

## **The Dawning of a New Era: Generative AI and the Evolution of the Legal Business Model**

The legal profession has been debating the end of the billable hour for years. Yet, despite all the talk and prophecies, the billable hour remains the predominant business model of law firms around the world. However, as the profession stands on the edge of a technological revolution, marked by the arrival of generative artificial intelligence (GenAI), the longstanding rule of the billable hour faces an unprecedented challenge.

### **The Billable Hour: The Legal Profession's T-1000**

The billable hour's stronghold over the legal profession comes down to several factors, not least of which is its simplicity and familiarity. For more than 50 years, legal professionals have measured their worth and productivity through billable hours, creating a straightforward metric of success, even if it isn't well-loved - and even though, in reality, it measures neither worth nor productivity. Furthermore, alternative fee arrangements (AFAs), despite their appeal for offering cost predictability and aligning the interests of clients and advisors, have struggled to gain universal acceptance. The change requires a fundamental overhaul of legal business models, a journey that most find daunting.

### **Time recording: Transparency and Accuracy**

Then we come to the most pernicious element of the billable hour: time recording. If you bill by the 6-minute unit, you have to be able to track your time, so you can bill for it. This is the fundamental foundation stone on which the billable hour is built, yet it's a castle built on sand, not stone. Despite products claiming they can accurately record a lawyer's time, they can't: they can't account for lawyers taking time out to chat with or answer questions from colleagues, clients or contacts; they can't account for toilet or food breaks; they can't account for anything that isn't taking place on any device they aren't linked to.

So the argument that time recording is accurate is, well, inaccurate. We hear stories all the time of lawyers recording time at the end of a day, week or month, to make up their target hours. A recent poll by Roll On Friday revealed that 35% of lawyers say they have padded their timesheets, with 13% saying they do it regularly. This is what happens when your number 1 performance metric is time recorded and you put pressure on your teams to hit those targets each month. What you don't get is accuracy.

Then there's transparency. Proponents of time recording and the billable hour argue that they are transparent, but they aren't. Giving an hourly rate, while not being able to state how many hours a matter is going to take, is not transparent. Neither is simply stating on a timesheet that a task took 4 hours. This is not transparency, it is simply "how it has always been done". Clients know it and so do lawyers.

### **Generative AI: The Catalyst for Change**

Enter GenAI, which promises to redefine the way lawyers work. GenAI has begun to demonstrate its potential to disrupt what, traditionally, lawyers have considered their domain: research and drafting. The ability of these systems to rapidly and accurately perform tasks such as document review and summarisation not only streamlines operations, but also introduces a level of efficiency the profession could have once only imagined.

### **The Implications for Legal Business Models**

The implications of this evolution for legal business models are far-reaching. As GenAI takes on more of the routine tasks traditionally performed by junior lawyers, the number of hours that can be billed to these tasks will decrease significantly (the World Economic Forum estimates that Gen AI will give lawyers back 46% of their time). This shift presents a problem for law firms reliant on hourly billing, challenging their revenue models and pushing them toward a tipping point where the adoption of AFAs becomes unavoidable. After all, which client, knowing that GenAI exists, will accept a law firm that doesn't use it? And with 46% of a lawyer's time back, will a client accept a doubling of an hourly rate because their lawyer has to make up for that lost time and billing?

Then there's client demand for greater transparency and certainty. BigHand's Annual Law Firm Finance Report 2024 revealed that 76% of law firms surveyed report an increase in client demand for financial transparency, reporting, and additional discounting; 48% are being asked to use technology to drive efficiencies; and 42% to demonstrate the value of their investment with their advisors.

### **Embracing Alternative Fee Arrangements**

The rise of GenAI offers an opportunity for both law firms and their clients to embrace AFAs. These models, which include value-based pricing and subscriptions, promise a mutually beneficial arrangement. Clients stand to gain from the cost predictability, transparency and efficiency that AFAs offer, while law firms can use AI to deliver high-quality, high-speed services at fair prices.

### **The Role of Lawyers in an AI-Driven World**

A common misconception surrounding the integration of AI into legal practice is the fear for the future of human legal professionals. However, the reality is far from a dystopian vision of lawyerless law firms. AI's role is to augment the capabilities of legal professionals, freeing them from routine tasks to focus on higher-value, strategic work. This evolution in the role of lawyers underscores the shift from a quantity-focused business model to one rooted in the quality and value of the services provided.

This is what lawyers were always meant to be: trusted advisors. Yet, somewhere along the way, lawyers and the legal profession at large have forgotten this, instead being seen as either the administrative arm of other advisors, or blockers to getting deals done.

AI is going to free up lawyers' time to allow them to work strategically with clients to get them better outcomes based on their specific needs.

