

Alternative Fee Arrangements: Value Fees and the Changing Legal Market

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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predicted the death of the billable hour, as clients express increasingly vehemently their dissatisfaction with this outdated way of valuing legal services.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 & Connelly. 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.

Chapter 1: Dawn of the billable hour

FROM TIME to time, words and concepts invade law firm marketing like wildfire. Client service, a topic near to my heart even before I began blogging about it in 2005, is one example. At first, only a few firms used the term and those firms actually believed in client service. After a while, every law firm was all client service all the time, even though they weren't doing anything differently. They all wanted to 'partner' with their clients, without a clue as to what the concept meant. To them, client service simply meant 'give us more work'. Indeed, most of these marketing wildfires are about talking the talk rather than a deep understanding, application and then execution of the concept.

In 2009, alternative fee arrangements (AFAs) became the latest of these marketing wildfire buzzwords. But something seems different this time. Perhaps the reason for the difference lies in the economy. This downturn was unlike anything any of us had experienced before. Law departments were no longer given a pass on budget cuts, and the cuts were severe. The need for change was beyond anything mere price discounts could cover. And it seems that the changes are permanent. If a law department proves it can perform capably with a budget 30 per cent lower than before, why would anybody expect the budget to increase when the need for the budget cut is not as acute? It is possible that, to use Malcolm Gladwell's term, we have reached a 'tipping point'.¹

Law firm leaders and others are struggling to understand what AFAs mean

for their firms. Is everything the same save the invoice? Is revenue higher or lower? Do we have to change our operations to accommodate this new fee structure? How does it integrate with our standard billable hour system? How do you figure out the price to charge?

These questions are, of course, ones that ordinary businesses grapple with every day. It appears that the business of law is finally catching up with the rest of the business world. For the world of clients, that is a good thing.

How did we get here?

Before discussing what this new world order means, a moment on how we got here is in order. Law, as it turns out, has never really been wholly immune from the economic pressures that influence 'normal' businesses. Like any other service business, it is, by its very nature, a buyer's market. For the longest time, this simple fact did not seem to register with either buyers or sellers of legal services. As a result of the buyer's willingness to suspend their power as buyer, lawyers have only felt immune to a large degree from the economic drivers of other businesses.

In 1958, lawyers were at a similar crossroads. At that time, the private lawyer's payroll expenses had jumped 52 per cent over the prior seven years, and his (yes, then almost all private lawyers were male) rent and other expenses had increased 65 per cent over the same period. His income had increased only 45 per cent compared to income growth of 83 per cent for dentists

and 157 per cent for doctors. Over the prior quarter century, the performance of the profession was even worse. It was considered to be a crisis.

The American Bar Association created the Special Committee on Economics of Law Practice. While the concept of hourly billing was not unknown, it was not common until the Special Committee recommended that lawyers engage in hourly billing: "Time being the lawyer's sole expendable asset, the economic worth of his ability, training and experience is determined by the use made of the hours available for the practice of his profession."

With this one sentence, the ABA's Special Committee launched the billable hour revolution. Often lost at this point is the Special Committee's statement a few pages later: "There are only approximately 1,300 fee-earning hours per year unless the lawyer works overtime."

Lawyers always have been good at finding language they like and ignoring the rest. But think about it – 1,300 hours! How things have changed. Today, lawyers who bill only 1,300 hours are likely to be fired.

By the time I began practising in 1982, the billable hour requirement for most firms was 2,000. That number grew, both as a written and, more frequently, unwritten rule. It was not uncommon to see lawyers bill 2,500 hours and some even billed more than 3,000 hours in a year. One former partner crossed the 3,000-hour threshold regularly and once came close to 4,000 hours. Other firms had similar 'success stories'. And lest there be any doubt, managing partners view lawyers billing hours in this range as geese that lay golden eggs.

The rise of the billable hour's prominence limited the means by which firms could grow revenue. Once the limits of human endurance were reached and no

more hours could be billed without medical intervention, firms could increase rates and they could increase the body count, the number of fee generators. Leverage models were born as was the annual increase of hourly rates. Firms looked to continually increase the ratio of associates to partners. Ratios of 1:1 were less than satisfactory, while the elite firms looked to ratios of 4, 5 or 6:1. But for most firms, there were limits to the leverage that could be achieved, meaning that the only way to increase total revenue was to increase hourly rates. And firms did this with abandon. Between 2000 and 2007, firms increased their hourly rates between eight and ten per cent a year, compared with average annual inflation of 2.5 per cent during that same period. On a more macro scale, legal spend as a percentage of gross domestic produce (GDP) grew from 0.4 per cent in 1978 to 1.8 per cent in 2003. Yet another way to look at the growth in legal spend was cited by Washington research group General Counsel Roundtable: "Corporations spent an average of 0.63 percent of revenue on legal expenses in 2005, compared with 0.52 percent in 2003."²

During the period ending in 2007, the manpower churn was on, and firms gave everything in pursuit of profits per partner, the scorecard by which partners compared firm performance. Lost in this pursuit was any real care about quality, development of associates and the impact of all of this on clients. Firms further divorced themselves from reality by measuring efficiency on how many hours a person worked rather than more standard outputs of production. It became inevitable that someday there would be a reckoning.

The start of change

At the time this report is being written, in-house law departments have been

struggling to cope with double-digit reductions in budgets, precisely at a moment when demands for legal services, both internal and external, are growing significantly. More for less has become the in-house Holy Grail.

Of course, the clients' 'less' comes at the expense of those accustomed to feeding at the trough. Partners and associates alike have been jolted from their complacency. Layoffs – the word firms chose to use to soften the blow of terminations – have become commonplace no matter whether your title was partner, associate or counsel. Even with draconian personnel cuts, many law firms are experiencing significant reductions in profits. The level of anxiety in the profession is at an all-time high.

Those about to enter the profession have become victims of this unprecedented upheaval. Law school graduates from the finest law schools, accustomed to lavish starting salaries and bonuses, have had their employment offers rescinded or postponed. Students in these elite law schools have been shocked as firms have cancelled their entire internship programmes and many have abandoned student recruiting efforts altogether. Their future is bleak as firms confront a period of unprecedented instability.

The hourly rate business model of the past half-century is broken, and clients are starting to realise it. The temperature surrounding alternative fees has been on the rise. Firms are reacting by characterising any work done using anything other than the firms' standard rates as an 'alternative fee'. This means, of course, that firms can characterise a higher percentage of their work as AFAs, trying to make themselves look like something that they are not. Firms have long experience in this type of gerrymandering, and have employed it successfully in calculating profits per partner

or the number of women and minority partners. Clients, for the most part, have taken a more measured approach, but their interest is growing and accelerating when most suffered budget cuts in recent years.

Economist Herbert Stein once said: "If something cannot go on forever, it will stop."³ It does not require an advanced degree to know the boundless rate increases and the growth in legal spending as a percentage of GDP or corporate revenue cannot continue. The anticipated reckoning may now be here. The widespread turmoil in the profession provides an enormous amount of fodder for a book. But a book focusing on what went wrong with the business of law looks in the wrong direction. Instead, the focus needs to be on the opportunities now opening up to those who choose to see them.

References

1. Gladwell, M., *The Tipping Point: How Little Things Can Make a Big Difference*, Abacus, 2001.
2. See www.executiveboard.com/legalandcompliance.
3. Herbert Stein (August 1916 – September 1999), senior fellow at the American Enterprise Institute and contributor to the *Wall Street Journal*.

Chapter 2: You get what you pay for

YOU'VE HEARD 'you get what you pay for' many times and in many different contexts. And it is generally true. It is true with respect to hours. If that's what you pay for, that's what you get – hours, and lots of them. Everyone who has heard that statement has tended to say: "Well, that may be true for others but not for me. I'm efficient. I'm fair. I don't have a heavy pen." That statement is like the universal proclamation of innocence from inside America's prisons: everyone claims to be innocent, but objectively, we know it is not true. To be sure, there are some lawyers who are models of fairness when it comes to their approach to billing. They are, however, in the minority. But even this well-meaning minority is victimised by the systemic problems inherently associated with the model. The system breeds problems that many don't even recognise as problems. Hourly billing is like the healthcare system. Everybody can tell a story about one person that perfectly illustrates a point, but it is hard to quarrel with the conclusion that the system is not working well.

There is not a soul in the profession who has not heard stories about problems with the billable hour. These stories tend to fit into categories. A few illustrations will identify these categories and demonstrate the range of problems associated with the hourly rate model, and then evaluate how those various problems impact clients. These stories are slightly altered versions of first-hand information or examples from people in a position to verify the truth of the story. Names have been changed for obvious reasons.

Example 1: Once a month timekeeping

Let's look at Bob the monthly biller. Bob is a senior partner who does his monthly billing on the first of the month. For years, on the first working day of the month, Bob would take his calendar and his paper chronology file and sit in a conference room and recreate the prior month's time. Bob typically recorded an average of 180 hours per month or roughly 2,100 hours per year. Bob customarily arrived at the office at about 9:20. He drank his cup of coffee, read the *Wall Street Journal*, visited with other lawyers and then began to work. During most days, Bob would meet with other partners to discuss firm business or firm politics. It was rare that Bob was not on the 5:07 train *en route* to his suburban home. Bob was rarely in the office on weekends. The maths, in Bob's case, simply did not work out. These days, Bob's approach is to read through his sent and deleted e-mail files, but the process is still after-the-fact recreation of time and the results remain remarkably consistent.

Example 2: Rounding errors

Mary is a very capable mid-level associate who is assigned to one of the firm's largest matters. Mary arrives at the office at 8:00 and generally departs at 7:00. Mary believes she spends "about an hour" on lunch and other breaks throughout the day. Thus, Mary customarily bills ten hours per day to the XYZ matter. Of course, Mary's calculation of her time frequently overlooks the visits that her colleagues make to her office, whether

for firm gossip or to discuss important legal issues. Mary also tends to overlook phone calls to her family or the periodic login to Facebook and Twitter to check on the status of friends. On a real-time basis, Mary tends to overbill by slightly more than one hour per day.

Example 3: Lawyer as secretary

Robert is an associate under tremendous pressure to bill hours. Robert's firm has terminated over 100 associates in the past year and rumour has it that more heads are on the chopping block. The firm has made clear that those without adequate hours will be the first to be considered for termination. Robert is carrying a large debt from his law school years. He is newly married and is about to become a father. Robert has just returned from the partner's office with the partner's handwritten edits to a 32-page draft brief. Robert's secretary is sitting by waiting to make the changes, but mindful of the need to bill as many hours as possible, Robert takes the brief into his office, closes the door and spends the next two and a half hours making the changes that in prior times would have been handled capably by a secretary. This pattern repeats itself on every document on which Robert works.

Example 4: Work that isn't really necessary

Harry, a young partner, is in line to take a deposition of a witness of little importance. His primary matter is ABC versus Acme. In prior years, he would have had an associate take the deposition, but mindful of the need to appear busy, Harry prepares an extensive outline, rationalising the time commitment by saying that the witness "could provide important background information". When Irene, the billing partner sees the timesheets at the end of the month, she sees that Harry has

spent a full day preparing for the deposition and a full day taking the deposition, a total of 19 hours. Since Irene is not involved in the case, she assumes the time is well spent and the bill will be transmitted to the client without any adjustment. In fact, nothing useful came out of the deposition, which is now being dutifully abstracted by one of the paralegals on the case.

Example 5: Bonus incentives

Bonus season is coming. In October, Marti is assigned to write a motion to dismiss a complaint. The case is rather straightforward, but Marti is in desperate need of additional hours in order to be on target for a year-end bonus. Instead of preparing a short, to-the-point motion, Marti undertakes research on the law of several states, looking for a nugget hidden in a haystack to use as part of the brief package. The brief reads impressively, and is filled with extensive string citations and cases from several jurisdictions. When the court later issues its opinion, it relies on a single case from the local court as a basis for granting the motion. Marti is convinced that her extensive research and citation to authority from many different states persuaded the judge to adopt her position even though the judge made no reference to any of that work product.

Example 6: My team is bigger than yours

Ralph, a senior partner high up in the firm's structure, has traditionally billed in excess of \$15m per year. The prospects for hitting that historical average have looked bleak until Ace Oil Company sends Ralph a large matter. The legal issues do not appear complex but the amount at issue is potentially very high. Based on the risk of great loss, Ralph assigns 14 lawyers to the team to handle the case. There will be a team of

lawyers who are responsible for securing the client's documents for production. There will be a team of lawyers who will be researching and parsing every legal issue in the case, however insignificant. There will be a team of lawyers who will be responsible for preparing deposition outlines and a different team responsible for taking the depositions. Then a team of paralegals will abstract the depositions so that there is a central location for all of the facts. In all, an average of 21 people bill time on the case each month.

Example 7: Those .2s really add up

Like most lawyers, Alice's firm utilizes a minimum billing entry of .2, or 12 minutes. Part of Alice's job is to contact the local lawyers on a group of cases once each week. On average, Alice will have a minimum of three contacts (voice messages, missed calls and finally a live conversation) with each of the 43 lawyers on her list. Alice dutifully bills .2 for each of the contacts, some of which are under a minute. In total, Alice spends 14 hours on this weekly task. Three times 43 times .2 equals 25.8 hours. Alice's billing rate is \$250, meaning the firm's client is billed almost \$3,000 per week for time that Alice did not spend working.

Example 8: The .1s add up even more

Some firms do not have a .2 minimum entry but use a .1 minimum, or six minutes. Mass tort litigation has given rise to a new way to game the system. Let's say you are handling a docket of several hundred cases. A defendant files a motion to substitute counsel in all of these cases, along with a draft order. The case paralegal enters .1 for each case to review the motion and .1 to review the draft order. For just 100 cases, the time entries total 20 hours for a literal total of ten minutes of actual work.

There are countless examples of hours devoted to a case in genuine good faith that suddenly are seen as unnecessary when looked at through the lens of alternative fees. The following illustrations, for instance, may sound familiar:

- After the other side files less than forthcoming interrogatory answers, filing a motion to compel and briefing it even though the information sought will be in the documents being produced or is easily obtained from an early witness;
- Taking numerous depositions regarding the same issue even after you've got useful testimony from two witnesses;
- Filing summary judgment even though you have little chance of winning because it will "help educate the judge";
- Running a minor issue to ground "just to be safe";
- Waiting to raise the issue of settlement for [pick a reason];
- Having deposition outlines prepared by young lawyers that are then completely redone by more senior lawyers; and
- Having legal memoranda prepared for an issue in a brief, rather than just writing the brief.

There are scores of such examples, but these make the point. And what do all these examples have in common? They all result in clients paying more and law firms making more. In some cases, the excess payments might be small, but the amounts add up. How much? Well, let's assume that these examples were all taking place in one firm:

Example 1: Bob the monthly biller. Assume conservatively that Bob's actual time was 160 hours per month instead of the 180 billed, and that Bob's billing rate is \$500. Overbilling total: \$10,000 per month.

Example 2: Mary's rounding errors total six hours per week. At Mary's \$300 billing rate, the total overbilling is \$7,200 per month.

Example 3: Robert, lawyer as secretary, finds he gains 14 hours per month. At his billing rate of \$340 per month, Robert's total overbilling is \$4,760 per month.

Example 4: Harry the partner working as an associate. In this one instance, the difference between Harry's rate and the rate of the associate who would have done the deposition otherwise is \$180 per hour. The 19 hours spent on the preparation and the deposition means the firm overbilled \$3,420.

Example 5: Bonus incentives. This is hard to calculate, but assume ten hours was spent on the brief that was unnecessary, at a rate of \$350 per hour. The overbilling totals \$3,500.

Example 6: Team building. Because it's hard to quantify the inefficiency created by this team, let's not assign any value.

Example 7: Those .2s add up. As the example shows, the overbilling for one person caused by the .2 is \$3,000 per month.

