



Alternative Fee Arrangements

*...DuPont, like other clients, does not want to buy time; it wants to buy results... - Thomas L. Sager,
Vice President and Assistant General Counsel, E.I. duPont de Nemours and Company*

Participant's Guide

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Common Alternative Billing Methods and When to Use Them

Ultimately, clients want to pay for results, not time. When asked, many of them will tell you that they want predictable costs, not surprises. And in the event of a poor result or cost overruns, they want their lawyers to share some responsibility. The most commonly used billing method, the hourly fee, in many cases discourages lawyers from satisfying these needs. Not surprisingly, many clients and their law firms are replacing the billable hour with one or more of the following alternatives:

Fixed or Flat Fees

- **Description:** Client engages law firm to provide a specific service (e.g. confidentiality agreement, simple will, buy-sell agreement) for a set price. This service could also represent one segment of a larger matter (e.g. initial investigation phase of a litigation matter).
- **Example:** Client, owner and operator of 122 hotels, pays law firm a fixed fee to handle the initial, 60-day investigation phase of a workers' compensation case.
- **Advantages:** Fee is not based on time and both client and firm know at the outset what the fee will be. This allows client to budget accordingly and avoid billing surprises. It allows firm to leverage its expertise and efficiency. It requires both firm and client to document with specificity what services will be performed for the fixed fee. It gives firm an incentive to improve workflow, make better use of technology and pay closer attention to the way in which it staffs matters.
- **Disadvantages:** Law firm assumes the risk of cost overruns. As a result, lawyers must foresee all contingencies and fully understand the costs of providing services, or risk losing money on the engagement. Client assumes the risk of a bad outcome. Thus, unforeseen circumstances could lead to tensions around the need for higher quality work product and/or additional effort from the firm.
- **When to Use:** High volume, routine, commodity work where costs are easy to predict and surprises are rare. Clients are comfortable assuming the risk of a bad outcome and law firms are comfortable assuming the risk of cost overruns. In every instance, alternative fee agreements should include safety valves or "reopeners" that allow both client and firm to revisit and revise the agreement should unforeseen circumstances occur.
- **Most Often Used With:** Performance bonuses or rewards based on achieving shared objectives (e.g. reducing overall costs, improving cycle time, early disposition, high damages award, etc.). This can help align interests and minimize the disadvantages inherent in this billing method.

Contingency Fees

- **Description:** Client pays law firm based on the results achieved. Payment is often expressed as a percentage of the recovery, settlement, or amount saved.
- **Example:** Client, a woman who believes that her husband died as a result of his doctor's misdiagnosis, retains law firm to bring a wrongful death action against the doctor and the hospital at which he works. Client agrees to pay law firm 35% of the recovery.
- **Advantages:** Clients only pay when law firms achieve successful results—they don't pay for time. Allows economically challenged clients to obtain legal representation. Allows law firms that carefully screen new matters to fully leverage their efficiency and expertise. Finally, provided the terms are clearly documented in the fee agreement, both client and lawyer know at the outset how the fee will be determined.
- **Disadvantages:** Law firms assume all of the risk. As a result, those firms with little experience, inefficient operations, poor screening processes, or weak financial skills, risk losing money. In addition, some jurisdictions are placing caps on contingencies in certain circumstances. Finally, if law firm achieves a successful result for client with very little effort, client may feel lawyer was overpaid.
- **When to Use:** When law firms are highly confident in their ability to achieve successful results through detailed screening, efficient operations, strong financial skills and of course, legal expertise. When clients with valid claims are unable to pay for legal representation in any other way.
- **Most Often Used With:** Fixed or flat fees or straight hourly billing. For example, client and firm might agree to segment a litigation matter in such a way that law firm bills for the initial investigation phase on a fixed fee or straight hourly fee basis. Once the details of the matter become clearer, client and firm could agree to a contingency fee arrangement.

Retrospective Based on Value

- **Description:** Fee is determined by law firm at the conclusion of a matter and is based on client objectives as defined at the outset. Often, client and firm also agree to a minimum fee based on straight or discounted hourly rates.
- **Example:** Client, a small American business hires law firm to help it obtain funding and expand into Europe. Client wants to obtain funding quickly from organizations that are best positioned to help it grow its European business. Law firm agrees to perform all of the necessary legal work and introduce client to key financiers at a reduced hourly rate. Client and firm agree that additional fees will be determined once funding is obtained.
- **Advantages:** Shifts focus from time spent to the value of results. The amount of the fee is based on the value to the client as defined by the client.

- **Disadvantages:** Requires a great deal of trust between lawyer and client. Client may not agree with how law firm values its services.
- **When to Use:** When client and law firm know and trust each other—and when the value to the client of the results achieved can be fairly and accurately calculated.
- **Most Often Used With:** Straight or discounted hourly billing up to an agreed upon minimum fee with performance bonuses or rewards based on achieving shared objectives (e.g. reducing overall costs, improving cycle time, early resolution, high damages award, etc.). This can help align interests and minimize the disadvantages inherent in this billing method.

Retainers

- **Description:** Client makes a deposit against charges for future services or client makes a deposit in return for which law firm guarantees its availability for a specific period of time and/or agrees to refrain from representing adverse parties.
- **Example:** Client, a national securities brokerage, pays law firm a \$7,500 monthly retainer in return for which law firm agrees to have two of its securities lawyers on call two days a week to answer brokers' questions.
- **Advantages:** Clients are more likely to seek legal help when they know the clock isn't ticking. Law firms are paid up front and thus can avoid collection and profitability problems provided retainer is kept current and accurately reflects the costs of providing legal services.
- **Disadvantages:** Clients must pay up front. Disagreements about what is included in the retainer can occur if the details of the retainer are not clearly specified in the representation agreement. This can cause lawyers to think they're doing too much and/or it can cause clients to think they're receiving too little.
- **When to Use:** When positive cash flow is important for the law firm. When clients want legal help without a ticking clock or when clients want to ensure that law firm doesn't represent an adverse party. Retainers are often used after the first engagement when a degree of trust has been established between law firm and client and when both parties have a better sense of costs involved in the representation. While not required, law firms are wise to provide client with periodic summaries of tasks performed and results achieved to demonstrate the value of the services client is receiving under the retainer.
- **Most Often Used With:** Since the retainer is a deposit against future charges, it can be used with virtually any billing alternative.

