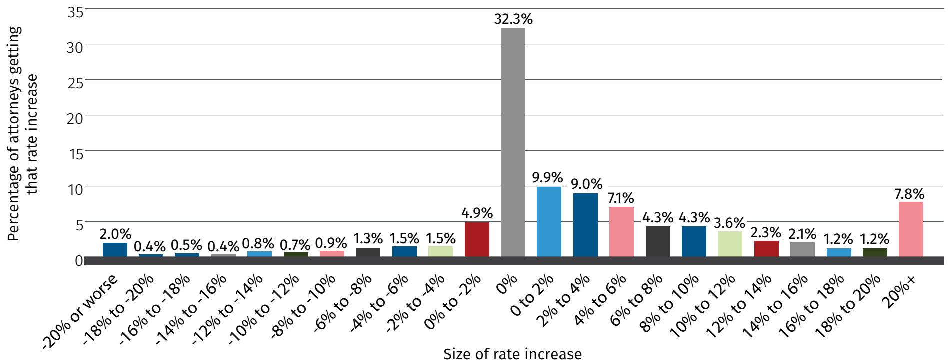
Figure 10: *Change in mean rate charged by individual associates, CLD spend only—excludes insurances claims rates, US rates only, 7/1/2020-6/30/2021 compared to 7/1/2021-6/30/2022*



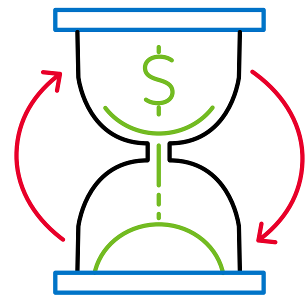
"No matter what rate increases firms could obtain for paralegals, paralegal work will rarely generate much revenue, so there is no incentive to push. Better to concentrate negotiating power on associate rates, followed by those of partners."

5. See Nathan Cemenska and Joel Surdykowski, "How much is attorney experience worth, anyway?" Published on Wolters Kluwer ELM Solutions blog on 3/2019, and republished here: https://www.linkedin.com/pulse/how-much-attorney-experience-worth-anyway-nathan-cemenska-jd-mba/
6. See LegalVIEW Insights Volume 4: Finance Edition available at: https://www.wolterskluwer.com/en/expert-insights/report-legalview-insights-volume-4-finance-statistical-differences-law-firm-staffing-ratios
7. Only about 5% of all hours billed. See LegalVIEW Insights Volume 4

Figure 11: *Change in mean rate charged by individual paralegals, CLD spend only—excludes insurances claims rates, US rates only, 7/1/2020 to 6/30/2021 compared to 7/1/2021 to 6/30/2022*



Insight #6: There is a strong case for negotiating life-of-matter rates for megamatters—the largest legal matters.



Previous analysis of LegalVIEW data showed that 61% of all outside counsel spend comes from what we termed "megamatters"—matters with greater than $1M in lifetime spend. However, those matters are often characterized by in-house counsel as "bet the company" or at least close to it, when in actuality, a litigation case with a potential exposure of $10M is hardly the existential threat to a multibillion-dollar corporation that some lawyers (particularly those making hundreds of thousands of dollars off it) would have you believe. However, though these large matters rarely represent an existential threat to the corporation, it is quite common for them to represent an existential threat to the law department's budget.

Most megamatters have serious consequences for the law department budget but usually only for two to three years. ***Figure 12*** below shows that spend tends to spike in the first one to two years in the three most common types of megamatters (patent litigation, product liability litigation, and mergers), then tapers off over a number of subsequent years.

However, about 24% of megamatters will drag on for seven to eight years or longer, and matters with >$10M in lifetime spend last that long 36% of the time (see ***Figure 14***). These "whales," as we will call them, thus can be not only a short-term threat to budget but also an ongoing drain that can compromise spend management outcomes for as much as a decade if the buyer does not do a good job following best practices and setting expectations at the outset. Setting up a case without best practices can be common for a number of reasons, including the fact that litigation often requires an immediate response that leaves no time for careful discussions, the fact that many of these cases are construed as "bet the company" and, therefore, should be exempt from having best practices imposed (a non sequitur, to be sure), and also due to simple neglect. However, CLDs that are aware of this tendency for cases to get started off on the wrong legal operations foot can institute measures to mitigate the problem and get those best practices put in from the start, at least some of the time.

There are many best practices that should be baked into legal matters, though they differ depending on the type of matter. In the case of megamatters, the largest cases are too complicated and unpredictable to allow for a rigid approach or one with too many breakable pieces, but that is no reason to not employ some measure of control. There are more flexible approaches that are low maintenance, introduce a minimum of moving and breakable pieces, and are effective at cost mitigation.

"Though these large matters rarely represent an existential threat to the corporation, it is quite common for them to represent an existential threat to the law department's budget."