Example 8: The .1s add up even more. This billing malfeasance happens weekly if not daily in many firms, but assume it happens one time per month. With a paralegal billing \$100 per hour, the overbilling is \$2,000.

The total from this less-than-complete list is approximately \$34,000 per month, from a total of seven people, or roughly \$5,000 per person. In a firm of 500 lawyers, if only half have encountered these billing problems, the firm would be overbilling its clients by over \$1m per month, or \$15m annually. *That's \$15m dollars being paid by clients who did not receive the benefit of the hours!* And keep in mind that this number does not include the costs attributable to the excessive team or the examples of chronic incentivised over-lawyering.

Why have clients not insisted these practices end? It's invisible, buried in detail, and they just don't see it. Or, they believe their lawyers are exceptions: "Of course it happens to other companies, but not mine. Unlike these other companies and their in-house lawyers, I have found the last honest law firm in the country." This is classic illusory superiority, or the Lake Wobegon effect, where everyone is above average.

The sad reality is that all-too-common practices mean that the total on a bill frequently bears only a passing relationship to work actually performed. The system is designed to look precise – it is based on fractional increments, after all – but is administered in a ham-handed way. Like the magician who focuses attention elsewhere with some sleight of hand, lawyers have focused their clients' eyes on the precision of the fractional entries while putting a curtain around the less seemly aspects of the practice.

It is impossible to quantify the amount of erroneous billing, mistaken over-billing, unintentional over-billing, .2 over-billing, excessive personnel usage and incentivised over-lawyering, but it sure feels significant. There is some data that justifies that feeling. The *Wall Street Journal* reported in August 2009 that pharmaceutical giant Pfizer, Inc., which spends more than \$500m annually on legal matters, had reduced its domestic law firm spending by 15 to 20 per cent by shifting away from hourly arrangements.¹ The same article reported estimates by BTI Consulting Group that average cost savings from AFAs were 15 per cent.

Instead of forcing the lawyers they hire to use a better-designed system, many in-house lawyers have added the role of 'fee police' to their job function, reviewing the minutiae of invoices and arguing about the total fees. Recognising that this is not the highest and

best use of in-house counsel's time, some companies hire legal auditors to review bills. While this has created jobs and a cottage industry, the expense is simply more money that the law department can't contribute to the corporate bottom line or dedicate to the corporation's legal welfare. And no one argues that these routine fee disputes contribute to a positive, trusting relationship between lawyers and their clients.

Food for thought

If it were possible to reduce by 30 per cent the amount of time in-house counsel had to spend policing the bills of *their own* outside counsel, and reduce by the same amount the total spent on third parties to audit the bills of outside counsel, how much would law departments gain in increased manpower availability? What if the savings were 40 or 50 per cent? Or even 100 per cent?

One well-known law-firm consultant recently relayed a story about a study of a large law firm undertaken by this consultant and her colleagues. The study uncovered a situation that may be all too common in hourly billing firms. On a large matter, there were three separate teams of associates all assigned to do the same research. When that fact was brought to the partner's attention he was completely unaware of that overlapping effort that had been occurring for quite some time. Because the firm was being paid by the hour, there was absolutely no incentive for the firm to uncover let alone remedy this gross inefficiency. However, when the firm had been pushed to alternative fee billing with this particular client, the effort to bring

project management to bear on the situation immediately uncovered the inefficiency and remedied it to the client's great benefit.

The hourly rate model thus creates a conundrum for many clients: spend time and internal resources policing the bills of your outside counsel; outsource a portion of that task to a third party and pay that expense; or do nothing and hope that trust doesn't come at too high a price.

The model does not work to the benefit of clients. Profits per partner in most large law firms, however, have exceeded \$1m for the past several years. Perhaps that is why law firms have been so loath to abandon the system.

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Chapter 3: Alternatives to the billable hour

We need common nomenclature

Everyone connected with the legal profession understands the concept of hourly billing. It's so simple a child in grade school can understand it. Work for an hour and your firm will be paid so many dollars. Work for two hours and your firm will be paid twice as much. No attempt is made to determine whether anything of value occurred during the hour. You could be sick and your mind might be elsewhere, or you could be fully engaged and have a creative spark that generates a flash that saves the client millions. What is produced in each hour could (and almost always does) vary widely. How much you are paid for the hour does not change a cent. Value is tied only to time, not to what you produce or the result you obtain. The simplicity is alluring.

So, isn't an 'alternative fee' a fee that is anything other than hourly rates? If only it were so simple. Lawyers, it turns out, have a special genius for word games. Most law firms have 'standard' hourly rates. These are the rates that firms typically charge for matters on which the firm is engaged. Some clients demand discounts from these hourly rates; sometimes firms accommodate these requests. Indeed, as the economy worsened, discounts were asked for and given far more frequently.

But firms don't like to say that they give discounts. It sounds so unseemly, so, well, second tier. The answer to this Hobson's choice? Play a word game. Characterise these discounted hourly rates as 'alternative fees'.

Other firms choose to offer 'blended' hourly rates for certain engagements. Instead of the senior partner charging \$600 per hour and others charging less down to the youngest associate charging \$300 per hour, the firms would charge all lawyers at \$425 per hour. *Voilà!* More 'alternative fees'. And as inquiries from media and clients increased, firms were only too happy to trumpet their experience with alternative fees. A classic example of turning lemons into lemonade!

But marketing skill aside, variations on standard hourly billing are not 'alternative fees'. At its core, the hourly billing model is cost-plus pricing. Hourly rates have the firm's profit margin built in. For every hour worked, the firm's profit increases. The incentive is to work more hours, not fewer. The incentive is to increase the cost because more cost means more profit. Discounting hourly rates or blending them does not change their inherent nature. If your firm gets paid more for each increment of time you work, you are working on an hourly rate model.

The notion of more time, and the incentive to bill more time to increase profit, is at the core of the hourly rate model. It is a quintessential zero sum game. The alternative to that model is something that does not create an incentive to work more in order to increase profit. Remember the cup lesson from the introduction? The incentive has to be on the lawyer or firm to decrease the cost of production in order to increase profit. There is a nearly limitless variety of alternative fees that satisfy this

broad definition. One's imagination is the only constraint.

Before we start talking about specific fee structures, let's return to the discussion of nomenclature. The description of fees as alternative has such a bad sound about it. In writing about the green energy movement, multi Pulitzer Prize winning author Tom Friedman wrote:¹

"In the world of ideas, to name something is to own it. If you can name an issue, you can own the issue. One thing that always struck me about the term 'green' was the degree to which, for so many years, it was defined by its opponents – by the people who wanted to disparage it. And they defined it as 'liberal', 'tree-hugging', 'sissy', 'girlie-man', 'unpatriotic', 'vaguely French'."

Friedman is right and the same idea applies here. 'Alternative' sounds so counter-cultural, like a 1970s hippie movement in San Francisco, some lifestyle no-one in the mainstream wants to emulate. It certainly does not sound 'corporate'. Alternative fees, or alternative fee arrangements, simply does not cut the terminology mustard.

I believe the essential characteristics of the fees that stand in contrast to hourly fees are:

1. The fee must align with the economic interests of the client and the lawyer;
2. The fee must create a financial incentive for the lawyer to reduce cost, not increase it; and
3. The fee structure must create incentives to accomplish a specific, identifiable client objective.

These are the same characteristics that we would use to define value delivered to a client. Hence, I believe the term that should

be applied to non-hourly fees is 'value fees'. Value fees identify what the client receives, just as hourly fees describe what the client receives. Value fees is a term that is simple, as is hourly fees. Value fees stand in contrast to hourly fees. In the game theory vernacular, value fees are non-zero sum situations, ones where both sides can gain. And, in the Friedman sense, value fees also sounds more corporate and less counter-cultural.

Others have different categories. In its discussion with its members, the General Counsel Roundtable has used these categories:

1. **Flat fee** – a specified sum paid for a specific matter. The fee can be paid in one sum or paid monthly or in connection with certain benchmarks in a matter;
2. **Fixed fee** – akin to a flat fee, but paid for a larger portfolio of work. A specified sum for all work in a certain area, or some other defined portfolio of work;
3. **Risk sharing** – outside counsel agrees to a flat fee for a matter, but the fee is adjusted up or down based on the outcome;
4. **Performance-based bonus** – this is much like the risk-sharing structure, but with only an upward adjustment possible;
5. **Capped fees** – a limit on total fees for a given matter;
6. **Volume discounts** – lower hourly rates based on amount of work; and
7. **Blended rates** – a single, uniform rate charged regardless of what lawyer performs the work.

Of course, volume discounts and blended rates are not really alternatives. They merely alter the rate to be applied to the hours worked, without changing the incentive structure. In these, more hours rather than fewer remains the incentive, and the General

Counsel Roundtable's own data show that these are among the least effective in reducing spend on outside lawyers. These hourly variations are not discussed here.

So let's start by describing the basic categories of value fees. There are endless variations, but only three broad categories. They are:

1. **Fixed fees** – fees where a specified sum is paid for a specified amount of work. These are referred to frequently as flat fees, fixed fees, portfolio fees or something akin to these. As we will discuss, there are numerous variations to this concept;
2. **Contingency fees** – fees where the amount paid to the lawyer is tied directly to the outcome, whether as a contingency or reverse contingency; and
3. **Modified hourly fees** – modified hourly arrangement that adds features that create the economic alignment and interest in reducing cost of production. There are, so far as I have encountered, only two approaches that achieve these objectives.

Within these categories, there are multiple variations. Before we spend a few moments looking at the positives and negatives of each category, as well as the variations, it is important to examine the point of any fee structure.

Fee structures are an incentive to behaviour

This may be the most important sentence in this book. When a lawyer and client agree on a fee structure, the lawyer has an incentive to behave in a certain way. As we have discussed, the incentive with the hourly rate fee structure is for the lawyer to bill more hours. Thus, the following behaviours are incentivised:

- Larger teams;
- More work, not less;
- Settle late, not early; and
- Keep as much work with the firm without regard to need or value.

We have been using the billable hour model for so long and it is so pervasive that many have not given any real thought to other behaviours that could be incentivised. Here are some examples:

- Budget certainty – more important now than ever;
- Cash-flow control;
- Reduced cycle time – generally considered the largest driver of total fees;
- Results – many are willing to pay more for wins than losses;
- Personnel availability – sometimes the client wants to be sure it will always have access to a specific lawyer or team;
- Save internal review time and effort – no hassle billing allows inside counsel to focus on adding real value to the corporate operation rather than spending time policing outside counsel bills;
- Risk sharing – business people in particular love the idea of lawyers investing in the outcome; and
- Incentives to lower costs, whether on legal spend alone or the total of indemnity and fees.

In addition to these general behaviours, there can be business-specific or matter-specific objectives. For example, if an employee leaves with trade secrets and time is of the essence, getting a result in hours rather than weeks has great value and could be identified as an objective to be rewarded. In every case, clients need to figure out what behaviours and outcomes they want to incentivise, and then work with their lawyer

to develop a fee structure that rewards these behaviours or outcomes, and penalises failure to achieve them.

For most clients and most cases, the objectives generally are:

- Lowest possible legal cost; and
- Acceptable economic resolution.

Not surprisingly, businesses implicitly or expressly recognise that they are not in the business of litigating lawsuits and want to minimise the distraction associated with claims. There obviously are lawsuits that are more important, where other behaviours are important. But these two key outcomes will guide our discussion.

Fixed fees

Sometimes called flat fees, there are countless variations of fixed fees. Some have tried to use flat fees to describe payment of a specified sum for a single case and fixed fees to describe payment of a specified sum for a larger group of cases. The distinction is, frankly, not terribly meaningful. The key element of the fixed fee, whether applied to a case, part of a case, or many cases, is that it gives budget certainty and creates huge incentives for the outside lawyer to reduce the cost of production. In its most basic form, these are the two attributes of this fee structure.

Compared with hourly rate incentives noted above, fixed fees incentivise very different behaviour, as can be seen in Table 1.

HOURLY RATE BEHAVIOURS	FIXED FEE BEHAVIOURS
Larger teams	Smaller teams
More work, not less	Less work, not more
Settle late, not early	Settle as early as possible
Keep work in the firm	Use cheapest resource

Table 1: Fixed fees incentivise different behaviour

Both fixed fees and hourly rate structures are indifferent to outcome. In fact, the only fee structure that inherently incentivises good outcomes is the contingency fee. But as noted, there are many variations on the basic fee structures that modify the behaviours incentivised.

What’s the most effective way to incentivise outcome? As with anything else, pay for it. That notion seems antithetical to many, but it is a business norm. When a company is buying widgets, it only pays for the widgets if they meet the buyer’s specifications. So before the buyer purchases the widgets, it provides the manufacturer with a set of performance or other specifications. The manufacturer either agrees to them or the parties negotiate a different measure of performance. Why should lawyers, both inside and outside, be immune from this common negotiation?

Of course the answer is that they should not. Inside and outside lawyers should discuss the desired outcome at the beginning of a matter. Too often what happens is that a complaint is e-mailed and lawyers start working without the first clue as to what the client desires in the way of an outcome. One approach that creates substantial incentives for great results is shown in Figure 1.

As indicated, however, a basic fixed fee only creates the budget certainty. A modification is needed to create the incentive for great results, as shown in Figure 2 (p18).

A portion of the monthly fee is held back pending the outcome. You might think that

the amount held back is not that important, but it is. The bucket is like an account earning compound interest at ten per cent. It grows.

The amount ‘at risk’ grows every month. It

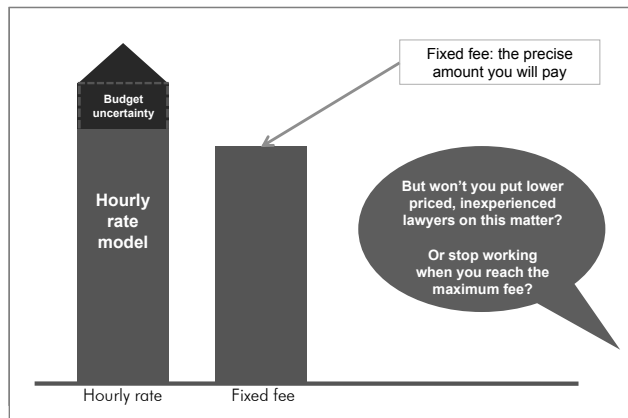


Figure 1: How do you obtain certainty?

doesn't take long before the amount the outside lawyer could be paid or lose is quite substantial relative to the monthly payment. This is the amount that creates the incentive for the lawyer to put their best team on the matter and to aggressively pursue the result desired by the client.

The key attribute to this fee structure is that the client determines whether to pay the amount in the bucket at the end of the matter, after the result is known and the client can assess the value of the service provided by the law firm. It is possible to create certain benchmarks for payment or to leave the matter entirely in the hands of the client.

To this point, nothing has been said about flat fees and the amount a client will pay. As noted, one of the incentives clients have is to obtain the lowest possible cost. There is nothing inherent in this fee structure that results in lower total fees. The essential theory of this fee structure is that because it creates huge incentives for outside lawyers to be efficient and try to shorten the time to resolution, there will be a reduction in the cost of production and that some of those savings will be passed on to the client.

Variations and incentives

This same 'holdback bucket' approach works on a portfolio of matters. The incentives are the same and the ability to quote lower fees is even higher. Look at this in the context of a simple example. Let's say that a client has a portfolio of single plaintiff employment cases. Historically, these cases have cost between \$20,000 and \$120,000 to litigate, but the average cost has been \$50,000 (this data can be either the client's or the firm's –

same analysis). If you were bidding on a single case, you would naturally bid in a way that protected you from the possibility that this case was not average but instead was one of the ones that might be at the high end. You're likely to bid in the range of \$75,000. But if you get a group of cases, the odds are that while one or two will cost more than the average, others will cost less and the group of cases will come near the average cost. A greater volume of work allows the firm to spread the risk associated with any one case across a group of cases, thus marginalising the price risk.

