

Alternative Fee Arrangements: Value Fees and the Changing Legal Market

PATRICK J. LAMB



Alternative Fee Arrangements: Value Fees and the Changing Legal Market

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UK/EUROPE OFFICE

Ark Group Ltd
Paulton House
8 Shepherdess Walk
London N1 7LB
United Kingdom
Tel +44 (0)20 7566 8276
Fax +44 (0)20 7324 2373
publishing@ark-group.com

NORTH AMERICA OFFICE

Ark Group USA
4408 N. Rockwood Drive
Suite 150
Peoria IL 61614
Tel +1 309 495 2853
Fax +1 309 495 2858
publishingna@ark-group.com

ASIA/PACIFIC OFFICE

Ark Group Australia Pty Ltd
Main Level
83 Walker Street
North Sydney NSW
Australia 2060
Tel +61 1300 550 662
Fax +61 1300 550 663
aga@arkgroupasia.com

Commissioning editor

Anna Shaw
ashaw@ark-group.com

Assistant editor

Stephanie Ramasamy
sramasamy@ark-group.com

Managing director

Jennifer Guy
jguy@ark-group.com

UK/Europe marketing enquiries

Robyn Macé
rmace@ark-group.com

US marketing enquiries

Daniel Smallwood
dsmallwood@ark-group.com

Asia/Pacific marketing enquiries

Steve Oesterreich
aga@arkgroupasia.com

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Executive summary

HEADLINES IN the legal press have long predicted the death of the billable hour, as clients express increasingly vehemently their dissatisfaction with this outdated way of valuing legal services. But the habits of decades are hard to shift, and the structures and behaviours that have resulted from this way of working require more than cursory attention.

The global financial crisis has acted as a catalyst to change, though. With businesses under huge pressures to cut costs, do more with less and gain greater certainty of costs, clients are necessarily becoming more assertive in their fee discussions with their law firms and demanding alternative fee arrangements. Firms must face up to the fact that some clients will simply not work on the basis of billable hours any more. Other clients may offer more regular work in exchange for more predictable cost.

But all of this is more easily said than done. What kind of fee structures are firms using, and how do you make them work for your firm? How do you put a face value on a piece of work, and how do you ensure continuing profitability? This report sets out to answer these questions and many more. Throughout the report, key points are illustrated with examples from firms and companies which have entered into alternative fee arrangements.

Chapter 1 sets the scene and explains where the billable hour came from, why it stuck and why the world is now changing.

Chapter 2 examines how it is that, deliberately or otherwise, firms can end up

overcharging their clients – sometimes quite significantly – as a result of the weaknesses of the billable hour as a fee model. The motivation for change among firms may be weak, but the benefits for clients are potentially enormous.

Before leaping into further discussions, it is important to be clear what is even meant by alternative fee arrangements. Chapter 3 describes the need to move away from the idea that more time spent on a matter means more money for the firm and proposes a new term: value fees. The link between fee structures and the behaviours they encourage is discussed, and possible ‘alternative’ structures are examined.

What do clients think about all of this? Chapter 4 explores clients’ views of alternative fee arrangements – and indeed about paying fees to their external counsel in general.

Chapter 5 shares the experiences of firms which are successfully using alternative fee arrangements. It explores why these firms decided to start offering alternatives to the billable hour, what they had to do differently to make the new structures work, the challenges faced and the outcomes.

One of the challenges, of course, is to put a clear value on legal services rendered. How do you decide on a price? Chapters 6 and 7 explore this key question, highlighting the need to identify the variables in a matter and really understand what the case means to your client – and indeed to your firm.

Chapter 8 focuses on the change that is needed for firms to be able to implement alternative fee arrangements with any level of success. How do law firms need to change their behaviour and culture to adopt a different way of working?

Continuing on the topic of change, Chapter 9 outlines some practical ways in which law firms and lawyers can adapt their working habits to support productivity and efficiency. Project management, Six Sigma and lean methodology, decision trees, early case assessment and early case mediation are discussed.

Chapter 10 explores the questions that smart buyers ask and how to respond to ensure they understand value fees. In particular, it is important to be able to respond satisfactorily to any concerns that quality will drop if lower fees are paid.

Chapter 11 explains how to be a smarter seller and make value fees work for you.

The focus is broadened in Chapter 12 to consider some more general benefits and challenges of value fees becoming more prevalent in the legal market. The impacts on staffing, training, results and cost-cutting are all discussed.

The final chapter constitutes a discussion of the old normal and the new normal, and the pace of change. What will lawyers need to know and do to survive and thrive in the new normal?

About the author

PATRICK LAMB is one of the founding members of Valorem Law Group, LLC. After spending 18 years at an AmLaw 100 firm, including several years as an equity partner, Pat left the firm to join a litigation boutique, where he spent seven years, including six as a member of the firm's management committee. During these years, he was an avid proponent of budgeting and non-hourly fee arrangements. Ultimately coming to the conclusion that firms could not exist in both the hourly and non-hourly worlds, Pat and three colleagues, all big firm refugees, formed Valorem, which began in January 2008 as a non-hourly, value-fee firm. The firm represents businesses in complex disputes, and has more than doubled in size since its inception.

Described by one in-house lawyer as "one of the few lawyers who gets it", Pat was named a legal rebel by the American Bar Association in 2009 and is a frequent speaker on value fees and the role of project management in the successful use of value fees. He began writing the popular blog 'In Search Of Perfect Client Service', at www.patrickjlamb.com, in 2005.

