FORTIFYING LAW FIRM ECONOMICS AGAINST THE PERILS OF (GEN-) AI AND ETHICS RULE 1.5

Law firms that do not consider adopting legal spend data analytics tools as part of their AI strategy risk setting themselves up for ethical violations and subpar economic results. As we move into the AI era, the economic outlook for the legal profession is in flux and those who ignore AI's impact do so at their peril. The greatest impact AI will have on the legal profession is a paradigm shift in the way that legal work is done.[1] AI now challenges attorneys to adjust their practices to remain competitive while staying within the bounds of ethical standards.

Legal ethics experts have observed that a lawyer's use of AI invokes at least seven of the ABA Model Rules of Professional Conduct.[2] Several ethical rules, such as avoiding the unauthorized practice of law or abiding by the duty of candor to the tribunal, only have a tangential impact on law firm economics (as long as the firm otherwise stays inside the ethical guardrails).

Other ethical rules, specifically Rule 1.5, have both direct ethical and economic effects. Rule 1.5 states: "[a] lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses."[3] The eight factors to be considered in determining the reasonableness of a fee under Rule 1.5, though, have mostly emphasized inputs and outputs by human beings

Before GenAI's emergence, the Rule 1.5 analysis centered on whether a human being performed legal work in a reasonable manner for a reasonable amount of time and, ultimately, for a reasonable cost. Courts and legal professionals had to answer questions like "was Task X more suitable for a partner-level legal professional or for an associate?" and "Is 13.4 hours a reasonable amount of time for a 5th year associate to complete Task Y?" Human-generated inputs and outputs formed the crux of a Rule 1.5 "reasonable fee" analysis.

> "Law firms with the data tools and knowledge to "value price" in the GenAI era will be the winners."

With the arrival of GenAI, routine tasks that were tackled by armies of legal professionals in weeks are now completed by AI in minutes—and the first cuts of those tasks are often performed better and more consistently by AI than by humans. Lawyers now must consider whether, when, and to what extent to use AI when performing certain legal services for clients and how much to charge when doing so. Efficiency dictates that AI should be the correct first-cut or first pass on things like document review, simple document drafting, and other routine and recurring tasks as long as the AI is reliable, accurate, cost-effective, and secure. But thanks to AI's efficiency, the question of how to monetize advice that has been AI-generated has become a key challenge for law firm leaders.

When legal work is partially done by attorneys and partially done by AI, lawyers need to be thoughtful about striking the proper balance as to a "reasonable fee" for dual-generated work product. Charging a disproportionately high amount of attorney time for a dual-generated work product will be unacceptable to a court (or a client) and will be seen as violating the tenets of Rule 1.5.

One court already has slashed legal counsel's fees by over 30% on these grounds stating: "[i]f artificial intelligence sources were employed, no doubt counsel's preparation time would have been significantly reduced."[4] State bar associations and ethics boards are likewise laser-focused on the Rule 1.5 challenge. The California Bar recently wrote: "[a] lawyer may use generative AI to more efficiently create work product and may charge for actual time spent [but] must not charge hourly fees for the time saved by using generative AI."[5] The Florida Bar echoed similar sentiments in a recent Advisory Opinion, stating that "[t]hough generative AI programs may make a lawyer's work more efficient, this increase in efficiency must not result in falsely inflated claims of time."

Against this backdrop, law firms will operate at a major disadvantage when they cannot determine or support a "reasonable fee" for dual-generated output. Because it is now possible to use data analytics tools to figure out how long thousands of legal tasks should take when lawyers do not use AI, it is quite easy to compare that amount-to-task duration when using AI, and law firms should take the time to do just that. Without industry-wide data and benchmarks, unprepared law firms will be at a massive economic disadvantage in front of a client, a court, or a fee expert.

As such, law firm and lawyers are well advised to implement or, at least consider, the following when developing and executing an AI strategy:

1. Leveraging Legal Spend Data Analytics and Tools. It is impossible to establish that a fee is "reasonable" under Rule 1.5 without context. To successfully collect or defend fees, lawyers need to start thinking contextually about how to calculate the human vs. "human plus machine" split of time and cost. Data provides context. When properly analyzed across a meaningful data pool, legal spend data can establish baselines as to what has been an historically reasonable fee when legal work has been done by "humans only" versus the fees in the dual generated work product work. Well-designed AI-powered data analytics tools can forecast shifts in workloads that properly allocate work to different skill and automation levels.