### **Navigating the Transition**

For law firms focused on making the transition to AFAs and integrating GenAI into their businesses, the way forward involves several key steps. First, firms must invest in understanding and deploying AI technologies, ensuring that their use maximises efficiency, focuses on effective outputs and complements the skills of their legal teams.

Secondly, the development of AFAs should reflect both the costs associated with AI deployment and the value these technologies bring to clients. This is an important point that, for the last 50 years and more, has been sadly overlooked by law firms in favour of hourly-rated inputs that bear no resemblance to the true value lawyers bring to their clients.

Lastly, law firms must embed a culture of innovation, where the exploration of new business models and technologies is encouraged and seen as integral to the firm's evolution.

### **Strategic Partnerships and the Client-Lawyer Relationship**

The adoption of GenAI and alternative fee arrangements won't just be limited to a change in billing practices; it will lay the foundations for a deeper evolution of the client-lawyer relationship.

According to the BigHand 2024 Annual Law Firm Report, 52% of firms report increasing demand from clients for strategic input into running their business. Relationships characterised by strategic partnerships where lawyers become integral advisors in their clients' success. In this model, lawyers leverage AI to enhance their advisory capabilities, ensuring clients benefit from legal expertise and innovative solutions that drive forward their business objectives.

As law firms move to provide faster outcomes, they will look to help their clients find better outcomes beyond the law.

The alternative is a world in which clients seek out their own solutions and bypass their outsourced legal advisors. Klarna, the Swedish fintech company, has already begun using ChatGPT to create first drafts of common types of contracts.

And this isn't the average lay client: this is the in-house legal team finding a solution that their outsourced legal advisors were unable or unwilling to meet.

And make no mistake: we are just at the very beginning of GenAI's journey - it is still in its infancy. As AI continues to improve, clients will be drawn to use it more and more themselves if their legal advisors aren't able to offer a reason not to.

### **The challenges for AFAs**

The transition from traditional billing to embracing AFAs and integrating generative AI does come with hurdles. Law firms face challenges, including the substantial initial investment required to implement AI technologies. Beyond the financial aspect, there's the cultural shift needed within firms to move away from the billable hour. Training teams to effectively use new technologies and adapt to a value-driven business model requires time and resources, potentially disrupting established workflows. Then there's the concern that reliance on AI for routine tasks could erode foundational legal skills among junior lawyers, who traditionally gain experience through such work.

Scepticism about the decline of the billable hour and the wholesale adoption of AI in legal practice remains. Critics argue that the billable hour has persisted because it straightforwardly quantifies legal work, providing a clear metric for productivity and revenue. They also raise concerns about the reliability of AI in interpreting complex legal documents, suggesting that AI cannot fully replicate the nuanced understanding a seasoned lawyer brings. Furthermore, there's apprehension regarding how AFAs work in complex, unpredictable legal matters where outcomes and workload are difficult to forecast.

### **Educating the Market**

A critical component of this transition will be educating both clients and law firm personnel about the benefits and implications of AI and AFAs. For clients, understanding the value proposition of these new models is key to their acceptance. This is actually easier than we imagine because our clients price on value in every other aspect of purchasing they undertake every day. Whether it is a car, clothes, food, or building work, fixed, up front prices allow us to make informed decisions about whether to go ahead with a purchase. The same would be the case for legal services.

For law firm personnel, a shift in mindset from equating billable hours with productivity to valuing efficiency, effectiveness and outcomes will be necessary. Training and continuous learning about generative AI's capabilities and ethical considerations will be integral to this educational process.

The billable hour may well offer a straightforward way to quantify legal work, serving as a clear metric for revenue. While this may be true, it's important to recognise that the billable hour fails to capture the true value delivered to clients. And the billable hour is not a measure of productivity. In fact, not only is it well-known to encourage inefficient working practices, it only measures time spent at a lawyer's desk, not the quality of the work done or whether it meets a client's need for speed.

AfAs, by contrast, encourage efficiency and innovation, allowing firms to differentiate themselves in a competitive market. They align more closely with client interests, building stronger relationships and enhancing client satisfaction by focusing on outcomes rather than hours spent. With a fixed, upfront price, lawyers are encouraged to find ways to improve outputs while maintaining and improving the quality of their work and advice. AI will dramatically help with both.

The concerns about AI's ability to interpret complex legal documents and its potential to miss the nuanced understanding a seasoned lawyer brings are well-known. However, the implementation of AI is not about replacing lawyers, but augmenting their capabilities. It can take over routine, time-consuming tasks, freeing lawyers to concentrate on higher-value, strategic work where their expertise is indispensable. This synergy between human insight and AI efficiency can lead to more comprehensive and effective legal outcomes.

AI should not be treated like a senior lawyer. Its work should be checked, amended and updated, just as we would with any junior lawyer.

The concern around training for junior lawyers is understandable; it is also based on the belief that our roles won't change, when they will. If lawyers are no longer document drafters and researchers, but rather trusted advisors, training of junior lawyers will shift accordingly.