The criteria for evaluating performance on a group of cases can be case by case or across the portfolio. We have one client where one of the key metrics is the settlement average of a certain type of case. Having said that, the other metrics could certainly override this one so that our performance is judged on a wide range of factors.

Another variation on a flat fee is a segmented flat fee. In this variation, a case is broken down into segments and a fee is set for each piece. For example, one segment might be initial investigation and pleadings, followed by segments for written discovery, depositions, expert discovery and

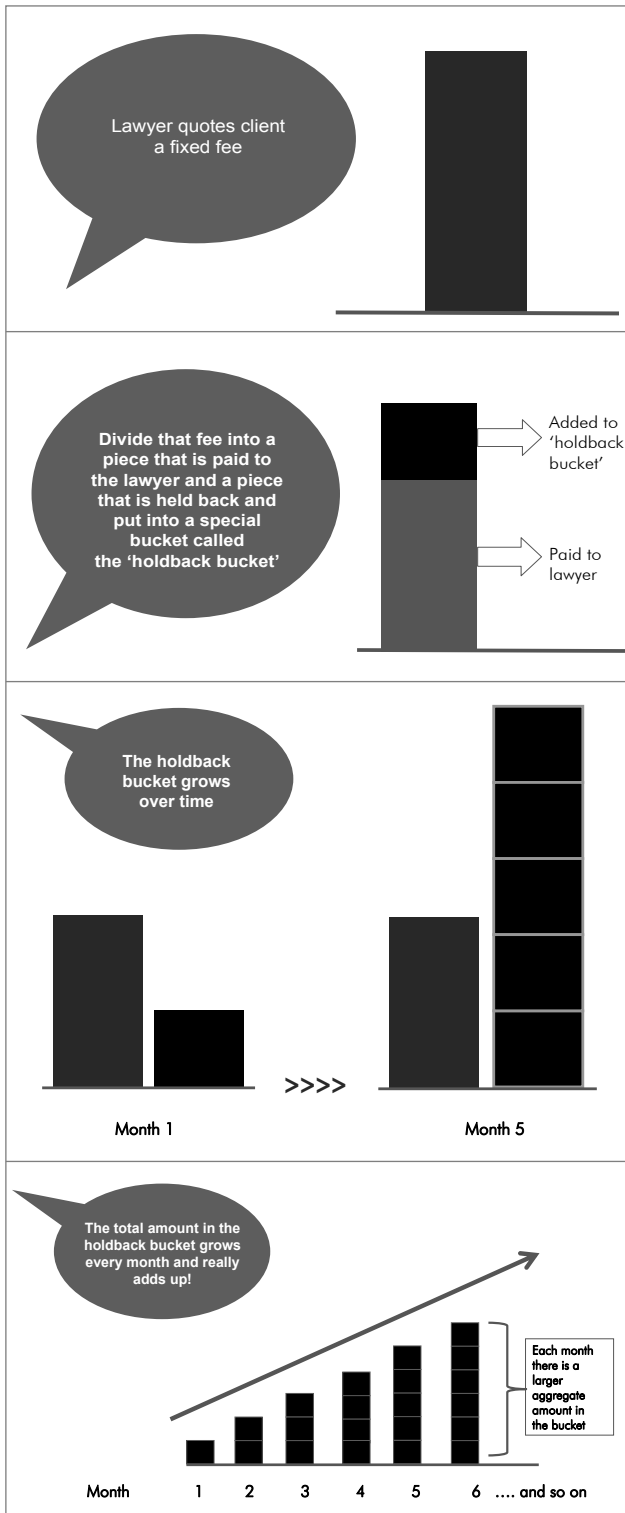


Figure 2: How the holdback bucket works

ending with trial preparation and trial. Typically clients ask for this approach when they are looking to gain the benefit of lower price for earlier resolution since, in theory at least, this would lead to a lower total payment. Hence, if the client thinks the suit is likely to resolve early and they want to try something different, this is the natural default. The other reason for approaching cases this way is when people do not want to invest the time in planning out the case. “There are too many variables”, or “This is so complex”, or “We don’t know what the other side is going to do”, are the kinds of things being said if complexity is the issue.

The flat fee by segment does not create an incentive to shorten the case since payment is made at the end of the segment. At most, if the lawyer is paid at the front end, it may increase the incentive to resolve a case at the beginning of a segment before the time is invested. But there is nowhere near the incentive to resolve early that there is under the entire case flat fee.

So when is the fixed fee appropriate? Always, but with this caveat: clients should require their lawyers to have ‘skin in the game’², meaning an economic interest in obtaining an outcome or result defined by the client as a desirable one. Why? Incentives and disincentives provide the answer. As mentioned, one of the most commonly identified failings of the traditional fixed fee arrangement is that it creates

incentives for the law firm to use the youngest and cheapest resource available in order to minimise the cost (thereby effectively increasing the profit margin and the work) or, in circumstances where a firm's work reaches the maximum level allowed, that the firms will simply stop doing needed work thereby reducing the quality of the result obtained. The easiest and most straightforward answer is to not remove outcome from the criteria by which a fee is paid. That means a law firm is forced to have skin in the game – that is, risk that it will not be paid as much for a lesser result than it will be for a greater result. Firms will use experienced lawyers rather than inexperienced ones because experienced lawyers are much more likely to be able to obtain the desired outcome.

In addition to a very highly motivated lawyer, clients obtain a much more thorough and accurate assessment of the quality of the case at the outset since firms will be reluctant to make investments in poor cases. Under the traditional hourly arrangement or even under a traditional fixed-fee arrangement, the firm has no incentive to identify the failings in the case and not take the work. But if a firm is forced to look at a case as an investment of its resources and not just the client's, a firm will make informed investment decisions. If the firm rejects a case because of the likelihood of losing, that sends their client a strong message about the quality of the case.

Dave Bohrer of San Jose's Confluence Law Partners quotes Neal Rubin, Cisco's litigation manager, in a recent article: "While firms are not equally risk positive or averse, a firm's willingness to accept risk provides a useful litmus test that can help instruct the client whether it has realistically assessed the strength of its case. The straight billable hour model provides no such feedback."³

The final value from the skin in the game approach is that it ensures that the firm will remain committed to the case through to the outcome. The firm cannot lose interest without losing its investment. If it turns out that the case develops unexpectedly and the prospects appear dim, hourly rate lawyers have no incentive to front this sooner rather than later. When you have an investment in the case, problems are fronted very quickly – if you are going to have to accept a bad outcome, better to do it sooner rather than later.

Another variation is a flat monthly fee payable for however long the case remains active. This approach limits the incentive to push as hard for early resolution, but that obstacle can be overcome by creating a specified incentive. For example, if the case resolves within a year, you will get a bonus \$50,000, or some number that is appropriate to create the desired incentive. Another option is for the monthly fee to decline over time as an incentive to push the case forward earlier.

There is an unlimited number of variations on the fixed fee theme. It is by far the most common value fee.

Contingency fees

Contingency fees are well known from their widespread use in personal injury cases. Plaintiffs' lawyers agree to take on a case in exchange for recovering their expenses and one third (or some other percentage) of the remaining recovery. In recent years, it has become more common to see corporations use contingency fees.

When are they appropriate? The natural tendency is to say anytime there is a recovery to be had. But that answer really misses the mark. Contingency fees are a good tool when cash is tight or there is not enough money in the budget

to bring a meritorious claim. But aside from those rare circumstances, both clients and outside counsel would be wise to look at contingency fee agreements as an investment decision. Examples will help illustrate the analysis.

Example A

A client has a \$10m claim. The claim looks to be solid and the damages are solid. The client estimates it has an 80 per cent chance of recovering the \$10m. If it does, the law firm working for a 30 per cent contingency will recover \$3m and the company will recover \$7m. The case is likely to take two years to reach resolution. The estimate for actual fees if the matter is handled on a non-contingent basis is \$1.4m. Thus, the client's decision is whether the risk of paying \$1.4m and getting nothing – a 20 per cent risk – is worth an 80 per cent chance of paying an extra \$1.6m to the lawyers. As the risk of not recovering goes up, the value of proceeding on a contingency goes up as well. But as the risk of not recovering goes up, the firm's interest in handling the case on a contingency goes down.

Example B

The client has a \$100m claim. The client and its counsel estimate the claim has a 50 per cent chance of prevailing if the case is handled as it normally would be. The firm believes it can improve that estimate if it devotes extraordinary resources to the case, but it is prepared to do so only if it sees potential for a 'mega-recovery'. That is, it would not be worth it to the firm to expand and devote exceptional resources to the matter for regular hourly rates. But if it stands to recover \$30m, the firm is prepared to make that investment. What options does the client have?

The point, hopefully, is clear. There is an overlay of investment decision that must

be factored into the analysis regarding contingency fees. What does it mean to a client if firms will not take a matter on a contingency? It means that the case is not a good investment for the firm. If it is not a good investment for the firm, why is it a good investment for the client? Likewise, if firms are jumping at a case, it is because they see it as a good investment for them. If it is, why would it not also be a good investment for the client, meaning investing fees and taking the contingent premium for itself?

In the corporate world, there is also the overlay of 'whose money is it?'. If a case is being pursued, against what business unit will fees be charged, and is there some reason why that unit may not want to invest in a case, or, on the other hand, why they would not want to see a large piece of the recovery go to the lawyers? It is important to be sensitive to the budget and accounting issues.

As with most things involving value fees, contingency fees do not need to be all or nothing. It is possible to combine fixed fees and contingency fees. The client would pay a lower fixed monthly payment (or some other payment frequency) to the law firm, which would then take some reduction in its contingent recovery, maybe from 30 per cent to 12 per cent. In this circumstance, the potential contingent recovery plays the same role *vis-à-vis* the incentives as the holdback bucket.

Finally, there is no reason contingency fees need to be used only when there is an affirmative recovery to be had. If a client is looking at a \$100m claim, firms are now starting to work on a 'reverse contingency' by taking a percentage of the amount saved. Obviously, the percentages are staggered so that modest savings are rewarded very little but material savings are handsomely rewarded.

In any contingency fee, the potential upside to the lawyers is a huge incentive to do whatever it takes to win, to devote

whatever resources and lawyer talent is required. At the same time, because of the risk of loss and the desire to maximise profit (revenue received minus cost to produce revenue), there is strong incentive to avoid spending money needlessly, and thus a strong incentive to control costs. As with the fixed fee arrangements, this fee structure forces lawyers to look at their costs as investments, and only those that provide a sufficient return are made.

Modified hourly arrangements

The idea of hourly arrangements as value fees sounds like an oxymoron and, to an extent, it is. But a few leading thinkers have developed systems using hourly rates that appear to shift the incentives lawyers operate under and align the economic interests of the law firm and the client. There are three that seem to fit the bill.

The Alliance Counsel Engagement System

The Alliance Counsel Engagement System (ACES®) was developed by Jeffrey Carr, the iconoclastic general counsel of FMC Technologies. More than a decade ago, Carr developed this model based on the way-ahead-of-his-time notion that, as a client, he did not want to buy hours. The foundation of the model is matter budgets, which are required for every matter and have to be signed off by inside counsel. The budgets cover both portions of the case and time period because the company budgets by time, not by phase of litigation. Lawyers are paid 80 per cent of what they bill so long as they are under budget. If the budget is exceeded, lawyers are paid 20 per cent for any excess. The unpaid portion goes into a bucket. The bucket or a portion of the bucket is surrendered for a poor result, or the entirety or a multiple of the bucket is

paid out depending on the positive result achieved. The system creates incentives for rapid resolution, so that lawyers bill fewer total hours but are paid higher net rates.

The other feature of the system that qualifies it as a value fee tool is that it does not matter what rates lawyers charge or how many people are assigned to the case. It does assume, reasonably I believe, that a firm's partners would balk at extended payments of 20 per cent, so that even though you could raise rates and assign multiple people, there is a significant economic penalty that the firm would face (being paid only 20 per cent of the over-budget amounts) and the risk of sacrificing a significant portion of the bucket at the conclusion of the matter.

The other very important feature of the ACES system is that it creates a level of financial discipline few lawyers have ever experienced. Litigation becomes numbers driven, including use of decision trees to evaluate cases and make buy-sell decisions.

Caps, with a twist

This was a nifty concept I first heard about from Jeffrey Novak, the general counsel of AOL Paid Services and assistant general counsel of AOL, Inc. Novak took an area and created a fee cap. He then offered to share the delta between that cap and the amount the firm actually spent. The illustration he offered (I have no idea if these numbers are real or not) was that spend in one area had been averaging \$3m. He created a cap of \$2m, which allowed him to immediately recognise the savings. The firm then spent \$1m, which allowed the firm to gain its share of the \$1m saved and allowed Novak to save AOL's percentage share of that million dollars. This model is illustrated in Figure 3.

The incentives for a law firm to reduce spend here are obvious. But unlike the results-

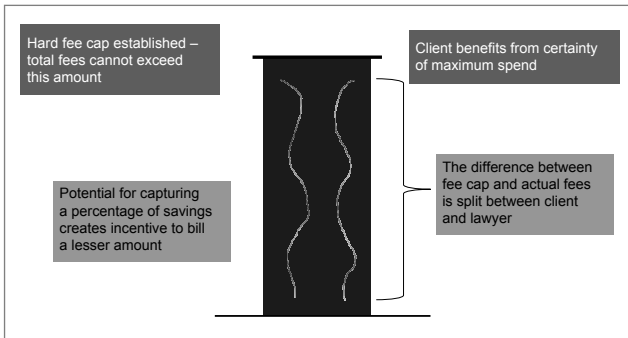


Figure 3: 'Hard cap' hourly model

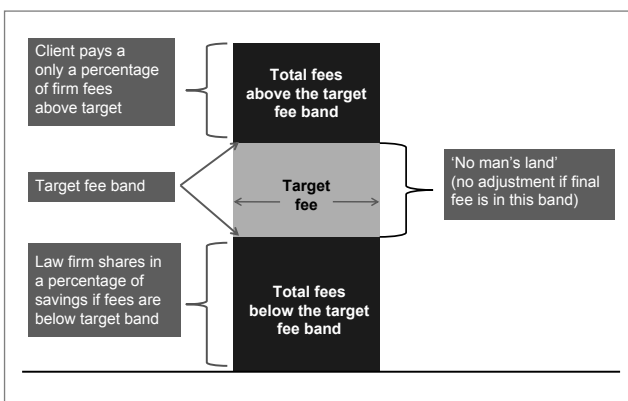


Figure 4: 'Risk bonding' fee model

based fixed-fee structure discussed previously, this structure does not create any incentive to achieve results. Thus, it falls on the in-house lawyer using this model to police work quality and results. The other flaw in the system is that (and I am guessing here) it causes headaches for inside counsel as they realise how much they have been overpaying. When I asked Novak about this, he said you definitely have to commit to "looking forward".

Risk collars

Risk collars shift some risk to lawyers. As such, they do not create material incentives to control costs, but they do create some incentive to do so, which makes this approach better than a standard hourly approach. Here's how it works.

There is target fee number and a band on either side of that number. If the law firm's fee falls in that band, also called 'no man's land', there is no adjustment to the fee. If the firm's fees fall below the lower portion of the target band, the firm gets a portion of the savings. On the flip side, if the firm exceeds the upper end of the target band, it receives a percentage of the portion of its fees over the band, typically a percentage in the range of 40-50 per cent, to avoid creating any incentive for runaway fees – see Figure 4.

This approach is the equivalent of an insurance company buying reinsurance or a homeowner buying an umbrella policy. The firm receives protection for a material overspend, which might be based on bad estimating on the front end, and also has an incentive to try to keep costs

below the bottom of the fee band. As with the caps-with-a-twist approach, this model creates incentives to do less work but without the corresponding incentive to obtain results. That incentive somehow has to be created for engagements where results matter, or it will fall to the inside lawyer overseeing the matter to police the results.

