



**Alternative Fees:
Are We REALLY Serious This Time?**

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The “Good Old Days”

- Forty years ago, legal fee billing went something like this:
 - Lawyers kept track of their time by matter on little cards or slips of paper, which were filed by client and matter
 - When a matter was ready to be billed, the partner call for all the cards in the “unbilled” file and sorted through them, reading the narrative recorded thereon and assessing the time spent
 - Having done this he (there were no female partners) considered the result received by the client and came up with a number that felt fair
 - The invoice read “For services rendered...”, contained a short narrative description of the work done, and quoted a single flat fee

ENTER THE ACCOUNTANTS

Hourly Billing – The Early Days

- Hourly billing was in common use by accountants and engineers long before 1969
 - Government cost-plus contracts
 - Services rendered outside the scope of annual audits
- Accountants and software companies began to offer crude computer-based time recording and billing systems
 - Early systems were magnetic-stripe card ledger systems
 - 1967/68 – Cravath Swaine & Moore
 - 1969 – Price Waterhouse
- Minicomputers offered affordable entry for smaller firms
 - Barrister, Informatics, CTLaw, Harris & Paulson, et. al.
- As more and more “passed-over” associates were placed in in-house counsel positions, clients became increasingly comfortable with hourly billing, especially the insurance companies

But, good ideas eventually go bad

Misaligned Incentives

- Lawyers were rewarded for effort, not results
 - Associates paid for billable hours
 - “Leave no stone unturned” litigation strategies
 - Excessive due diligence on transactions
 - Over-lawyering in the name of loss prevention
- General counsel were in a weak position vis-à-vis outside counsel
 - Many owed their jobs to the company’s chief outside counsel
 - Outside counsel typically had a stronger relationship with top management
- Cost control was difficult
 - Outside counsel managed the priorities
 - Budgets were non-existent
 - Not knowing how to manage the amount of time, general counsel focused on controlling hourly rates
- For a lot of Wall Street firms, hours were irrelevant, as their fees were set as a percentage of the value of the transaction or securities offering
- On Main Street, however, the economic stagnation of the 1970s and the 1980 and 1982 Recessions started putting pressure on margins

The Beginnings of Change

- Late 1970s – Companies begin to bring more work in-house and dramatically increase the size of law departments
- 1980 – ACCA becomes an active force in leading the cost-control charge
 - “Convergence”
 - Press for budgets and capped fees
 - Attempts to end the cycle of annual hourly rate increases
 - “Task-based billing”
- Early 1980s - A Cleveland defense litigation firm switched to annual retainers and flat fees
- Mid 1980s – A major power shift in favor of in-house counsel puts outside counsel on the defensive
- Mid 1980s, Steve Brill and American Lawyer, predicts that alternative fees would replace hourly billing within five years
- Late 1980s ACCA and ABA join forces to brainstorm creative solutions
- 1989 – ABA publishes Beyond the Billable Hour, edited by Richard C. Reed, Esq.; in following years, it goes through two more editions under different titles

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What Happened?

- After much ballyhoo (remember TQM in law firms?), little progress was made
 - In house counsel only wanted capped fees, not flat fees, fearing that outside counsel might make more than the value of their hours
 - Outside counsel preferred flat fees, but with “carve-outs” and provisions to renegotiate the fee if a matter got out of hand
 - The fundamental problem was a lack of trust
- Instead of devoting time and effort to develop a workable alternative fee structure, many corporations adopted the DuPont “convergence” program
 - Dramatically reduce the size of the panel of outside counsel firms
 - Promise firms access to a much greater volume of work
 - Require that hourly rates be heavily discounted in exchange for increased volume
- Alcoa briefly cut a deal with one firm to handle any and all cases for a flat annual retainer
- Insurance companies pushed even harder on rates, disallowed certain activities, required electronic billing and used computers to audit legal invoices

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Where Are We Today?

- While some progress has been made, as of 2007 more than 85% of legal work was still billed on the hourly basis
 - Increasingly, clients are requiring budgets and task-based coding of time charges
 - Insurance companies have tried to switch to flat fees per task (e. g., \$X to take a deposition)
 - Other than improved progress reporting and better communication regarding fees, complex litigation and most complex transactions are still billed hourly
- Some firms – many of them start-ups who wanted to differentiate – have actively marketed alternative fees as part of their core strategy; Bartlit Beck and Tucker Ellis & West are two that come to mind
- The 2008/2009 Recession has probably done more to advance the alternative fee debate than any other factor
 - Over 10 years, non-legal costs at major corporations increase 20%, while law firm prices rose 75% (Corporate Executive Board survey)
 - According to AmLaw statistics, law firm profits per partner grew at an annual rate of nearly 10%, almost all of it fueled by increasing rates
 - 5% on the revenue line translates to 15% growth in profits at most firms

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Where Are We Going?