They'll be taught how to use AI and extract the best information available; they'll then learn how to interpret AI's output for clients' specific circumstances; and they'll learn how to communicate that advice by spending more time with clients than ever before.

As our leaders' roles change, so will the training we provide to junior lawyers.

### **Pricing complex legal work**

An argument often put forward by proponents of the billable hour is that a lot of legal work is complex, with too many variables and unknown outcomes to be able to fix a price. Litigation is often held up as the principal example of how up front pricing can't work in all cases.

But most clients don't want their matter to go all the way to court. And they certainly don't want to feel they have come too far, and been billed too much, not to see it through. Because clients are given estimates and are billed in arrears, they don't know how deep they are financially into a matter until after the event.

With up front pricing, you allow the client two advantages:

1. The ability to break down and scope matters into stages and price only for what they know is coming up; and

2. The ability to budget for and make informed decisions about whether to proceed at each stage based on the cost of the upcoming stage.

Yes, breaking matters down into stages and pricing each stage requires time, but it isn't additional time; it is front-loaded time: time at the beginning of each stage rather than throughout the stage, so although it may seem like a lot, it actually saves a lot of time throughout because you have scoped each stage at the outset and only have to return to the scope if it changes.

It also saves lawyers time that would be spent reviewing timesheets, writing off time, negotiating with clients, handling bill-related complaints. All of this time is taken away with upfront pricing.

### **Regulatory and Ethical Considerations**

As law firms navigate this shift, the ethical implications of integrating AI into legal practices need careful consideration. Client confidentiality and data security are paramount, given the sensitive nature of legal work. Firms must ensure that AI systems comply with data protection regulations and that client information is safeguarded against breaches. There's also the ethical responsibility to ensure that AI tools are used in a way that enhances, rather than diminishes, the quality of legal advice. This includes maintaining oversight over AI outputs to prevent errors and biases from affecting legal outcomes. Regulatory frameworks may need to adapt to accommodate new technologies and billing models, ensuring they promote innovation while protecting the interests of clients and the integrity of the legal profession.

Lawyers need to be educated not only on how AI contributes to cost savings and efficiencies and effective outputs, but also on how to ensure clients are fully informed about the nature and value of the services they receive and how AI plays its role in this too.

### **The Future of the Legal Profession**

It is clear that the legal profession is at the point of a transformative shift. The integration of GenAI into legal practices is not a question of if, but when, and its implications for the legal profession are profound. The billable hour, while unlikely to disappear entirely, will no longer dominate the landscape. Instead, a new era of legal pricing is emerging — one characterised by flexibility, efficiency, effectiveness and a deeper alignment between the interests of law firms and their clients.

In this new era, the winners will be those who recognise the potential of genAI to revolutionise not just legal work, but the very foundations of legal business models. By embracing this potential and moving towards AFAs, law firms can navigate both the challenges posed by technological advancements and seize the opportunities they present. The future of the legal profession is not one of displacement, but of empowerment, where technology and innovative

pricing models combine to deliver superior value to clients and create a more sustainable and thriving legal profession.

## **A Call to Action**

For law firms ready to navigate this transformation, the move involves several strategic steps. Initially, firms should conduct a thorough assessment of their current technologies and workflows to identify opportunities for AI integration. Engaging in partnerships with AI providers and seeking expert consultations can offer insights into the practical application of AI in their specific legal context. To transition to AFAs, firms can start with pilot projects, allowing for experimentation and adjustment in a controlled environment. Additionally, investing in training for both lawyers and clients about the benefits and workings of AFAs can facilitate a smoother transition. Fostering an internal culture that values innovation and efficiency over traditional metrics of productivity is crucial.

Moving to AFAs and embracing the use of AI represents the best path forward for the legal profession for several reasons. It aligns with broader industry trends towards service and value orientation, meets client demands for cost predictability and efficiency, and uses technology to improve service delivery. Moreover, it positions law firms as forward-thinking, client-centric, and adaptable to the changing legal landscape.

The integration of generative AI into legal businesses represents more than just a technological upgrade; it signifies a transformative shift in the delivery, pricing, and perception of legal services. As the legal profession stands on the brink of this evolution, the call to action for law firms is clear: to embrace change, invest in technology, and adopt business models that reflect the true value of the services provided. In doing so, law firms will not only secure their place in the future of the legal industry, but also contribute to its ongoing innovation and success.

While the road ahead may be paved with challenges, the opportunities presented by generative AI and alternative fee arrangements are immense. By creating a culture of innovation, embracing new technologies, and reimagining the business model, the legal profession can ensure that it not only survives, but thrives in the age of AI. The future of the legal profession is here, and it promises a landscape where efficiency, effectiveness, value, and client satisfaction are at the forefront of how we work.

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