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Chapter 4: Clients save money

SO, DO clients that use value fees save money? That's the real question, isn't it? There is compelling evidence that value fees reduce legal spend.

What doesn't work

First, we know what doesn't work. The General Counsel Roundtable has found that volume discounts are the least effective means of reducing spend on outside counsel.¹ John Weber, general manager of CT TyMetrix, who reviews huge amounts of fee data and has interviewed more than 100 clients, agrees.² Fred Bartlit of Bartlit Beck frequently relates a comment made by Harry Pearce: "When rates go down, hours go up!"

We also know that blended rates don't work. John Weber refers to blended rates as "arguably the least effective AFA in history". It is not hard to understand why. Law firm partners are compensated in significant measure on their realisation rates – that is, how much they collect versus the total number of hours worked on their clients' matters times the standard hourly rate of the person doing the work. Discounts reduce realisation but by pushing work down to lower-level attorneys, realisation can be pushed north of 100 per cent. In the main, people behave in the way that rewards them most.

Paul Beach, assistant general counsel of United Technologies, notes one other important flaw in the discount/blended fee approach: if it works at all, it only works for one year. Then firms are right back to asking

for increases. The reason, as discussed previously, is that these approaches do nothing to change the fundamental economic drivers. Firms still look to 'more' for their profit, whether more hours or higher rates. The structures do nothing to create incentives for efficiency.

What does work

So if blended rates and discounts are not the answer, what is? The General Counsel Roundtable study found that fixed fees and 'risk sharing' (outside counsel paid a bonus or deducted a penalty based on outcome) were the two arrangements that provided the greatest cost reduction. The risk sharing is the same as the holdback bucket model described in the previous chapter.

Mark Chandler, the highly-regarded general counsel of Cisco has found this to be true. He won't hire law firms unless they agree to fixed fee arrangements. About 80 per cent of Cisco's external legal spend is on fixed fee arrangements. Citigroup has joined the movement as well, with about 30 per cent of its external spend on value fees, mainly fixed or contingency fees. Michael Helfer has 'minimal' sympathy for anyone opposing fixed fees. Levi Strauss recently agreed to have Orrick handle all its legal work worldwide, except for brand-protection work, on an annual fixed fee paid in monthly increments.

As part of the Association of Corporate Counsel's Value Challenge,³ General Electric reported that it has implemented practices

for handling complex patent litigation on a value fee basis. These matters are being handled on both fixed fee and contingency fee agreements. At United Technologies, approximately 55 per cent of its spend is on value fees, and it recently retained one firm to handle its single plaintiff employment litigation nationally for a fixed fee.

Synopsis is a company that creates electronic design automation for semiconductor design and manufacturing. It generates about \$1.3bn in revenue. It recently completed its fourth consecutive year of lowering legal spending, an overall reduction of 50 per cent. It accomplished this without any major staffing changes to its total of 20 attorneys. Three of the elements of general counsel Brian Cabrera's approach are noteworthy here:

- A business and results focus for the department;
- Keener evaluation of the risks and rewards of litigation; and
- Cost reduction using fixed fees or other alternatives.

These elements appear to be common to the law departments that are most successful in achieving year-on-year improvements.

Measuring spend

Another common feature to law departments that successfully utilise value fees to drive costs down is their access to data on the cost of handling their matters. Coachman Industries, a maker of recreational vehicles, tracked its spend data for a number of categories for several years. In 2008, it entered into an agreement with two law firms:

"[Law Firms A and B] will provide all legal services for Coachman Industries for 2008 for a fixed fee that is less than the average

spending for legal services over the previous five years. The fee includes:

- All fees for legal services, including hiring of local counsel where necessary
- Monthly Early-Warning Report on emerging risks
- Two annual training sessions with client groups
- Delivery of training sessions at biannual virtual law firm retreat."

This approach accomplished the objectives of improving efficiency and allowed Coachman to budget accurately and save over 100 hours of internal lawyer time since in-house counsel no longer needed to review invoices. But, most importantly, notice that the structure creates year-on-year savings and places pressure on outside counsel to create ways to lower costs each year, the same pressure that 'real' businesses deal with on a daily basis.

In the world of legal spend, one of the most important metrics is the ratio of total legal spend to total company revenues. The Hildebrandt 2009 Law Department Survey reported that in that lean year, the spend ratio was 0.4 per cent, down from 0.43 per cent in 2008.⁴ In that context, FMC Technologies' spend ratio of 0.19 per cent stands out. FMC Technologies, the Fortune 500 energy company with annual sales of approximately \$4.6bn, has utilised the ACES system for several years, and its spend as a percentage of revenue has shown consistent declines – see Figures 1 and 2.

What makes this accomplishment even more remarkable is the consistency of external spend, even in the face of annual rate increases and ever-increasing demand for 'more' in the world of outside law firms.

These results are strong evidence that changing the incentives of outside counsel changes results.

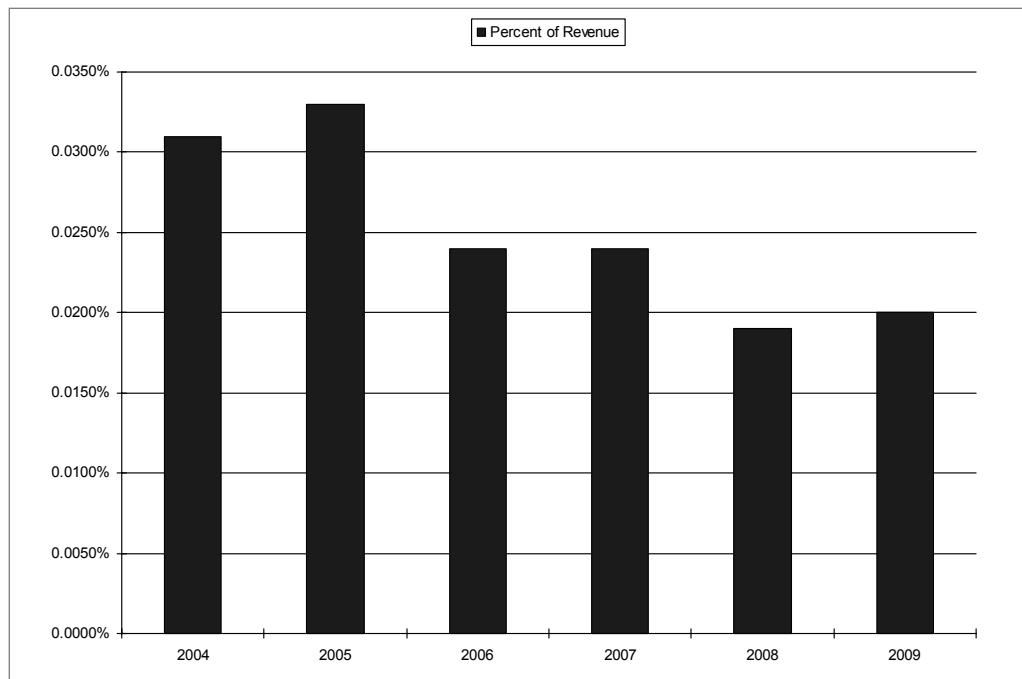


Figure 1: External legal spend as a percentage of revenue

The bottom-line questions are: how much saving are companies achieving and how much more is there to obtain? On 24 August 2009, the *Wall Street Journal* reported that Pfizer had achieved savings of 15 to 20 per cent through fixed-fee arrangements.⁵ The article reported on findings by BTI Consulting that cost savings from use of value fees average 15 per cent. These savings are impressive, but can greater savings be found?

It is widely reported and generally accepted that the profit margin for law firms in normal years is about 35 per cent. That margin is very healthy, especially when considering it comes associated with all the inefficiencies inherent in cost-plus pricing. These margins do not reflect any extraordinary measures by firms to take the fat out of their process, reduce cycle time or cut the fat from the litigation process. When all these factors are included, it appears that

spend reductions of around 30 per cent or more are feasible.

Lawyers, both inside and outside, need to develop a different mentality about legal spend. It seems appropriate to end this discussion with, perhaps, the most candid statement ever made to the Securities and Exchange Commission. In 2008, Expeditors International of Washington spent approximately \$10m in legal fees in connection with antitrust investigations. In its report on Form 8-K filed on 23 June 2009, the company responded to a query about how much it expected its legal spend to be in 2009. It said:

“When you come from a frame of reference, as we do, where \$0 spent on legal expense would be the most preferred alternative, having to predict anything beyond that, by its nature, would become inherently and incredibly biased towards our own wants,

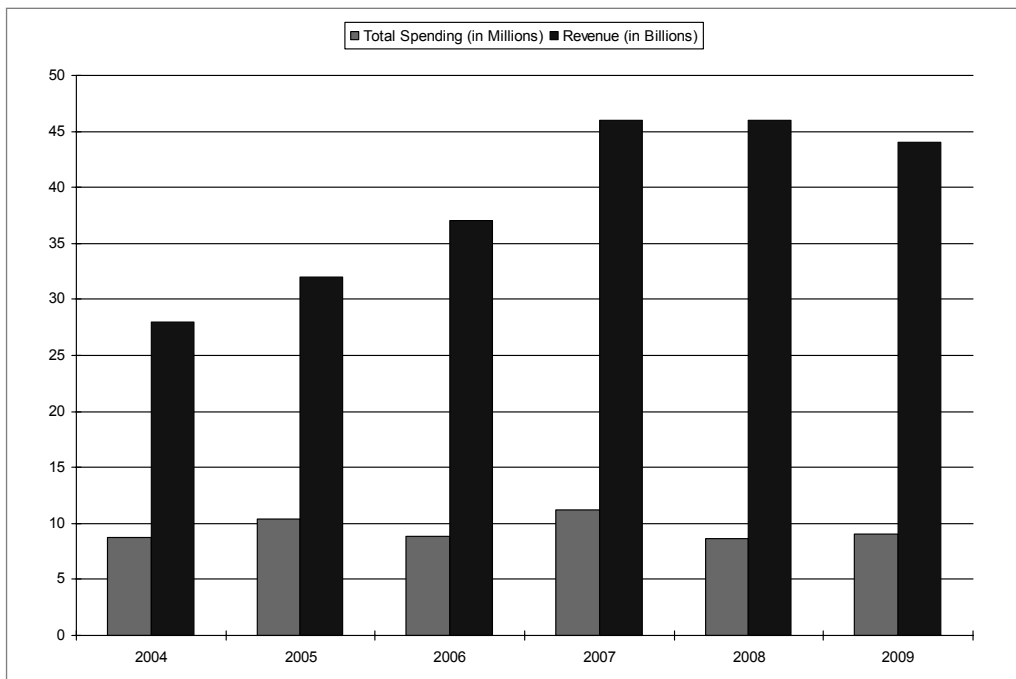


Figure 2: External legal spend versus revenue

desires and expectations. To us, this is somewhat akin to being asked to predict how many minutes after being force fed a dead frog we would throw-up...and the operative word is 'force', as we'd never elect to do either on our own. In both cases (the legal fees or swallowing the dead frog) we're certain we would eventually throw up. In neither case do we know exactly how much money or how much time would pass before we did. In both cases, however, our gut check, no pun intended, is not very much and not very long! It should go without saying that given our druthers, we'd rather not spend the legal fees or eat the dead frog in the first place. Sometimes you don't get the luxury of deciding what you have to eat. When you do, and it's unpalatable, it should be obvious that you would eat as little as possible. What we are certain of is that if we were talking about being force fed dead frogs and not incurring excessive legal fees,

people would be content accepting at face value that it would be as little as possible."⁶

The comparison of legal fees and being forced to eat dead frogs may well be the most candid statement ever about how inside lawyers feel about spending money on outside counsel. The goal of reducing those expenditures and getting them to the lowest level practical can be accomplished only **by eliminating the economic war between inside and outside counsel and shifting the incentives for outside counsel from more fees to increasing efficiency and controlling costs.** These latter incentives are the currency of businesses operating in competitive markets, and if they are made the currency of the legal profession, the same kinds of cost reductions and enhanced efficiency businesses produce year on year can – and will – occur in the legal marketplace as well.

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Chapter 5: Stories of firms succeeding using value fees

Bartlit Beck

No law firm is more successful using value fees than Bartlit Beck Herman Palenchar & Scott. The firm was formed in 1992 when Fred Bartlit, Phil Beck, Skip Herman and a group of colleagues left Chicago-based behemoth Kirkland & Ellis to launch their new venture. The firm began with 19 former Kirkland lawyers. It now has 54 partners and 16 associates. That's right, the firm is partner-heavy, and takes delight in eschewing the traditional notions of leverage, pyramid shape and 'up or out'.

David Berten, now a principal at Global IP Law Group, was one of the lawyers who left Kirkland to form Bartlit Beck. He tells a story that illustrates the different mindset that differentiated the Bartlit Beck founders. While at Kirkland, Phil Beck was on trial and came into Berten's office to tell him to find out every instance in which a witness had used a certain word or phrase in his deposition. Beck needed the information for his cross examination of the witness the next day. "Sorry you may have to work all night on this," was his departing message to Berten. Minutes later, Berten gave Beck what he needed. In response to Beck's query about how Berten had retrieved the information so quickly, Berten opened Beck's mind to the value of a computer. The story has it that when Beck later marvelled at the possibilities while talking to other senior Kirkland lawyers, they lamented the loss of billable hours while Beck was focused on how to use technology to be a better trial lawyer.

Whether the later part is true or not, the story illustrates one of the essential trademarks of lawyers who navigate the world of value fees: openness to change. For years, perhaps to this day, Bartlit Beck lawyers have been known as being technology savvy. At 77 years old, Fred Bartlit is as adept at creating effective presentations as most lawyers in the office. The willingness to see things that are new and figure out ways to incorporate them into what you do is a trademark of an open, agile mind.

Bartlit Beck does not have hourly rates and does not do hourly billing. It has not done so since 2001, and it has refused engagements where the prospective client has insisted on using hourly billing. When I visited with Skip Herman to talk about the firm's evolution to a pure value-fee firm, I asked about their first value-fee engagement. In its early years, the firm was working on a huge antitrust lawsuit for United Technologies, and it was consuming a huge portion of the firm's lawyers. Like many trial lawyers, the Bartlit Beck lawyers chafed at the idea of being paid the same amount whether they won or lost. So they made a proposal to United Technologies: if the firm won the case, United Technologies would pay them a bonus of \$2m. If the firm lost the case, it would refund \$1m.

The idea that a law firm was willing to bet on itself in that way so captivated the CEO that the deal was made, and Bartlit Beck went on to prevail, earning its multi-

million dollar bonus. Interestingly, when asked whether there were any moments where Bartlit Beck's future was in jeopardy, Skip allowed that, in true riverboat gambler fashion, he wasn't at all sure where the firm would have found the money to make the payment to United Technologies had the antitrust case been lost.

Few firms can compete with Bartlit Beck as one of the leading go-to firms for bet-the-company litigation. It is not one of the leading boutique firms, but one of the leading firms. Most matters now – in the area of 80 per cent – are priced as base, flat monthly payments for as long as the matter lasts, with a certain percentage of the fee being placed into a bucket, a holdback. The holdback can be literal (the money is segregated somewhere) or virtual (a running total agreed to by the principals). But the holdback or bucket amount becomes the basis for a bonus payment, generally between one and five times the bucket amount, at the end of the matter, depending on the outcome and the client's level of satisfaction.

The criteria for awarding the bonus can be spelled out or not. The more the firm has worked with a client and a mutual trust exists, there may be no criteria at all, simply an agreement that client will be fair to the firm. With new clients where no pre-existing relationship exists, guidelines may be discussed, but the decision on how much the bonus should be is left in the hands of the client. The essential feature of this approach is that the client is deciding the firm's total fee after the client knows the value it received from the firm's performance.