Capped Fees

- **Description:** Client pays law firm up to a specified maximum amount, but no more.

- **Example:** Client retains law firm for a litigation matter. Law firm agrees that its fee for the initial investigation will not exceed \$50,000. Thereafter, client and law agree to additional “not-to-exceed” fees for each of the subsequent phases of litigation.
- **Advantages:** Rewards law firms that know how to leverage their efficiencies and expertise. Client is able to predict maximum costs and shift some of the financial risk to the law firm.
- **Disadvantages:** Can hurt law firms if they misjudge costs or if unforeseen circumstances occur and there is no safety valve provision that allows for renegotiation and revision. Also, if cap is set too low, it can discourage law firm from conducting a thorough assessment during the early stages of a matter.
- **When to Use:** High volume, routine, commodity work where costs are easy to predict and surprises are rare. Client and firm have a strong relationship. Clients are comfortable assuming the risk of a bad outcome. In every instance, alternative fee agreements should include safety valves or “reopeners” that allow both client and firm to revisit and revise the agreement should unforeseen circumstances occur.
- **Most Often Used With:** Straight or discounted hourly billing with performance bonuses or rewards based on achieving shared objectives (e.g. reducing overall costs, improving cycle time, early resolution, high damages award, etc.). This can help align interests and minimize the disadvantages inherent in this billing method.

Blended Hourly Rates

- **Description:** All time is billed equally regardless of who works on the matter.
- **Example:** Law firm agrees to charge client an hourly rate of \$135 for all of the work it performs on a large antitrust matter regardless of who in the firm performs it.
- **Advantages:** Easy to negotiate and administer. Clients pay low hourly rates and law firm’s senior lawyers are encouraged to delegate work to the lowest cost provider.
- **Disadvantages:** As value is still based on time, the incentive is for lawyers to bill more hours not to become more efficient or seek early resolution. Often results in the use of less experienced and less efficient lawyers. This can lead to lower quality work product and increased hours. It can also threaten firm profitability if lawyers don’t fully understand the costs of providing services.
- **When to Use:** Routine matters that don’t require a wide range of expertise and where it is easy to predict the required tasks and the personnel mix needed to perform them.
- **Most Often Used With:** Performance bonuses or rewards based on achieving shared objectives (e.g. reducing overall costs, improving cycle time, early disposition, high

damages award, etc.). This can help align interests and minimize the disadvantages inherent in this billing method.

Volume Discounts and Discounted Fees

- **Description:** Law firm reduces its hourly rates in return for client guaranteeing a certain volume of legal work.
- **Example:** Client, a global corporation that operates over 10,000 quick-service restaurants, agrees to send law firm all of its North American slip and fall defense work in exchange for a 10% reduction on all hourly rates.
- **Advantages:** A good alternative billing start. Guaranteed work for law firm saves business development costs. Reduced rates give client an incentive to send more work to the firm.
- **Disadvantages:** As value is still based on time, the incentive is for lawyers to bill more hours not to become more efficient or seek early resolution. Volume discounts can also be a risky proposition for firms that don't fully understand the costs of providing the services that are subject to the discount. Finally, firms risk offending other, similarly situated clients who hear about the discounts.
- **When to Use:** High volume, routine matters when cost is the client's primary concern.
- **Most Often Used With:** Performance bonuses or rewards based on achieving shared objectives (e.g. reducing overall costs, improving cycle time, early disposition, high damages award, etc.). This can help align interests and minimize the disadvantages inherent in this billing method.

Evaluation of Creative Billing Methods

	Hourly	Discounted	Retainer	Blended	Fixed	Capped	Contingent	Value
Risk of Cost Overruns	Client	Client	Law Firm	Client	Law Firm	Depends on Cap Amount	Law Firm	Shared
Risk of Bad Outcome	Client	Client	Client	Client	Client	Client	Shared	Shared
Degree of Trust Required	Low	Low to Medium	Medium	Medium	Medium	Medium	Medium	High
Alignment of Objectives	Low	Low to Medium	Low to Medium	Low to Medium	Medium	Medium	Medium	High
Predictability of Total Fee	Low	Low	High	Low	High	High	Medium	Low to Medium
Incentive for Efficiency	Low	Low	Low to Medium	Low to Medium	High	High	Medium	Medium to High
Value to Client	Low	Low	Low to Medium	Low to Medium	Medium to High	Medium to High	Medium	High
Frequency of Use by Rank	1							8

Internal Risk Analysis



Questions for Roundtable Discussions

1. What are the benefits of using alternative pricing strategies for the law firm? What are the benefits for the clients?

LAW FIRM BENEFITS

CLIENT BENEFITS

2. What are the internal obstacles to implementing alternative pricing strategies? What are the external obstacles?

INTERNAL OBSTACLES

EXTERNAL OBSTACLES

3. Has your firm successfully used alternative pricing strategies? In what circumstances? What was the result?

4. Why are lawyers reluctant to move away from the billable hour?

5. What can the marketing function do to assist their firms in implementing alternative fee strategies and promoting the results?

IMPLEMENTATION

PROMOTION