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Associate Raises Drop Jaws In-House

Clients Say Firms Raise Salaries At Their Own Peril

By **Melissa Maleske**

Law360, New York (June 17, 2016, 7:21 PM ET) --

The reaction to the recent wave of law firm associate salary raises was swift among the cohort of corporate legal departments that have been most active in pushing back against law firm rates and billing practices.

On the Corporate Legal Operations Consortium's website, message board traffic skyrocketed as the legal ops directors charged with reining in outside legal costs expressed renewed disbelief and frustration. To them, the flurry of **announced law firm associate raises** that began with Cravath Swaine & Moore LLP on June 6 was salt in a long-festering wound, another reminder that law firms and their clients live on different planets.

"Is anybody alive out there?" posted CLOC co-founder David Cambria, incredulous that this was the response from firms after their back-and-forth with clients over extravagant fees bolstered by outdated billing practices and compensation models.

"There's just massive frustration," says Amar Sarwal, the Association of Corporate Counsel's chief legal strategist. "People are stunned because — well, look at the market environment around them."

Had the associate raises happened in a vacuum, law departments may have reacted differently. Most consumers of any goods or services think little about the internal compensation structures that influence the price of whatever they're buying. But in the context of the discontent with law firms that has been spreading and intensifying among corporate clients for more than a decade, the raises were received as tone deaf at best.

"We as an organization, as a group, have been telling law firms our concerns over the rate structures, the compensation plans and the way they measure success, and how that doesn't align with value-based billing or with the fact that not all the work you do for us is as difficult or as worthy of the rates you're charging," Cambria says. "And yet apparently the message hasn't been clear enough."

It's not yet known whether associate rates will rise along with their salaries. Many clients say that if there's no effect on them except perhaps a stronger set of associates in the top-paying firms, then there's no foul.

"However they want to manage their firms is fine by me as long as they don't think for a second that they're going to pass these costs down," says Stephanie Corey, the legal chief of staff at Flextronics and another co-founder of CLOC. "If this expense is going to be taken out of the managing partners' gigantic bonuses, it's fine. But I'm not paying for it."

Corey says Cravath and the many firms that followed its lead on raising salaries would have done better by their clients if they informed them proactively that the costs would not trickle down.

"I think people would have taken it a bit differently, but they didn't say anything about it," Corey says. "And that's why all of their clients are now wondering whether this is going to affect us."

In-house, few are optimistic.

Sarwal says he'd be happy to avert his eyes from the raises were it not for law firms' lockstep approach to promotions and compensation increases and the hourly model that still dominates the industry. The ACC's focus on deriving more value out of law firms has always incorporated the proposition that there's no reason both the client and the service provider can't benefit equally. Because those practices remain the norm at almost all law firms, however, there's little question that the costs will be passed down to clients, he says.

And Cambria believes it will begin happening almost immediately. He calls the lockstep associate-level rate increases law firms' "dirty little secret" that allows them to ratchet up client costs while pointing to flat partner rates.

The law departments that pay outside counsel based on nonhourly billing models will be most insulated from any rate increases. Jeff Carr, the former general counsel of FMC Technologies, says that when the standard BigLaw starting salary rose to $160,000 in the early to mid-2000s, he merely yawned. His company used value-based billing arrangements in all of its matters, so any cost increase was irrelevant to him. His budgets were what they were, regardless of what the law firms wanted to change.

Even if it's assumed that law firms will manage to adjust their internal cost structures so that clients don't feel the effects of salary raises, the in-house world still struggles to understand the utility of the raises. Cravath's memo announcing the raises did not touch on the why, but clients were quick to discount any of the most likely reasons, including recruiting the highest echelon of law school graduates and boosting its reputation among both potential employees and clients.

"I don't understand logically why they would do this. … Who are they trying to impress?" Corey says. "It's not like great employees are hard to find — it's a hiring manager's market."

And Cambria doubts that the firms will experience any reputational benefit from adopting market-leading salaries. Cravath is a special case, he says — it has built a brand on doing bespoke, bet-the-company work. For Cravath and the very few firms with similar credentials, it makes sense that they would be aggressive in trying to obtain the best and brightest lawyers.

"I think the argument becomes much less tenable when you start talking about the other 40-plus firms that have started to follow suit on associate salaries, because as you get further down the Am Law 100, those firms primarily are not doing that bet-the-company work," Cambria says. "They're doing good legal work, but they're doing it across a wider swath of types of matters, and it doesn't really justify trying to hire the rock stars — nor are there that many rock stars to justify [a $180,000 starting salary]."