In addition to this flat monthly fee approach, Bartlit Beck uses contingency fees, partial contingency fees (an upfront payment or reduced payments in exchange for a piece of the outcome), and reverse contingency and reverse partial contingency

fees, where the payment is based on the amount of savings achieved by the firm over a negotiated amount of potential exposure faced by the firm.

One last personal anecdote about Bartlit Beck's stunning success using this fee model. I was at dinner with an in-house lawyer from DuPont, one of the firm's clients, preparing for our panel presentation the next day, and our discussion turned to lawyers sharing risk in cases. The lawyer told me she had paid Bartlit Beck "a nine figure bonus" just days before our meeting. I started counting spaces since I wasn't accustomed to nine figures when it came to payments to lawyers. The DuPont lawyer caught herself – it was only eight figures, she explained, and low eight figures – "but they were worth every penny."

Seyfarth Shaw

It is probably surprising to find a story about a large law firm in a guide to value fees. I know I was surprised to hear about Seyfarth's success, but the story is so compelling that I would have been remiss not to include it.

Seyfarth is a 700-lawyer firm based in Chicago, or at least it used to be headquartered in Chicago. It earned its reputation as a management firm in employment and labour matters, and while it has developed strengths in many of the areas typically associated with firms of its size, it remains a strong competitor in the labour and employment field.

A few years ago, Seyfarth began implementing various Six Sigma concepts into the firm, and no firm has been more public in the adoption of Six Sigma and Lean principles to the firm's business and practices areas. The point is not to discuss 'Seyfarth Lean', which is detailed on the firm's website and elsewhere, but to focus on one part of the outcome of that effort. As a result of its focus on the process of handling single

plaintiff employment cases and the analysis of its cost data related to those cases, Seyfarth developed the comfort to offer to defend those cases for a fixed fee.

Think back to the introduction and the three stories: eliminate the fat from the litigation process, place the incentive to control cost on the person or entity most able to do so, and develop solutions. Using those three criteria, Seyfarth's approach to single plaintiff employment cases has been a huge success. The process evaluation and application of Seyfarth Lean principles has eliminated or at least reduced the level of fat in the defence of this kind of case. Seyfarth, which is the cost centre, has assumed the burden of controlling cost and has the incentive to do so. And by taking these two steps, Seyfarth has been able to go to clients and prospects alike and propose solutions to their employment case problems: single portfolio fees. Clients must love the budget certainty associated with cases that historically have priced out all over the board.

Has the approach been successful? I was at a recent event where Paul Beach, the assistant general counsel of United Technologies, mentioned that the company traditionally had no relationship with Seyfarth, but that after hearing about Seyfarth's approach, now gives all of its employment litigation to Seyfarth. The company has more than 200,000 employees and the payment to Seyfarth is greater than \$2m. It is a flat, predictable amount for United Technologies, and to the extent Seyfarth can imagine and develop ways to reduce its cost of production, it has a chance to earn even more profit on the deal.

Exemplar Law Group

Just out of law school with both a JD and an MBA, Christopher Marston knew he did not want to work for a traditional law firm.

Not finding a firm that viewed the practice of law the way he did, Marston started Exemplar Law, LLC. From its start in 2004, Exemplar has grown from its origin in Boston to six locations and 26 professionals. They are not lawyers, because Exemplar is about providing business solutions to its mid-market business clients, and that includes business advice and strategy, secondments in law or finance and investment banking.

Exemplar's holistic approach to its client's health makes it a rarity, but its pricing certainly makes it unique. The firm does not bill by the hour and its lawyers do not keep time sheets. The firm's pricing is entirely 'value billing'. Marston once told me of charging two clients two different amounts for what was essentially the same work because the work had different value to each client. The value is judged from the client's perspective – what the work is worth to them. Marston's job is to figure out how to perform the work at a cost less than the value fee.

One way Marston did this was by creating the Fuselage Pricing Model, where clients have a choice of first-class, business-class and coach-class pricing. While Exemplar does handle some litigation, this pricing model works with standard business counselling and corporate matters. In a regular airline, the difference in class includes differences such as the level of attention flight attendants provide. Exemplar's clients who choose first-class pricing get on-demand attention from a team of lawyers, providing the firm's best people in every area of expertise. A client who chooses coach-class pricing, by contrast, does not have on-demand access, and its access is to a single, highly trained lawyer. That lawyer may not have the same depth of experience and knowledge in a particular area that a specialist advising the first-class

client has, but he or she is experienced enough to provide sound general counsel. The difference between a specialist and a generalist is something most business people appreciate. It mirrors their experience with doctors, and to the extent any have worked with a general counsel, they know that general counsel, by definition, can have expertise in only some of the areas on which a company needs legal guidance. They have, however, enough general experience to offer sound if not expert counsel and, most of the time, that is good enough.

Exemplar is one of the only firms where the concept of 'good enough' is apparent in its pricing.

Valorem Law Group

This is the firm I founded with Nicole Auerbach, Mark Sayre and Hugh Totten in January 2008. This date is important because it is eight full months before the collapse of Lehman Brothers and the tanking of the economy. We launched the firm to do complex commercial litigation using non-hourly billing. We believed that there was growing uneasiness among in-house counsel that the hourly model was not sustainable.

Our website launched in early April 2008 with a banner announcing: 'The Billable Hour Is Dead.' We jumped into the deep end of value fees when many people still thought alternative fee arrangements were weird. One partner at Katten Muchin telephoned Auerbach before she left to inquire whether she was crazy, thinking there was no place in the world for any billing arrangement not driven by six-minute increments. Coincidentally, that same partner called some months later to ask how value fees worked. As time has shown, we were right, and the economic collapse later that year merely accelerated an already growing interest in value fees.

Many businesses and business writers inspired our thinking as we developed our model, but only two law firms did so: Bartlit Beck and Summit Law Group in Seattle. The inspirations from Bartlit Beck will be apparent in the next few paragraphs. The inspiration from Summit related to its relentless focus on customer satisfaction and its use of the value adjustment line.

As a start-up firm with no inventory of receivables and mouths to feed at home (between the partners, we have 11 children, ten of which have yet to graduate from high school and start college), we really liked the fixed monthly payment idea since it would accelerate the time when we would see money coming through the door. As trial lawyers and fierce competitors, we also embraced the notion that we should be paid more for winning, so we determined that we would have skin in the game on every engagement. That meant that on every matter, some portion of our fee was at risk, dependent upon the outcome we achieved for our client.

It is important to note here that 'outcome' does not mean the same thing as 'result at trial'. Most clients are in the business of making and selling goods or selling services, not in the business of litigating claims. Lawsuits are incidental to the business and frequently a distraction, diverting resources from the business of making and selling whatever the business makes and sells. In that context, it is sometimes critical to achieve a resolution and the speed of the resolution may be what is most important to the client. Hence, 'outcome' must be judged in the context of the client's hierarchy of objectives.

We have taken some matters on contingency and some on partial contingency. We have priced lawsuits in phases. We have quoted fixed fees for the entirety of a lawsuit,

and we have quoted flat monthly fees for handling a replenishing portfolio of lawsuits. Our holdbacks have ranged from ten per cent to approximately 90 per cent. In the 90 per cent case, we achieved a negotiated resolution that, from a business perspective, provides the client with more than it would have achieved had we gone to trial and won every issue. We took our success bucket in that matter in the form of warrants to purchase stock in the company.

We clearly were beneficiaries of the economic collapse. Companies were cutting back on their legal budgets and needed to push the envelope to discover new ways to save money. We had our message and could show the savings. But what makes Valorem attractive to the clients that have engaged us are the value-fee structures we offer, our interest in customising the fee to reward favourable outcomes as the client defines them, and our willingness to bet on our ability to achieve those outcomes.

Have we made mistakes? You bet. As recovering hourly rate lawyers, all of us were comfortable with the 'deep dive'. You know what that is – you want to know everything so you chase every rabbit and exhaust every lead. That's not a good approach when your fee is set. It eats into your profit margins. Lawyers may not take quickly to project-management efforts, but they are essential to maximising profit under value-fee arrangements. We sometimes revert back to the old ways of doing things, but generally we police each other and continually ask whether a particular project or piece of the case is going to make a difference to the outcome. It is sometimes hard to let go of things that are not going to make a difference, but some gentle reminders of who and what we are generally help people make the right decision.

We expected that one of the biggest challenges associated with using value fees

would be convincing clients that the work quality will not suffer. We addressed that from day one in two ways. The first is the holdback, or success, bucket discussed in Chapter 3. By putting a significant portion of our fee 'at risk' and then letting our client decide whether we've earned the fee, we created a uniquely powerful incentive to make sure the client believes our service and the result we obtained is so exceptional that we are entitled to the fee. Clients appreciate the value of this incentive. The other way we persuade clients that there will be no quality shortcomings is through the value adjustment line we borrowed (with permission) from our friends at Summit Law Group. Our version of the value adjustment line works like this. Every invoice is our proposed fee. Beneath the proposed fee, we include a box for an adjustment and this line: "If, for any reason, you do not believe that the services we provided should be valued as agreed, we encourage you to make any adjustment – up or down – that you believe is warranted." There are two boxes. One says 'Value Adjustment' and the other the new 'Total Due'. These two value tools create comfort for our clients that we will always let ourselves be measured by the value we provide them.

So many others...

This list of firms is obviously not exhaustive. Many other firms have similar or better stories. Morgan Lewis, for example, is one of the pioneers in BigLaw, having entered into a fixed fee agreement with Cisco a number of years ago to handle Cisco's litigation portfolio on a fixed fee basis. Orrick has created a product that most multinational companies need, a service to register and handle the local paperwork in every country where its client has subsidiaries. It charges a flat fee for that service. Orrick also recently

committed to handling Levi Strauss' litigation portfolio on a fixed-fee basis. Shepherd Law Group in Boston does employment litigation on a fixed-fee basis. Indeed, it is so committed to value fees that its lawyers do not even keep timesheets.

What should you make of these various examples? One easy lesson is that there are easy lessons to be learned. Every firm that has offered value fees has made mistakes, and no firm that chooses to do so will avoid all mistakes. But to the extent firms can learn from the successes and failures of others, that effort is worthwhile.

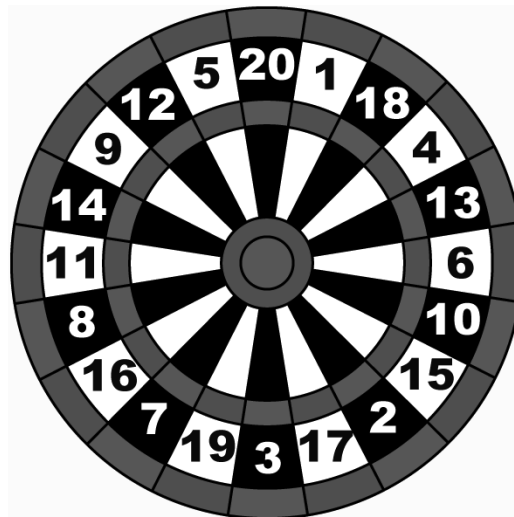
Chapter 6: How do you determine the price?

You determine price in one of two ways:

1. A Ouija Board; or



2. Throwing darts at a board randomly covered with numbers.



At least it seems that way in the beginning.

Chapter 7: Pricing, part II

DETERMINING THE price of a piece of litigation is one of the most difficult skills a lawyer can master. The factors to consider are long and varied. Businesses that price their product without knowing its cost either go out of business or are damned lucky. Smart businesses know the cost of producing their product. Law is a business. Therefore, lawyers must know the cost of producing their product – the successful handling of a case.

Cost and price, it must be said, are different. Price is what the client pays, or revenue. Cost is what the lawyer pays. Revenue minus cost equals profit, expressed as:

$$R - C = P$$

Outside the law department, those who buy for most businesses are concerned about their price, not the producer's cost or profit. Many law departments get hung up on how much it costs their lawyers to produce a result, as if they should micro-manage the law firm's business operations. The law departments that do so frequently want to give their business to their *status quo* firms, but are concerned about their price. So rather than search out a lower price, they spend their energy debating their favoured firms' cost structure. This has been seen recently in the extraordinary attention paid to starting associate salaries when they reached \$160,000. Clients complained that if firms were paying that much, their cost structures were too high. Some clients went so far as to refuse to allow new associates to be staffed

on their matters because of the lack of value for amount paid.

All of these concerns about firms' cost structures were warranted. The firms had been engaged in cost-plus pricing for so long that they had no incentive to reduce costs. And even after the economy went into free fall, the cost-control approaches of most firms were akin to a surgeon operating on a hangnail while ignoring the blood spurting out of the bullet hole. Clients seem to be taking the attitude that if you can't do it yourself, we will figure out how to do it for you. This paternalistic attitude is exactly that – paternalistic. If the clients decided to let the market teach the lessons, they simply would have moved to new providers of legal services.

Many did. The more sophisticated consumers of legal services – and each day, more law departments are becoming sophisticated in this way – are refusing to micro-manage their firms. They instead focus relentlessly on the value they receive, a large part of which is the price they pay. Like the fast food 'cups guy' described in the introduction (lesson number two), these sophisticated buyers let the firms worry about the firm's cost of production. If the firm cannot get its cost of production down, these clients will move their business to firms that lower their cost of production and can, as a result, charge a lower price.

Look at this illustration from the client's perspective. The client agrees to pay \$1m for a firm to handle a certain

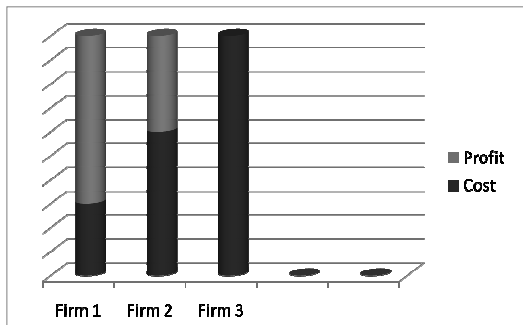


Figure 1: Cost structures and profitability

portfolio of cases. Does the client care if the firm chooses to pay its associates \$160,000 per year? If it does, is the client going to figure out what salary the firm should pay and then negotiate with firm management over the number? Of course not – concern about the law firm’s cost structure is a remnant of the hourly rate era when firms charged on a cost-plus basis. Clients knew that if firms paid the highest salaries to their associates, those costs would be passed on to them in the form of higher rates. In the circumstance here, if the client got a good price for the portfolio of cases, it no longer needs to worry about the firm’s cost structure.

From the firm’s standpoint, if revenue – the prices paid by clients – is fixed, the only way to increase profit is to reduce costs. Figure 1 illustrates three firms with three different cost structures and, as a result, three different levels of profitability.

Determining risk

Each lawyer pricing a case will have to know his or her firm’s cost structure, lest the firm be the third firm in this illustration. Lowering the cost structure will be discussed in a later chapter. But assuming service quality is the same, it seems to me clients should be more concerned about the firm that makes nothing or too little on the

engagement rather than being concerned that one firm makes too much.

There are some basic truths that are important when deciding a value fee for a case. First, the risk of being wrong on your costs increases the longer a matter is on-going – see Figure 2.

As the complexity of a matter increases, the risk of being wrong on costs increases – see Figure 3.

Conversely, the risk of being wrong on cost estimates decreases as the amount of investigation increases – see Figure 4.

Thus, on every matter, there will be costs that are more certain than others, and other costs that are completely unknowable – see Figure 5.

Determining cost

For pricing, it is important to examine the components of cost. The first step is to identify the various factors that *will* affect the cost of handling a particular case. The next step is to identify the additional factors that *could* affect the cost of handling a particular case. The next step is to identify the circumstances under which the factors on the second list, the ‘maybe’ list, would become actual cost items – in other words move from list one to list two. Generally the factors in the ‘could affect’ category relate to discovery issues. An example of a factor that could affect cost is the need for more personnel if more documents are produced than expected, and the time available for review is limited.