For a discussion of those lighter-touch approaches, consult LegalVIEW Insights Volume 4.[8] In this report, we just want to point out that our client base reports that negotiating life-of-matter rates on megamatters and whales, or at least the initial portions thereof, could be low maintenance and effective. Especially given the fact that relationship partners bidding on whales, if successful, personally get matter and potential origination credit that will enlarge their year-end draws for years to come, they are very reluctant to walk away from a big, juicy piece of exotic legal work even when it is lower margin than the firm would like. Furthermore, any economic pain caused to the firm from life-of-matter rates is not immediate but occurs only later, when rates would have gone up but couldn't due to the agreement. This makes life-of-matter rates easier to swallow for firms, which tend to think only a year or two ahead. For clients, thinking of rates on a matter-by-matter basis, rather than a firm-by-firm basis (as part of panel management, for instance), can represent a way to reframe certain rate negotiations in a way that gives more bargaining power to the client—even with some of the largest firms in the world.

"The largest cases are too complicated and unpredictable to allow for a rigid approach or one with too many breakable pieces, but that is no reason to not employ some measure of control."

Figure 12: *When does spend peak in megamatters?*

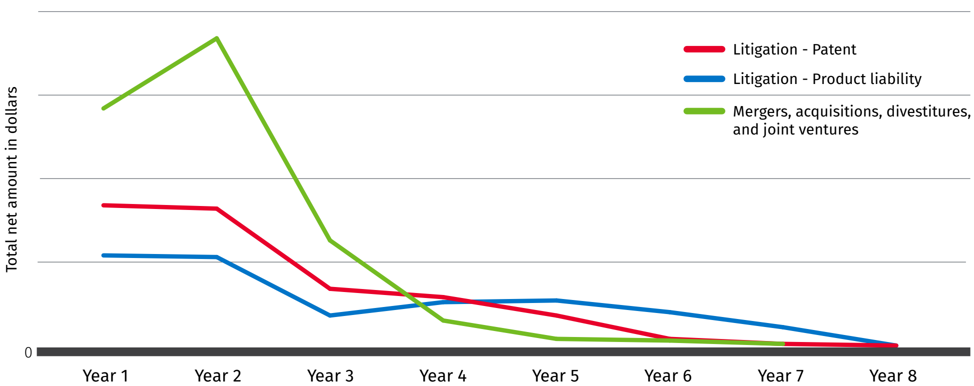


Figure 13: *When does spend peak in megamatters? (Megamatters of >7 year duration only)*

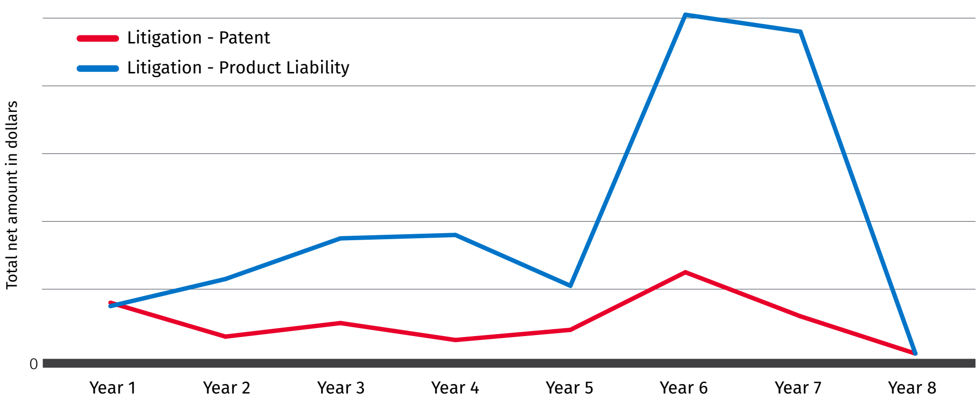
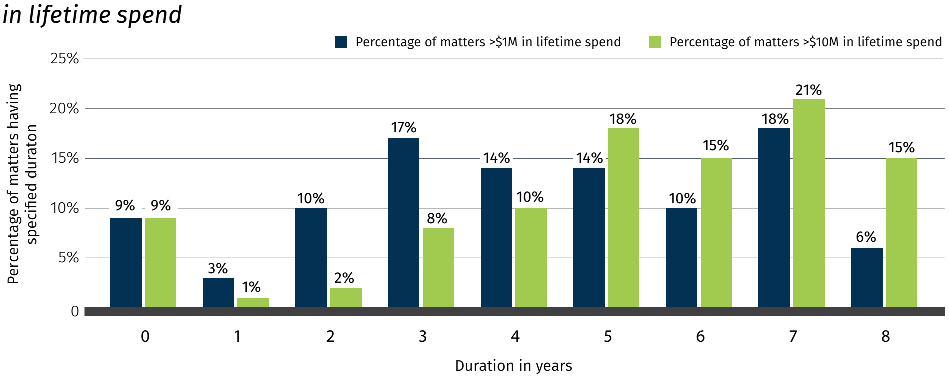


Figure 14: *Megamatter duration in years, Matters >$1M in lifetime spend vs. Matters >$10M in lifetime spend*



8. LegalVIEW Insights Volume 4 - Statistical Differences in Law Firm Staffing Ratios: https://www.wolterskluwer.com/en/expert-insights/report-legalview-insights-volume-4-statistical-differences-law-firm-staffing-ratios

The LegalVIEW Insights report is based on an analysis on the invoice data in the LegalVIEW database, which includes over $155 billion in invoice data from medium to enterprise-size ELM Solutions clients. The analysis excluded invoice data from insurance clients and is based on when the legal service was provided, not the billing date. Sample size and clients were held constant over the analysis time period to eliminate the risk of changes in the sample skewing the results.

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