Carr is of a similar mind. His immediate reaction to this wave of increases and last decade's $160,000 benchmark was the same: "There's not an associate on the face of the earth that's worth $160,000 — now $180,000 — to me as the customer."

A separate effect that law departments are already feeling is increased pressure on their own employees' salaries, which started in the last year as law firms announced outsize associate bonuses. Here, too, Cravath set the tone, announcing a 2015 bonus scale of $15,000 for first-years to $100,000 for eighth- and ninth-years.

Eliza Stoker, the executive director of search firm Major Lindsey & Africa's in-house practice group for the eastern U.S., says until very recently it was accurate to tell law firm associates eyeing a law department position that they should expect a 30 percent pay cut. In light of "astronomical" bonuses, however, the differential has grown, she says, and associate raises will only make it larger. As law firm raises hit the headlines, many associates who had been seeking in-house positions contacted MLA about their potential asking salary.

"We've had a harder time negotiating," Stoker says. "We play middleman when we get to negotiations, and we want to close it and close it fairly, with the right compensation for the right candidate. And we've had a lot more aggressive behavior from candidates who are taking the view that they'll just wait for another opportunity to come along that pays better."

On the other hand, she says, law department salaries have been on the rise for a while as in-house counsel have become viewed as strategic business partners — and as they have taken on more and more work rather than sending it all out to firms in response to growing cost pressure within corporations.

That cost pressure also places limitations on in-house salaries. With the exception of the most senior corporate counsel at large companies, there are very few in-house attorneys who pull in the kind of pay they could make as a law firm partner and, often, as a law firm associate. Corporations use their own pay scales, Stoker says, and in-house salaries are heavily dependent on individual factors, including the way CEOs view the inside legal function.

And that makes it even harder for in-house counsel not to scoff at the pay increases. Virtually all in-house lawyers and a large percentage of legal operations directors know the law firm world intimately because they cut their teeth in it. The law firm-client relationship is not a typical arm's-length business relationship, Sarwal points out, and that has only heightened the shocked reaction that many clients had to the increases. In some instances, first-year associates will now be pulling in double the pay of an in-house lawyer with far more experience, Cambria says.

As Corey puts it: "I think everyone's response to making $180K fresh out of school was that we all picked the wrong career."

To the parties already frustrated with law firms, the associate rate hikes may simply push them further away from traditional law firm engagement models. For years, observers have predicted the fall of BigLaw and all the practices for which it stands. If law firms have been digging their own graves, this is a meaningful shovelful if you go by the in-house reaction.

"At one level, I'm so pleased with this dynamic at 'OldLaw' — which is in the business of selling hours — as it simply accelerates the irrelevancy of the business model," says Carr, who now works for Valorem Law, a law firm that never charges clients by the hour and aims to emphasize efficiency and prevention.

The frustration surrounding the salary increases may cause law departments to demand more alternative billing arrangements, to demand greater efficiency and project management chops, and to use nontraditional legal service providers more. If expenses are passed down to clients, they will almost certainly keep more work in-house, aided by a larger in-house team, as the cost differential between in-house counsel and outside counsel becomes starker.

Put simply, additional expenses on the client make the "make versus buy" decisions going on within law departments a much easier call, Cambria says.

What's certain is that in-house eyes will be on bills until it's clearer how the salary increase will affect legal bills.

Sarwal recommends that clients take a page from Bank of America global GC David Leitch's book. The Wall Street Journal reported on Wednesday that he emailed a group of his law firms emphasizing that he did not see the justification for such increases and that his company did not "expect to bear the costs of the firms' decisions."

Corey, when asked whether she believes other law departments will follow suit, replied: "Oh yeah — I mean, my general counsel couldn't believe it. He was very surprised."

In-house counsel should be watching their legal bills closely anyway, in-house commentators say. This should make them double down. Groups like the ACC and CLOC have spent years encouraging law firm clients to push back — their message is to remember that clients have the power with law firms.

"You're the client," Carr says. "Act like one." When clients ask for something and make it clear they're willing to take their fees and walk, the service provider will deliver.

"To any client that has a new relationship with a firm, I would strongly advise them to reach out to their firms and make clear that these kinds of increases are unacceptable given the current market environment," Sarwal says. "They make no sense, and law firms should not expect to get these increases paid for on the backs of clients. It's as simple as that."