Deciding price

Once cost is determined, the price to be quoted must be decided. The factors that go into a price quotation vary from quotation to quotation and from one person to another. But there are important lessons to be learned from those who have been pricing fixed-fee

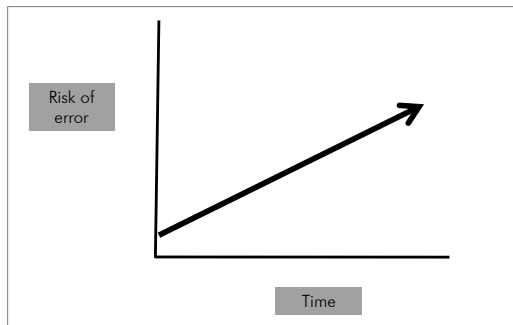


Figure 2: Cost risks increase with time

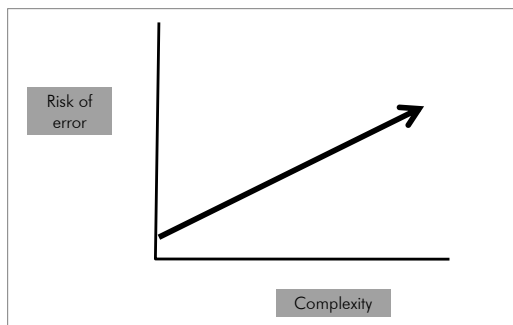


Figure 3: Cost risks as complexity rises

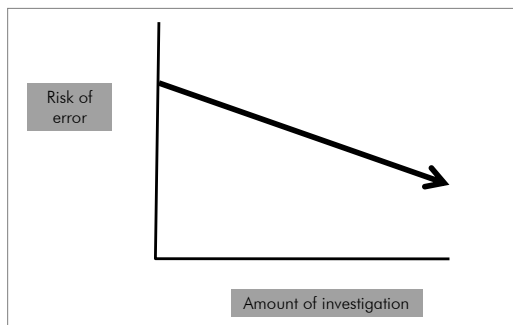


Figure 4: Cost risks as investigation increases

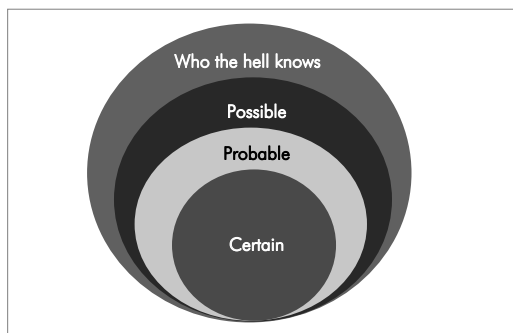


Figure 5: What will it cost?

work for years. Jay Shepherd is the CEO of Shepherd Law Group, based in Boston. Shepherd Law Group represents employers in labour matters. The firm does not use hourly billing and its lawyers do not keep timesheets. The firm represents a number of large institutions, including Bank of New York, Adobe Systems, Northern Trust Bank, Costco and Mellon Financial. How does Jay Shepherd price a case? According to Jay:

1. I analyse the client;
2. I assess the importance of the situation;
3. I assess the urgency of the situation;
4. I pay attention to what my competitors charge;
5. I consider the relative values of the different possible outcomes;
6. I figure out how hard it would be for the client to get better service elsewhere.;
7. I determine how important my firm's expertise is to the likelihood of a successful outcome (in other words, is this going to be easier because of our particular skills, or could any trained monkey use the internet to find the answers?);
8. I consider what we've charged other clients in the past for similar work;
9. I consider whether those charges were heavy or light in retrospect;
10. I consider the likelihood of getting more work from this client;
11. I assess how much work we've done for this client already;
12. I wonder how important getting this particular job is to our firm (if it isn't, I might raise the price); and
13. I decide whether to do a single price for the whole gig, or whether (and how) to break up the job into mini-gigs with separate prices.

Then I say: "This is our price."

Bartlit Beck may be the most successful AFA firm in the US. It has not used billable hours since 2001, so there may be no one with more experience pricing litigation than Skip Herman, the firm's managing partner. What does he look at to price a case?

1. The jurisdiction (time to trial is key);
2. Who's on the other side and what their incentives are (a firm on contingency fees is different to one on hourly rate);
3. The number of people who will be involved in a case;
4. The firm's experience with the client; and
5. He breaks the case up into periods: investigation, pleadings, discovery, pretrial and trial.

The less you know when you engage in the pricing process, the more risk there is that the cost on which the price quoted was based will be wrong. So Bartlit Beck, like most firms that utilise value fees, engages in extensive due diligence before taking on a case. This due diligence allows more refined estimates.

When you are determining a price, you have to know what you expect your cost to be, and **unless you want to go out of business, you offer a price that is higher than your expected cost**. Thus, as the risk of error in estimating actual cost increases, the need to implement controls to contain cost overruns increases. But in all cases, reducing costs will increase profits. And while neither Skip Herman nor Jay Shepherd expressly mentioned the firm's cost of producing a result as part of their price analysis, both are **acutely aware of their cost structure** and that awareness is woven into their pricing analysis.

Our own pricing efforts have led us to take similar factors into account. Here is our list (remember, we are a litigation-only firm) and an explanation for why we consider these items important:

1. Case locale – where the case is pending, whether we have established local counsel relationships in the area. This is more or less relevant depending on how much work you expect local counsel to do, and your experience with them. Some lawyers get the idea of cost control, even as local counsel, others don't;
2. Time to trial – this is a Parkinson's Law issue ('work expands to fill the time available for its completion'). **Cycle time is a significant driver of total cost**;
3. Opposing counsel – Skip Herman's point that opposing counsel's fee structure (and thus their incentive to be efficient or not) is right on the money. Plus, some people are viewed as reasonable, while some are not;
4. Case dimensions – the number of parties and complexity of the issues are important. Multiple parties mean multiple sets of discovery responses, more depositions, more scheduling complications, more gamesmanship;
5. Business dynamics – the motivation of the parties is very important. Are the parties' competitors fighting for market share or do they have ongoing economic relationships? Is this a situation where people just got angry with one other or is there something more there? Pre-filing discussions may have shed some insight into the level of expected intransigence;
6. Internal costs – while not always dispositive, the cost you expect to incur should be a floor for your price quote;
7. **Capacity** – if you are busy and don't 'need' the work, you may not use the sharpest pencil in calculating the price quote. On the other hand, if you have excess capacity, you may sharpen your pencil to improve the odds of being engaged;

8. Prices being quoted by your competitors – you rarely know this information, but sometimes you can make educated guesstimates;
9. Your unique abilities – whether you might be better at the matter than everyone else;
10. Relationship with the client – if this is an ongoing relationship, or if you have an opportunity to get additional work from the client, your cost of marketing and business development is reduced accordingly. If you are constantly getting ‘one-off’ matters, your business development costs will be higher;
11. Opportunities – what doors are opened for you if you get this engagement? Publicity, development of expertise in a substantive area, and referral opportunities are examples of non-monetary value that must be considered;
12. Clarity of objectives – how clear or certain are the client’s objectives? If ‘success’ is likely to be a moving target, you cannot price as close to cost as you otherwise might;
13. Client personality – is the contact person at the client high maintenance, low maintenance, or something in between? Clients who are indecisive, who endlessly debate minor points, or who endlessly shift strategies consume lawyers and add to the cost of doing business. The price will reflect that because our experience is that some clients drive up our costs of handling a matter a large amount. An interior decorator dealing with a client who needs to see 47 shades of the same colour, some multiple times, is going to charge that client more than a client who is prepared to defer to the decorator’s expertise.
14. Client’s risk tolerance – if the client is risk averse, the efficiencies of taking

short-cuts to get to critical points faster may be lost; and

15. **E-discovery and document issues** – e-discovery can be the largest black hole in litigation, so an important part of our due diligence is getting a firm grip on the volume of documents likely to be involved in the litigation, for all parties.

Issues relating to settlement

There is one additional factor that may well be the biggest factor in pricing. I’m sure you’ve heard the old joke about the way lawyers are trained: “Bill. Bill. Bill. Settle.” It is, unfortunately, fairly common for lawsuits to settle on the courthouse steps or in the trial preparation phase. Fred Bartlit, of Bartlit Beck, refers to the phenomenon as the client receiving ‘the letter’. The letter comes after all the discovery in the case has been conducted and all the motions for summary judgment and other pre-trial wrangling have occurred with trial being on the near horizon. The letter informs the client that because of the way the case has shaped up, the client should now consider settling the case rather than trying it. Of course, this advice is inconsistent with the advice that the firm had offered previously as a justification for conducting all of the discovery.

One way or another, by whatever name is attached to it, lawyers settle cases. We know that approximately 98 per cent of all cases resolve. For that reason, **the timing of settlement** takes on an enormous degree of significance. If a case settles at the end of discovery or shortly before trial, a large percentage of the transaction costs have been incurred by the client and the lawyers have maximised their revenue from the matter. In a fixed-fee or results-based fee environment, the incentives regarding the timing of settlement are switched. The firm no longer benefits by having the matter drag

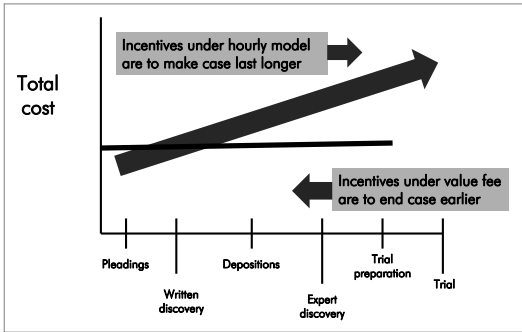


Figure 6: Incentives to settle

on endlessly. Instead, the firm’s profit margin grows only if settlement is accelerated to a much earlier part of the process – see Figure 6.

How does this impact pricing? If you price a case through the beginning of trial, your ability to achieve a positive margin is enhanced significantly, but the cost to the client is dramatically increased. Conversely, if you price a case so that early settlement becomes the anticipated basis for the pricing, and the case does *not* settle earlier, then the risk of the firm being ‘underwater’ is that much greater. There is, of course, a balance between the two extremes, and it is typically in that middle area that most value fee lawyers target their pricing.

In order to target pricing in that manner, it is incumbent on the lawyer to determine the client’s attitude toward settlement and learn what can be learned about your adversary’s attitude toward settlement. This inquiry is not limited simply to the in-house counsel, but must also extend to the business people who have approval or at least a voice in the settlement decision.

If the **client’s attitude toward settlement** is not realistic, the lawyer will factor that in to the pricing decision and the needle will move toward the full price end of the dial, as illustrated in Figure 7. Conversely, if the client’s attitude is to accelerate settlement,

the needle will move toward the direction of lower prices.

There is a tendency for clients and indeed lawyers to believe that early efforts to resolve are a mark of weakness and need to be avoided. This attitude is, in my view, the result of years and years of effective marketing by lawyers looking for ways to convince clients to continue to invest in cases and delay settlement until the latest possible moment. If one takes the issue outside the purview of lawyers and considers the dispute as a simple business problem to be resolved, there are few illustrations where a CEO or other senior executive would take the position that the resolution of problems should simply be deferred indefinitely. Once again, the approach used on the business side of our client’s operation should easily inform the manner in which the legal side of the equation is handled.

This important role the client’s attitude can play in the pricing of a case is a little-considered phenomenon, but should be at the forefront of both the client’s and the pricing lawyer’s mindset. And because settlement is a binary process – that is, both sides must agree – the information and understanding about the **adversary’s approach to settlement** will also be an extremely important consideration.

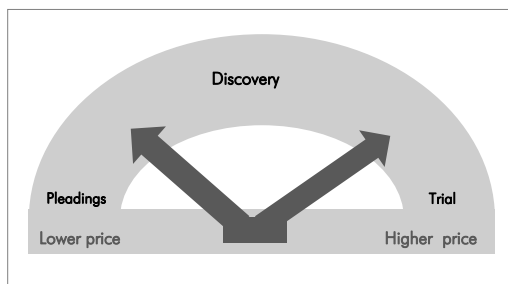


Figure 7: Client’s lack of realism on settlement will push the price higher because quick settlement will be unlikely

Some additional insights...

While the process of creating a budget is not the same as creating a fixed price, it is similar. Some lawyers create a 'high level' budget looking at many of the factors listed above. Others tend to build their estimates more granularly. Ralph Palumbo of Summit Law Group in Seattle builds his budgets using a form with more than 100 line items. He says that he is always wrong on 100 per cent of the line items but within three per cent on the total budget. If you are not ready or willing to jump into the deep end and start offering fixed fees, keep in mind that prices are neither right nor wrong. They are not accurate or inaccurate. They just are. They are a number, just as the price you pay for a new pair of shoes is a number. Sometimes, shoes are sold at a tremendous mark-up and the seller earns huge profits. For other types of shoes, the seller misreads the market and style isn't selling, so the shoes are sold at a loss.

You are going to make mistakes and some matters will not be profitable. Life happens. Oil companies drill dry wells. It happens. **Figure out where you went wrong and avoid making the same mistake again.** But resist the temptation to look to the client to insure you against a loss. After all, no one insures our clients against a loss.

The main aim is to add value.

Reference

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Chapter 8: Change

Step 1: Determining a firm's DNA

Virtually every law firm has billed by the hour since before the most senior lawyer in the firm began practising. Every molecule of the firm, every measuring device, every judgment of worth is designed around the concept of billable hours. Maximising hours has become part of the fundamental make-up and culture, the DNA, of virtually every firm.

This DNA is implanted in associates beginning on their first day with a firm. Each person is schooled in the importance of keeping track of time. Beginning immediately, associates are judged on the number of hours they bill and the quality of work they produce. The latter often becomes a function of time. More time researching and polishing work product generally produces better work, at least under the definition of 'good work' used in most law firms.

Let me offer an example. When I was a young associate, I was asked to draft a motion for an extension of time to respond to some written discovery requests. I wrote a two-page motion. I turned it in and was promptly summoned to the partner's office and chastised for producing an inferior piece of work. Thirteen drafts later, we filed a 15-page motion, complete with string citations about the judge's authority to exercise discretion to grant an extension. When we arrived in court, the judge said he hadn't seen the motion and the opposing lawyer said we should have called him because he had no objection. When I mentioned that the exercise seemed like a

colossal waste, the partner pointed out that we had prepared an excellent motion and we would be paid for all our work. That is how he defined success, and I never forgot it.

Associates are not taught to discern between work product that merits the extra time and work product that does not, and no associate who desires to advance or maximise his or her bonus will dare turn in 'good enough' work product prepared efficiently. Advancement requires hours. Advancement requires great work on the most mundane of matters. Good enough is never good enough if you want to advance. Thus, institutionally, firms inculcate lawyers with this notion of extreme quality in every circumstance. Clients, however, rarely want to pay for that extreme quality in every circumstance. Faced with a remote client and a partner who will be reviewing them for bonus and advancement, which road is the associate likely to take? The client loses.

The institutional pressure for hours is becoming more acute, not less. During the past two years, associates have been terminated (law firm's euphemistically refer to these terminations as 'layoffs', as if the condemned have a chance of being called back) in record numbers. Those most likely to be terminated are those not billing some defined number of hours. Even firms that have not outright terminated associates for failing to bill a targeted number of hours have penalised those associates in their compensation. The message is clear: bill a specified number of hours or face termination or financial penalty.

In the face of this unrelenting message, can anyone claim surprise that associates are using their prodigious intellect to find more billable hours on every matter to which they are assigned? Many associates have graduated from law school with significant debt. Some have started families. All have lease or mortgage obligations. The prospect of losing one's job in an environment where new employment is a long shot can cause even the most scrupulous person to push the envelope of rationalisation to justify survival.