- In 2009, it is clear that alternative fees/pricing approaches are at center stage in the minds of clients
 - ACC Value Challenge – “Meet. Talk. Act.”
 - The economic environment has squeezed out all the fat in non-legal costs, and CEOs have ordered their law departments to lower outside counsel spending
 - Even if general counsel have not embraced the alternative fee concept, CEOs have – it just makes good business sense
- We found, by talking to our clients and friends in the profession, that high fees charged by big firms are driving work to high quality firms with lower fee structures and different leverage models
 - Whether this will finally force big firms to question and – one hopes – abandon the old business model and recruiting strategies remains to be seen
 - Will bigger firms who laid off hundreds of lawyers over the last year use this opportunity to re-tool their leverage models, pricing mentality and reward systems?

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Where Are We Going? (cont'd)

- Alternative fees/pricing will probably not eclipse the billable hour/standard rate (as a majority of overall fees) in the foreseeable future, but
 - They will account for a considerably larger proportion of billing methods for most firms in dealing with their major clients, regardless of size
 - Law firms who ignore the importance of this shift/trend without a positive response to their clients' inquiries, do so at their own peril; it's what the CEO wants, so you had better listen
- The ACC Value Challenge (more on this later) addresses management concerns over value vs. cost in a positive way that cannot be ignored
 - Firms that lead in this area will be seen as innovative
 - Firms that resist will be branded as inflexible, intransigent and self-serving

The Experience Gap

- Alternative fees/pricing, at their core, involve the business management concepts of planning, estimating, and project management – skills not typically found in the tool kit of lawyers, both outside and inside
 - Fixed fee estimations and, subsequently, competent project management to achieve those fee estimates are learned skills
 - If a lawyer has not handled cases/matters in a fixed fee environment, he/she usually tends to underbid the level of effort
 - Further, the lawyer is usually not experienced at monitoring/controlling time spent against specific activities/tasks
 - The more esoteric elements of alternative fees/pricing – such as success fees, litigation bundling, platform/standardized bids on transactions – take it to another level of complexity
 - These all involve managing and sharing risk between the lawyer and the client in a world of uncertainty
 - Unlike people trained in business management, lawyers are uneasy functioning in the world of uncertainty.

Prerequisites for Success

- Effective use of alternative fees/pricing requires three fundamental things:
 - **Trust** between the client and the outside attorney – it takes experience for this concept to work effectively and trust is necessary to build a process that works for both parties
 - **Training** of partners in the approaches to alternative fees/pricing and, importantly, the availability of templates and management aids (e.g. – Excel estimation models, project management software)
 - **Measurement and data** that support effective front-end estimation and back-end monitoring of cases and matters as they develop – a billable hour is often not longer a useful statistic, others (such as percent of task completion, etc.) become much more important
- As the ACC Value Challenge eloquently points out, none of this happens if either side feels that the other side is out to skewer them
 - Outside counsel have to accept some level of over-run as a cost of doing business that is associated with learning
 - Clients have to accept occasional premiums as a return on the investment outside counsel has made to learn how to drive value

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Not a Monolithic Concept

- Alternative fees/pricing are often treated in the legal management media (and in the minds of lawyers) as somewhat of a monolithic concept – fixed fees; this is not the case
 - Alternative fees/pricing involve a variety of techniques (e.g. – success fees, blended rates, bundling, standard approaches), as well as fixed fee estimation
 - Clients vary widely in their support of and use of approaches to alternative fees.
 - Some strongly support them as a win/win in their relationship with outside counsel and see the concept as a way to control and manage costs – and this is the point of the ACC Value Challenge
 - Others see them as a means to “squeeze” outside counsel – win/win is not important and not a consideration; we saw this in the 1980s
 - Other clients think these concepts are, at best, a fad and will fade like other fads before them; this attitude is what killed the debate in the last 20 years
 - Finally, others view alternative fees/pricing to be nothing but away to get a discount off present standard rates; this perpetuates the problem
 - If alternative fees are to work effectively, the viewpoint taken by the ACC Value Challenge is the only one that will work