2. Know the Cost of Hallucinations. AI is far from perfect. Often, it is far from "good enough." Lawyers have an ethical duty to ensure that the output of AI has been professionally reviewed consistent with the ethical duties of competence, candor and supervision. Lawyers should factor the review of AI-generated output into the "reasonableness" equation, because cite-checking and proofreading AI outputs is fully compensable, just like as if a senior lawyer were reviewing junior associate or paraprofessional work. When that required review shows that the AI-generated work product has "hallucinated," thereby requiring modification or improvement, all or some of the "redo" cost should also be compensable for lawyers.

3. Adopt "Premium" Hourly Rate Structure. AI is not going to replace lawyers. It will, however, replace some of the routine, low-value work that lawyers do. If AI can effectively, securely, and efficiently handle low-value work, then that leaves only "high-value" work for lawyers to handle. Clients benefit from lower costs associated with lower value AI-generated work. The eight-factor test under Rule 1.5 supports the conclusion that if lawyers are handling high(er) value work only, a premium hourly rate structure at a higher level than the standard hourly rate may be appropriate. The value proposition is not "we need to raise rates to balance our budget" but rather "we are raising our rates because true legal expertise is **the** service being delivered."

4. Investigate and Evaluate AI. As AI usage deepens in the legal industry, it will become difficult for lawyers to bill their clients a reasonable fee without leveraging AI technologies. Lawyers will not need to adopt every AI product, but just like Westlaw and eDiscovery tools, the market will force the adoption of some. Firms should assess when the legal industry expects legal professionals to use AI and focus their AI strategy on those areas in order to balance optimal efficiency with law firm economics.

5. Consider Appointing an AI-Pricing Guru. Forward-thinking law firm leaders should recognize the havoc that the confluence of Rule 1.5 and AI will have on the law firm economic model. Getting out in front of the challenge with the right resources is critical. Legal spend analytics tools are just the start. It's important for knowledgeable experts at law firms to be tasked with, and given the resources towards, solving the Rule 1.5 issue before it's unwieldy. Law firm business experts, like CFOs, COOs, and Chief Pricing Officers are well suited to get ahead of this economic issue, but ultimately, lawyers need to look around the corners of Rule 1.5 to address an inevitable challenge proactively.

The effective use of GenAI will distinguish successful and unsuccessful law firms within the next three-five years. A vital contributor to success is being able to ensure that fees charged for part-human generated, part-AI-generated work is properly priced according to Rule 1.5's ethical mandate. As has always been the case, firms are more likely to be able to collect truly reasonable fees.

[1] See Erin Mulvaney and Lauren Weber, "End of the Billable Hour? Law Firms Get On Board With Artificial Intelligence," Wall Street Journal (May 11, 2023).

[2] The following rules are regularly noted as being invoked by the use of AI: Rule 1.1 (Competence); Rule 1.3 (Diligence); Rule 1.4 (Communications); Rule 1.5 (Fees); Rule 1.6 (Confidentiality of Information; Rule 3.3 (Duty of Candor); Rule 5.3 (Duty of Supervision) and Rule 5.5 (Unauthorized Practice of Law).

[3] Model Rules of Prof'l Conduct R. 1.5 (2023).

[4] Cass v. 1410088 Ontario Inc., 2018 ONSC 6959 (2018).

[5] The State Bar of California Standing Committee on Professional Responsibility and Conduct Practical Guidance For the Use of Generative Artificial Intelligence in the Practice of Law, available at https://www.calbar.ca.gov/Portals/0/documents/ ethics/Generative-AI-Practical-Guidance.pdf.   What the Committee did not discuss, though, is what alternative pricing structure would be appropriate.

[6] Florida Bar, Proposed Advisory Opinion 24-1 Regarding Lawyers' Use of Generative Artificial Intelligence – Official Notice (Nov. 13, 2023), available at https://www.floridabar.org/the-florida-bar-news/proposed-advisory-opinion-24-1-regarding-lawyers-use-of-generative-artificial-intelligence-official-notice/