So how is the envelope pushed? We discussed illustrations of the problem in Chapter 2, but the subtlety with which lawyers deal with the pressure are worth focusing some attention on. Some 'adjustments' are easy. If you are writing a brief, you read a few more cases, or spend more time researching to be sure there are no more cases to read. Perhaps you expand your research from one jurisdiction to others. You study the arguments more to find better, finer arguments to hone your brief. You proofread the brief a few more times to ensure the draft is error free before submitting to the partner for review. And when you receive the brief back from the partner's edits, you correct the brief yourself rather than having your assistant do so as you did in 'the good old days'. Heck, sometimes it's just as simple as reading more slowly.

This 'at all costs' mentality can permeate every aspect of an associate's work. Assigned to prepare a deposition outline? You can review lots and lots of documents to select the nuggets that will become deposition exhibits. You can familiarise – or re-familiarise – yourself with everything that's been said about the witness or the subject matter by looking at every document or every deposition that is even tangentially relevant. All this is done at the altar of thoroughness

and quality. And it is hard to question the commitment to those values since they are integral to almost every firm's brand.

These same pressures do not end when one achieves partnership. As a junior partner, the pressures are essentially the same, only greater. Junior partners are, after all, more expensive and therefore more expendable than associates. As a result, many junior partners have found themselves competing with associates on their case teams for work on that case. And, at a minimum, junior partners are really good at thinking about rabbit holes to explore, again justifying such effort in the name of quality and thoroughness.

Billing partners face a different set of pressures that are far less subtle. Power and prestige within the firm are tied to billing totals. Compensation is tied to billing totals. Power, prestige, compensation... What else is there?

Firms will challenge this characterisation. Procedures and culture will be the bulwarks against this kind of self-driven excess. The assumption, of course, is that the procedures and cultural impediments really exist and are effective all the time. Firms will rarely point to structural changes that have eliminated the incentive to excess. You will have some firms point to the elimination of their lock-step or point to the fact that hours are not a component of advancement or bonuses. Frankly, I would ask to see the raw data. Saying it doesn't matter is easy, but if the people who advance or the people who get higher bonuses are the ones who work long hours, the institution's message to its lawyers is unambiguous. **As long as revenue is a function of time invested, firms will find ways to get people to spend time doing stuff. That is, after all, their *raison d'être*.** One need only look at law firm behaviour in the past two years to see that, like a crack addict, they cannot turn away from annual rate increases.

The *National Law Journal's* 2009 annual survey of billing rates showed an increase in rates of 2.5 per cent.¹ Think about that. In the midst of the worst economic environment most clients have ever experienced, many firms raised rates. Altman Weil's 2010 billing rates survey indicates that firms plan to raise rates in 2010 by an average of 3.2 per cent.² Even when presented with the perfect opportunity to work with clients and seize work by responding to clients' economic difficulties in a client-focused manner, the effort in the hourly rate model is to raise rates rather than drive down the cost of production and grow wallet share.

Does a hybrid model work?

Some firms have seen the value of using non-hourly fee arrangements with certain clients or on certain matters. Is this hybrid model workable? Here are some issues to consider:

- What role does **realisation** play in the firm's compensation analysis? Many firms analyse the percentage of billings that are collected. But many also compare the amount billed to the amount that 'could have been billed' if the matter was billed at **standard hourly** rates. If your team bills X on a matter, but the amount would have been X + Y had you billed the client on an hourly basis, your realisation rate is reduced.
- **Do those lawyers working on AFA matters face the same institutional pressures to bill hours** as those on hourly matters? If so, the AFA isn't really designed to achieve the result of producing better results at lower cost to the client. It is, instead, just a way of trying to capture the

same amount of revenue as before, but under a different name. A wolf in sheep's clothing is still a wolf.

- Has the firm changed its leverage model? On an hourly model, you want larger teams, with armies of lawyers relentlessly examining every nook, cranny and rabbit hole on every case. The model that maximises profit on most value fees is an experience-based model where very small teams of highly skilled and experienced lawyers handle a matter. This different staffing model should be reflected in a different make-up of a firm. The idea of a pyramid should be jettisoned in favour of a diamond model or something close to it – see Figure 1.
- Does your firm still embrace in words or practice an 'up or out' model? The idea of developing a person's skills and then jettisoning him just as he reaches the level of skill and experience where he can contribute most to the firm's profitability is peculiar. If you are engaged on a value fee, particularly one where results make a difference, **you want the experienced middle in lieu of rookies.**

These are but a few of the differences, but they are at the core of most firms.

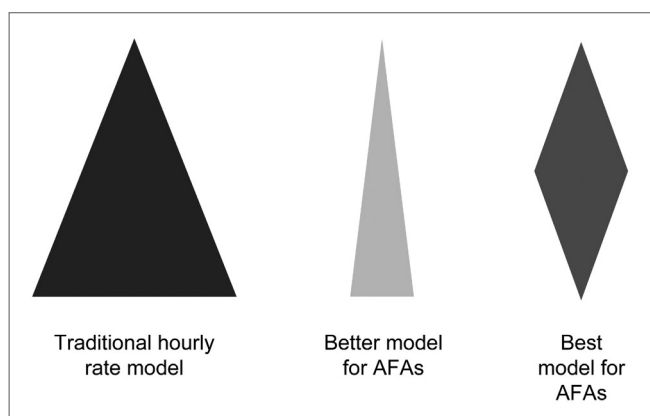


Figure 1: Staffing models

There should be vast differences in the values, appearance and practices of a firm that embraces value fees and a traditional hourly rate firm. The differences are profound and exclusive. You cannot value both leverage and anti-leverage at the same time. You cannot tell some associates to bill more hours to make partner and then tell others to bill fewer to achieve the same end.

Some firms will recognise the need to embrace value fees and that the shift to a value-fee model must be complete. Is it as easy as flipping that switch? Absolutely not. Recognising the need for this profound change is the easiest part of the transition. The hard part comes next.

Step 2: Changing a firm's DNA

Recognising the need to change is the first step on the path to achieving change. Certainly selecting the right path is to be applauded. But the decision to change, to move toward a value-fee model, is only the first step. The path toward effectively achieving change is long, hard and fraught with peril. There will be many opportunities to fall and fail. When you have always emphasised more, how do you suddenly emphasise less? When you have achieved greater compensation by billing more, how do you stop seeking more and look instead at reducing costs of producing results as the way to achieve profit? It is a daunting, difficult task.

The three most important steps to achieve a **DNA makeover** are to identify the end result desired, determine a time frame to make the economic and structural changes needed, and overcome inertia. The value fee business model is as different to the hourly fee business model as night is to day. Like dawn and dusk, it is easy to identify points of overlap. But at their core, the models are very different. One example

illustrates the point. If a client wants an answer to a question, and there is some research involved, one expects the firm using the hourly model to have a highly paid, highly skilled associate do the research and then write a memo. That memo is then reviewed by the partner who sends it on to the client and perhaps calls to discuss the findings. **The value-fee lawyer, on the other hand, calls a low-price but very capable contract lawyer to find the most important few cases. The value-fee lawyer does not want her attorneys doing basic research because others outside the firm can do it as well, far more cheaply.** The value-fee lawyer reads the cases and calls the client to give the answer. Maybe she sends an e-mail afterwards. One firm has an incentive to keep the process as it has been for years, the other has a financial motive to shrink the process.

Money talks; you look at life differently when it's your money.

Firms have to undergo radical surgery. They need to look different. More importantly, they need to act differently. Most of all, they need to be different at a molecular level. In the next chapter, I discuss a handful of tools that will help change the way firms practise – *if they utilise the tools aggressively*. It will not be enough to talk about change. If the next chapter is about tools to help change at a granular level, the issue confronted here is one of leadership and vision, and to a lesser extent, strategy and tactics.

I believe in a concept I've labelled **'visionary reverse engineering'**. Regular reverse engineering is when you take a device or a system and dissect it so you can appreciate its inner workings and then duplicate them. There are not, for the moment at least, firms of any scale that lawyers can look to and say: "I want to

change our firm to look like that one.” So instead of looking for one that does exist, imagine one that doesn’t, but that would be great if it did. And then work backwards to where you are. This effort will help you identify the changes your firm needs to make, and which changes are most important.

Among the crucial questions to ask when identifying what the end result will look like are:

1. Will you share risk with your client?
2. If so, what will your personnel spread look like? Will your firm become diamond-shaped? Will you eliminate up-and-out policies and practices, whether formalised or not?
3. Are you prepared for rapid restructuring? From a personnel standpoint?
4. If you restructure, are you prepared to make adjustments to your real-estate assets?
5. What types of fees will be your defaults?
6. Are you prepared to invest in data mining to see your costs of production?
7. Who will be pricing your various engagements?
8. What steps will you implement to create virtuous cost-reduction circles?
9. How will you adjust your compensation systems for associates and partners to eliminate hours and gross revenues as the drivers of compensation?
10. What other ways exist to take advantage of and leverage the experience of your more experienced lawyers?

This law question bears some reflection. We’ve all seen situations where Bob brings in a client, but may not have the right experience to be the best person for handling a particular matter. In a billable hour world, the risk of underperforming for

a client was Bob’s risk – if his efforts did not satisfy a client, the client might not hire Bob again. But in the new world, there are two related issues. Mary might be the best lawyer for Bob’s new client, and Bob might be the best lawyer for Janice’s client. It is, in the new risk-sharing world, really important to make sure Bob ends up on Janice’s client’s matter and that Mary ends up handling the matter Bob brought in. That line-up produces the most likely positive outcome for the firm – two efficiently handled cases where profit margins are higher by virtue of Bob and Mary handling their respective matters.

Our solution at Valorem, one that is not likely to be scalable directly, is the ‘rising tide’ compensation model. Partners make the same amount, so that the only way to earn more is for the ‘rising tide to raise all boats’. The incentive to work together and to do the work that is going to maximise client satisfaction and results is huge. The incentive to hold each accountable and the interest in being accountable to your colleagues is enormous.

Lawyers tend, as a group, to be risk averse. No revelation there. But one way this plays out is in how firms brand themselves and how they market themselves. Almost every BigLaw firm, according to firm websites, is a large firm with multiple offices across the globe/country, which does great work in every conceivable area and is stocked with the very best lawyers from the very best law schools. The firms are all value oriented and interested in providing great client service to all clients in a partnering manner. These websites are like elevator music – not offensive but certainly not memorable.

If you are making this change, it is important that your clients be part of it, advising you and helping you fashion a

new firm that will benefit them. But as you reform yourself, remember that if you try to be everything to everybody, you will end up being nothing to everybody.

Figure out your true strengths and leverage those. Change to be something extraordinary, because the extraordinary firms are the ones that will succeed in a results-driven value-fee world.

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Chapter 9: The tools of change

IF CHANGE is not accomplished by the mere flip of a switch, it is essential to discuss the tools that are available to drive the change. Fortunately for the legal profession, it does not need to start from scratch and create new tools. The profession can use, with minor modification, tools used in the business world.

Project management

Outside the legal profession, project management is a fundamental tool in any business enterprise. When my colleagues and I began our Valorem adventure, we retained an architect to design a basic footprint for our office configuration. After we approved the concept, the architect then developed a detailed set of blueprints. The blueprints were, in turn, provided to the builder who worked with the various subcontractors whose input was necessary to develop a proposal. The builder then submitted a firm proposal based on the blueprints and design elements created by the architect. After we approved the builder's budget, the builder developed a project-management plan that showed the precise sequence of every activity involved in the build-out process and the amount of time each activity would take. This way, we were able to follow the progress to ensure that the project remained on schedule and on budget.

During the course of the build-out process, we decided to make minor alterations or either enhance or reduce the quality of various finishes. These resulted

in change orders that either lowered or increased the overall price. But because of the detailed blueprint and the detailed project-management plan, it was always clear whether something that we wanted to do was within or without the scope of the original project.

When we moved into our new space, we gathered in our collaboration room to discuss what we had learned through the build out. Here are our main take-aways:

- When operating on a tight budget, budget certainty is critical;
- Pricing out change orders before committing to them is important;
- The schedule outline that showed the sequence of things to be done is an excellent tool to track progress and identify delays early; and
- The weekly meetings with the contractor in which we discussed progress, problems, forthcoming issues and generally made sure that we were on schedule for our anticipated completion date were essential to maintaining progress and provided a large measure of accountability.

We looked at the process from the contractor's perspective and marvelled at their ability to deliver the sequence and order materials for delivery just at the right time so the materials did not arrive too early or too late. Materials that arrived too early could have interfered with the execution

and performance of other subcontractors who had earlier tasks to do. Planning, in the building process was everything.

We then asked ourselves if there was any reason our clients would analyse the litigation process and their encounter with us differently than we had analysed the building process in our encounter with the contractor. In all likelihood, the values and attributes we saw in our contractor and the process would be things that our clients would look for in the lawyers they dealt with: budget certainty, schedule certainty, knowing the cost of changes to the plan of execution, completing a task quickly and efficiently, and regular updates on progress and discussions in advance of anticipated problems. These were things that we believed we provided naturally, but not systemically; we needed to ensure that all of these attributes were part of our delivery of every service to every client.

For the contractor, project-management skills are the tools to achieve these important ends. Project management allows the planning and sequencing of a build out, and the planning, ordering and delivery of materials that allows a build out to be completed on schedule and on budget. For the contractor, the project manager is the conductor orchestrating an outstanding symphony performance. It is an orchestration accomplished on a tight budget with narrow margins and when successfully accomplished, the contractor earns a profit.

Timothy Corcoran of Altman Weil recently wrote that in some of his early sessions training BigLaw partners on project management: "A handful of partners would sheepishly acknowledge that they had no idea project management was a term of art."¹ Until very recently, lawyers that did recognise the term have considered the concept of project management beneath them. After all, lawyers were artisans not

merchants or manufacturers. Each matter was unique and required the utmost in flexibility. But the topic has been getting growing attention, especially from clients who have seen internally how important project management can be to efficient operation. Many outside lawyers are, as a result, starting to realise the 'artisan' argument does not hold water. Much of what lawyers do is a commoditised process. Even within highly customised bet-the-company cases, there are elements of commodity work and the process is similar from one case to the next, even if the facts are not. A document production in a bet-the-company case, for example, is essentially the same as a document production in any other case.

For those who decide to utilise value-fee arrangements, project-management skills are critical to the pricing process and to the equally important management process that will ensure that lawyers operate within the cost structure required once a price is quoted.

Those making the switch need to create the right mindset among those they work with. And the most important realisation lawyers must confront is that the need to change will be the hardest imaginable test of their discipline. Did you ever watch a professional basketball player shoot free throws? Almost any player who is any good at the task goes through exactly the same set up ritual in his form. His or her form is exactly the same on every shot. Ask yourself the same thing after watching an outstanding professional golfer. Every swing looks exactly the same every time. Muscle memory is an incredible asset when performing a task.

"All projects are managed. Some are managed deliberately, some inadvertently. Deliberate project management is better."
Steve Levy, Lexician²

Muscle memory is what needs to be overcome for lawyers to change the way they handle cases in a non-billable-hour model. In changing, decades of muscle memory, decades of institutional focus and decades of a universal, unitary way of looking at the performance of tasks and relating to a client cannot happen with the flip of a switch. The transition from a billable-hour to a non-billable-hour model will be one of the most difficult, daunting tasks any lawyer and any law firm will encounter.

For law firms embracing change, project-management skills will be the cornerstone on which that change is built. One large firm that has made a substantial commitment to project management is Seyfarth Shaw, a national firm with an outstanding labour and employment practice. There is an intersection between **project management** and **knowledge management**. One of the goals of both is the performance of work efficiently. One way to obtain efficiency is to have access to prior work that will allow current work to be handled in a more efficient manner. For example, if you are removing a case from a state court to a federal court, the documents that must be prepared are going to be fundamentally the same in every case. True there will be specific facts that will need to be added, but the recitation to the statute, the appearance of the document, the types of documents that need to be prepared, will all be identical. Having access to those kinds of documents without having to spend time locating them will be an efficiency that will produce results.