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Case Studies

- Goal Alignment - A mid-west defense law firm agreed to handle all medical claims from the East Coast to the Mississippi River for an annual retainer to be re-negotiated annually. The retainer was adjusted based on:
 - Number of files opened vs. number of files closed
 - Number of files closed without payment
 - Ratio of settlements to initial claims
 - Loss adjustment expense
- Task Billing - An Albany NY patent firm handles applications for several technology companies for a flat fee per application, plus, if required, a second flat fee for completing responses to office actions related to the application
- Risk/reward – A New England firm performs a full range of legal services needed by several early-stage companies in exchange for a monthly retainer, with a few carve-outs. Performance premiums kick in as various stages of financing are completed. There is an equity kicker if the client goes public.

Case Studies (cont'd)

- Experience-Based Fees – A Mid-West firm handles product liability litigation on a flat-fee per case basis. Fees vary according to the size of the initial claim and are renegotiated biennially, based on a statistical analysis of the relationship between results achieved and defense costs incurred.
- Risk-Sharing – An East Coast firm handles all private M&A transactions for two operating divisions of a Fortune 50 company. Target fees are set based upon the size of the transaction, adjusted for complexity (negotiated). The law firm is guaranteed the target fee so long as the value of time charges (cost) fall within 80% to 120% of target. If cost exceeds 120% the firm receives 80% of the excess over 120%. If cost falls below 80%, the firm gets 80% of target.
- Phase Billing – A New York firm handles accountants' liability suits on a flat-fee per phase. The client pays a flat fee for an "Initial Case Assessment". A second flat fee is then negotiated for discovery and motions. After discovery and motions and complete, a case strategy is developed and additional flat fees are negotiated for alternate case strategies.

The ACC Value Challenge – An Overview

- See www.acc.com/valuechallenge
- Initiated in 2009, this program is an attempt to restructure the value-for-fee relationship between clients and outside counsel. It includes:
 - An overview of how a law firm should approach the challenge – “Meet. Talk. Act.”
 - A draft “Covenant with Counsel” that spells out rights and responsibilities of both parties
 - Guidelines and checklists for client/lawyer issue discussion and resolution
 - Spreadsheets and templates to support matter budgeting, alternative staffing analyses and general modeling of fee proposals
 - Agreement forms, templates and samples
 - Resources for training and support in the area of project management
 - Suggested metrics to maintain, including the ACC Value Index that allows clients to rate the value provided by individual lawyers, practice groups and firms
- With the right leadership on both sides, this might just catch on

What is a Smart Firm to Do?

- Internal Steps
 - First, decide on an **alternative fees/pricing strategy**. Is this something the firm will do to accommodate all or just a few clients? Or, does it plan to take its alternative fee approach to market (as Bartlit Beck has)?
 - Invest in **training and support** – training in the concepts and tools to be used and support (usually from management and/or financial personnel) in utilizing the tools and concepts.
 - It is important to **focus** on a few important clients and proactively develop approaches that meet their needs. If a firm works well in with a few key clients, it can transfer those skills/experience it learns to others.
 - Finally, develop **information systems and experience** and use the information and experience to better understand and meet client needs and, importantly, produce a more predictable and acceptable bottom line from using these concepts.
 - **Align your reward systems** to measure and reward long-term value, not just hours and fees.
 - Work with marketing people to **develop an effective way to roll out your message**, initially, and promote your successes.

What is a Smart Firm to Do? (cont'd)

- External Steps
 - **Explore the ACC Value Challenge.** If it makes sense, make a commitment to its principles.
 - Start with "Meet. Talk. Act." program with no more than three clients.
 - Work with the clients to understand their business objectives better and at devise ways of working together that align their goals with yours.
 - Work with the clients to indentify key measures and metrics to support alternative billing and to track results over time. This should include looking at information available within the clients' organizations.
 - If your clients are insurance companies, pose the value/cost/risk question to their actuaries. Risk assessment and management is their business. With the right data you can build an effective pricing model.
 - Negotiate a tailored alternative fee agreement with each client
 - **Implement the three programs and measure results** over a two-year period, then, adjust accordingly. In the meantime, restart the program with three additional clients.
 - Where possible, **learn from other law firms** (excluding you competition) that are experimenting with alternative fees.
 - TAGLaw members may be a great source of collaboration.

QUESTIONS/COMMENTS



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