Foreword – A warning

SEVERAL FUTURISTS have predicted an accelerating rate of change. For example, in the next ten years we will experience the amount of change we experienced in the entire 20th century. While this sounds far-fetched, I draw from my own experience to see that it may not be so far from the truth. Typewriters and correction fluid gave way to computers that check spelling and identify errors in grammar. Mail delivery gave way to FedEx, which gave way to electronic delivery of documents. Travelling to meetings is giving way to telepresence. While there may be debate about how fast dramatic change will happen, the debate is only about the pace of dramatic change, not whether things will change dramatically.

As you read this report, you can unleash your legal training and fashion arguments about why certain observations are wrong or why points made are distinguishable (the 'I'm special' argument). You can do those things, put the book down and do nothing. That is precisely what the leading buggy-whip manufacturers would have done at the beginning of the 20th century.

Alternatively, you can take this book as food for further thought. And then you can unleash the power of your mind to imagine a different future and make it so.

This book is dedicated to those who opt for the latter approach.

Introduction: Three stories. Three lessons.

I WAS working on two different matters with two different partners. One partner was one of my mentors, Frank Grossi. Frank had been mentored by legendary trial lawyer Edward Bennett Williams, the founder of Williams & Connolly. Frank did not suffer fools and he hated the endless waste in litigation. He was all about getting a case to trial as fast as possible. "If the case is going to settle," he told me, "it will settle sooner and more favourably if the other side knows that we plan to go to trial." At the very same time I was working with another partner, whose approach to litigation was the polar opposite. She was legendary for the huge number of hours she billed, and she never met a motion that shouldn't be brought, a brief that should not be rewritten or a rabbit hole that should not be explored. Discovery fights were the bread and butter of every case. The juxtaposition of these two approaches was so marked that I could not help but see that much of what happens in litigation does not make a difference to the outcome.

Lesson number one: *There's a lot of fat in litigation that can be cut out with no effect on the outcome.*

When I was a young lawyer, I was assigned to defend the deposition of a witness who worked for a large fast-food enterprise. When I went to prepare for him, I found out he was 'the cups guy', responsible for purchasing all of the cups the company needed for its own operations and those of most franchises. I expected an army of

people would be involved, and he told me it was just him, and 'cups' was only part of his overall job. "I just figure out the number of cups we need and what performance specifications cups must meet. Then I figure out how much we will pay for that total number of cups and I ask companies to bid on a portion of the total." He went on to explain that he didn't worry about how the cup suppliers sourced the cups, or what they paid for raw materials. "We're not a cup company. They are. They're in a superior position to figure out how to lower costs. The more they lower their costs, the more profit they make this year. And then next year, I can reduce the amount I have to pay since they'll figure out new ways to be more efficient."

Lesson number two: *Those whose job it is to do it can best figure out how to do it better.*

There was a company that sold paint to an auto manufacturer. The manufacturer had its employees apply the paint. There used to be a lot of problems. The applicators blamed the problem on the paint. The paint company blamed the problem on the applicators. The manufacturer didn't care where the blame resided. It wanted the problem solved. It wanted a solution. The paint seller then offered a solution: it would take over the process of painting every car manufactured. Instead of the manufacturer's employees applying the paint, the company offered a total solution, from selling paint to applying it. It worked. The problem was solved and the company made a lot more money.

Lesson number three: *If you want to be a player, solve a problem.*

These three lessons – the existence of waste in the process; putting the onus to control the cost of production (eliminate waste) on those closest to the production process; and selling solutions instead of pieces – are the foundation of this report. These lessons are the core of a view of the practice of litigation that varies dramatically from the way things are normally done. But change has arrived, and lawyers will either learn new ways to approach their work, or they will soon have no work left to approach.

Lawyers have worked for so long under a cost-plus billing system that the idea of capping a fee and figuring out how to deliver the ‘product’ at lower cost is utterly alien to most. But for savvy clients, particularly chief executive officers (CEOs) and chief finance officers (CFOs), the idea of cost-plus services is an anathema. Smart general counsel (GC), aware that “what interests my boss must fascinate me”, are looking at ways to substantially reduce legal costs and share this with the CEO and CFO in a “I will contribute a penny per share” or similar metric that directly resonates with the company’s most important audience, its shareholders. Less aggressive GCs are being forced to go through the same exercise when their budgets are simply reduced 20 per cent or substantially more.

So, we have an unparalleled opportunity arising:

- Law departments are being forced to reduce costs on an unparalleled scale;
- There is fat in the legal services that have been delivered; and
- Those closest to the fat – outside lawyers – are smart people. Properly motivated, they can reduce the cost of delivering legal services by huge amounts.

What lawyers need to accomplish this cost reduction are tools and motivation. The latter of these, motivation, should exist in spades. One of my favorite quotations, attributed to Samuel Johnson, is that “nothing so concentrates a person’s mind like the prospect of being hanged in the morning”. The need to survive is a powerful form of motivation. Alternative fees are an essential tool in the redesign of the delivery of legal services. Indeed, alternative fees are the most important tool because this is the tool that will motivate the use of other key tools.

The third lesson is also critical to the redesign of the delivery of legal services. Clients have problems that need solutions. Jeff Carr, the legendary GC of FMC Technologies, always tells audiences that inside counsel “are not in the business of answering interesting legal questions. We are in the business of offering practical, actionable advice”. It is rare that a one-off matter is the real headache. Such matters are symptoms of larger problems. It is true that many in-house lawyers are content to simply manage those larger problems. But just as the paint supplier saw an opportunity to provide a larger and more valuable service (to its great economic benefit), the key to real success is learning to diagnose the real problem and develop winning solutions.