Jim Hassett, the highly respected founder of LegalBizDev (www.legalbizdev.com), conducted an extraordinary investigation for a recent study of alternative fees.³ He interviewed AmLaw 100 chairmen, senior partners and C-suite executives. The prediction that surprised him the most

was a significant move to adapt project-management techniques from other businesses. "If we can teach our people to manage, we can make more money," a CFO of a firm with more than 1,000 lawyers told him.

In a private e-mail, Jim phrased his view this way:

"Project-management techniques can reduce costs and increase profitability for any type of legal billing arrangement. The results are easiest to see with fixed fees. When a law firm agrees to handle a certain matter for a flat rate, it must find a way to meet legal needs within a limited budget. The less the firm spends, the more money it will make. But, as that CFO went on to explain, 'A large number of lawyers do not know how to manage. [In the past], the more hours that got charged, the more money [they] made. And so they've never really had to manage [costs].'"

Timothy Corcoran of Altman Weil recently described the importance project management has for lawyers this way:⁴

"Just as many of us grew up with the notion that our home values will always increase, Biglaw partners have grown up with the notion that profits only result from high billable hours multiplied by ever-increasing billing rates. There are even some who believe the ACC Value Challenge will result in lower compensation for outside counsel. Hogwash! Every other industry in the world operates under an assumption that another equally viable path to profitability is by lowering costs. And we're not just talking about eliminating free soda. If a client were to pay less because the firm put the client's interests first and determined that the legal issue doesn't need as much lawyering, we'd very likely see an increase in realisation rates, we'd reduce

the opportunity cost of assigning lawyers to tasks that ultimately will not be billed, we'll engender client loyalty and reduce our cost to acquire the next matter (the cost of sales)."

If firms successfully move to a fixed-fee world, controlling the cost of the legal work and reducing it to the lowest possible level is the way to reduce costs. Remember the example of the fast food cups guy from the introduction. Like him, clients are shifting the burden of controlling costs to those best able to do so – outside lawyers.

Perhaps the biggest challenge lawyers will face is the training issue. Do firms hire outside project managers and hope that lawyers pick things up or refrain from sabotaging the work of the 'pros', or do they put their lawyers into immersion training? Like me, Jim Hassett is of the view that people need to learn to walk first:⁵

"For example, we recently conducted a workshop at Warner Norcross & Judd in which senior partners quickly reviewed project management best practices and picked out the ones that best fit their needs. After reviewing our list, one lawyer decided to focus on setting estimated hourly goals before beginning each task. He noted that the firm already did this with law students in their summer programs. When these interns were given a new assignment, they were asked to estimate how many hours it would take before they began. If the estimate seemed out of line, the supervising lawyer discussed the task with the law student to see if he or she really understood what was required. The lawyer from our workshop is now adapting this technique to working with his partners on alternative fee matters."

Now, you don't need a masters degree in project management or a professional

certification to discuss ideas like 'estimate hours in advance'. With most lawyers, it is easy to find ways to reduce costs. The hard part is getting them to do it. We believe the best way to maximise follow-up is to let each lawyer find his own answer.

At Valorem, we started much the same way, and now engage in a monthly 'what will the next month look like?' exercise on every matter. In addition, the 'how long should this take?' discussion happens on every assignment. We urge everyone to ask themselves about how the project could be done faster and better before doing it.

When Jim Hassett conducts his workshops, he organises the work around eight key issues:

1. Set objectives and define scope;
2. Identify and schedule activities;
3. Assign tasks and manage the team;
4. Plan and manage the budget;
5. Assess risks;
6. Manage quality;
7. Manage client communication and expectations; and
8. Negotiate changes of scope.

Hassett's approach may not work for everyone, and others provide different types of project-management training.

Let's face it. Lawyers have a long way to go to master project-management skills. Figure 1 illustrates where lawyers are on the learning curve. So the key isn't to become an expert overnight. The key is to get better every day.

Six Sigma/Lean

I am sure experts in one or the other area will cringe when I say this, but the concepts of Six Sigma and Lean are first cousins to project management. According to Wikipedia, Six Sigma is explained as:⁶

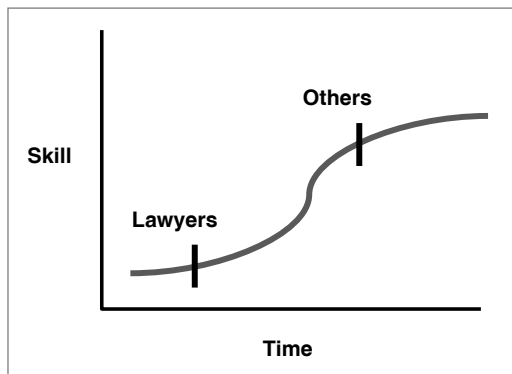


Figure 1: Lawyers' project-management learning curve

"Six Sigma seeks to improve the quality of process outputs by identifying and removing the causes of defects (errors) and minimizing variability in manufacturing and business processes. It uses a set of quality management methods, including statistical methods, and creates a special infrastructure of people within the organization ('Black Belts', 'Green Belts', etc.) who are experts in these methods. Each Six Sigma project carried out within an organization follows a defined sequence of steps and has quantified targets. These targets can be financial (cost reduction or profit increase) or whatever is critical to the customer of that process (cycle time, safety, delivery, etc.).

"The term *six sigma* originated from terminology associated with manufacturing, specifically terms associated with statistical modelling of manufacturing processes. The maturity of a manufacturing process can be described by a *sigma* rating indicating its yield, or the percentage of defect-free products it creates. A six-sigma process is one in which 99.99966% of the products manufactured are free of defects, compared to a one-sigma process in which only 31% are free of defects. Motorola set a goal of 'six sigmas' for all of its manufacturing operations and this goal became a byword for the management and engineering practices used to achieve it."

Six Sigma focuses on making the process work right without really investigating the need for the process at all. Lean, another concept from manufacturing, focuses on the 'is it necessary?' question. Lean is all about the elimination of waste. The seven wastes are delay, duplication, unnecessary movement, unclear communications, incorrect inventory, an opportunity lost to retain or win customers, and errors in the service transaction. The Lean concepts may be more directly applicable to law than are the Six Sigma concepts, but there is enough overlap that it should be apparent that efforts to streamline the process of the practice of law can bring some great efficiencies.

Let me offer you a very easy example of project management, inadvertent style. We discovered quite by accident that we spent more time answering interrogatories when our associates began drafting answers and objections immediately, rather than first having a strategy session with the team to figure out our approach to the written discovery. Now, before our associates do any work on interrogatories, the trial lawyer must first review the discovery and meet with the team to discuss the responses. The result of this approach? Far fewer touches and much more efficient preparation of the responses.

Fred Bartlit of Bartlit Beck has offered another similar experience in many of his speeches. He asks how firms in the billable-hour model prepare for an expert's deposition. He then recites the standard way: associate prepares an outline, which is way over-inclusive. Someone else edits and by the time it gets to the senior partner, a huge amount of time has been spent for a piece of work the partner invariably recreates. Bartlit notes that at Bartlit Beck, the senior lawyer creates the deposition outline and then circulates it for comment. According to Bartlit, the process is hugely more efficient (and thus less costly).

The key take-away is that **people and firms must make efforts to study their processes.** Perhaps no large firm has put more money and effort into implementing the concepts of Six Sigma and Lean than Seyfarth Shaw. Karla Goldstein is one of the project managers involved in the

implementation of the process at the firm. She explained that as part of the process, Seyfarth project managers mapped out the process by which the firm handled its single plaintiff employment cases. All of the steps involved in the handling of those cases were written down on sticky notes which were then

Case Handling Process – As Defendant					
	Who	How long?	By when	Variance	Notes
Administrative					
1. Do conflict check					
2. Advise [redacted] of new matter					
3. Open new matter in Timeslips					
4. Open new matter in Imanage					
5. Open new matter in Wiki					
6. Fee arrangement is discussed					
7. Prepare engagement letter					
8. Review and sign off on engagement letter					
9. Email/mail engagement letter					
10. Retain engagement letter in accounting file					
11. Decide staffing					
12. Local counsel required?					
13. Identify local counsel options					
14. Present local counsel options to client					
15. Confirm agreement with local counsel in writing					
Preliminary procedural analysis					
16. Review jurisdiction					
17. Review venue					
18. Can case be removed?					
19. Investigate states of incorporation or principal place of business					
20. Review forum non conveniens					
21. Review necessary parties					
22. Review ADR Issues					
23. Review readily apparent defects in complaint					
24. Is right entity named					
25. Review statute of limitations issues					
26. Evaluate pros and cons of motion to dismiss					
27. Determine readily apparent counterclaims					
28. Determine readily apparent defenses of counterclaims					
29. Prepare client report (Form A)					
Preliminary discussions with Client					
30. Review results of preliminary procedural analysis (Form A)					
31. Decide whether to pursue any procedural issues					
32. Determine whether entity analysis is required					
33. Obtain names of key witness					
34. Obtain access to key witnesses					
35. Discussion of what documents are central to case					
36. Obtain core case documents					
Preliminary investigation?					
37. Telephonic interviews of key witnesses					
38. Review of critical documents					
39. Conduct preliminary research on scope of damages					
40. Assess scope of damages					
41. Determine impact on business and financial statements					
42. Assess litigation reserves					
43. Discuss results of preliminary investigation with client					
44. Complete ECA Form with available information					

Figure 2: Project management for lawyers

put on a wall in the sequence of execution. Seyfarth lawyers then met to evaluate the process map that had been prepared. They reorganised the sequence. They added additional steps that had been overlooked. And then the real review began to determine whether there were efficiencies to be gained from handling the cases differently – different sequences of events, different processes implemented to handle repetitious tasks and so forth. The result was a highly streamlined process by which single plaintiff employment cases could be handled as effectively but in a much lower cost manner.

How successful has the firm been? One answer came in a recent Ark Group conference on value fees, held in New York in March 2010. Paul Beach, assistant general counsel of United Technologies, was one of the speakers. He explained that prior to Seyfarth's presentation to United Technologies, the firm had been handling no work for the company. The presentation demonstrated the process-mapping approach, the efficiencies that had been created and the resulting streamlined handling of single plaintiff employment cases. As Beach explained, Seyfarth is now handling all of United Technologies' single plaintiff employment cases, an engagement worth over \$2m per year to the firm.

As part of Valorem's effort to utilise project-management skills, we have outlined all of the steps typically taken or that could be taken in a case to state or federal court. We created a process map, a portion of which is shown in Figure 2.

The column at the far right is in the process of being populated with hot links to specific rules where appropriate, links to documents used and prepared in other cases that can be exemplars for the current case, and other similar steps that will allow one team of lawyers to piggyback on the

experience of others and bring efficiency to the latest matter.

The process-mapping effort does not interfere with anyone's ability to handle a case 'creatively' or in a customised manner. The process-mapping effort, for example, does not create any limit on what kind of deposition someone might take. It does suggest to the person taking the deposition that the preparation process is more efficient if she does the first draft of the deposition outline herself. The argument that law is a custom service or that knowledge workers are somehow immune from process issues simply ignores the reality of the world in which we – and our clients – now operate.

Decision trees

When I was a younger lawyer, I attended a seminar on risk analysis. The instructor asked if anyone in the audience had told his or her client that they had a 'good chance' of winning a case. Nearly everyone admitted they had. The instructor then asked everyone to write down the percentage chance of winning they had in mind when they said 'good chance'. He then collected the papers and noted down the numbers. The spread was from 25 to 90 per cent, and the greatest concentration was in the 40 to 60 per cent range. The instructor went on to wonder what would happen if the client heard '80 per cent chance of winning' when the lawyer said 'good chance', while the lawyer meant 30 per cent. It was clear that **verbal characterisations were not the best means of communicating,** and hence not the best bases for decision-making.

Decision trees eliminate this ambiguity. Percentage chances of various events happening are spelled out precisely – see Figure 3.

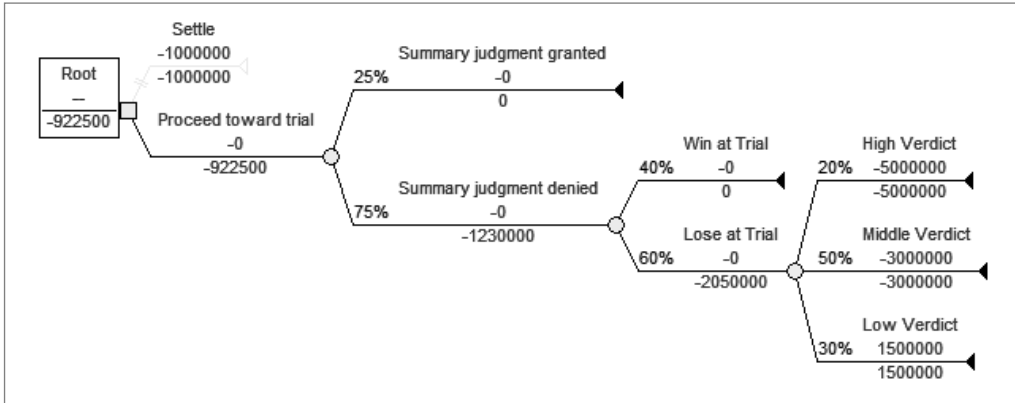


Figure 3: Example decision tree

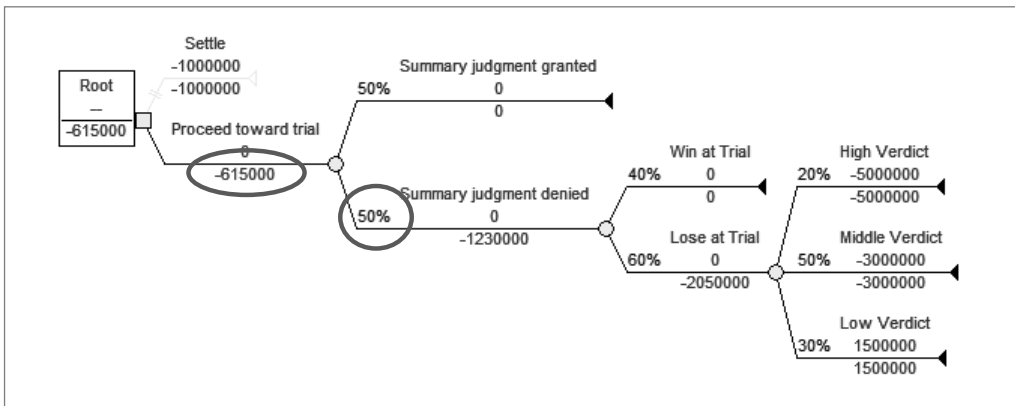


Figure 4: Impact of different outcomes

The precision of the calculations should not be interpreted as anything other than a way for everyone to see the same thing and see the meaning of any different outlook. For example, compare Figure 4 with Figure 3. The difference is that Figure 4 reflects a higher chance, 50 per cent, of prevailing on summary judgment. The effect on the value of the case is roughly \$300,000. Consider Figure 5. If you revert back to the original 75 per cent chance of settlement and increase your chance of winning at trial to 60 per cent, it has the same roughly \$300,000 impact.

Decision trees do much more than eliminate the consequences of ambiguous

language. They help you allocate resources. If you feel that significant and expensive effort might only improve the odds at one decision point by five per cent, you might choose to allocate resources to another decision point where your chance to improve the outcome may be higher.

Decision trees are an effective tool to focus the views of business people, who frequently are trained in business school in the use of trees, and the valuation aspect helps bring focus to the real value a case has.

Finally, do not overlook the impact of decision trees on your adversary's assessment of the case. In a mediation or

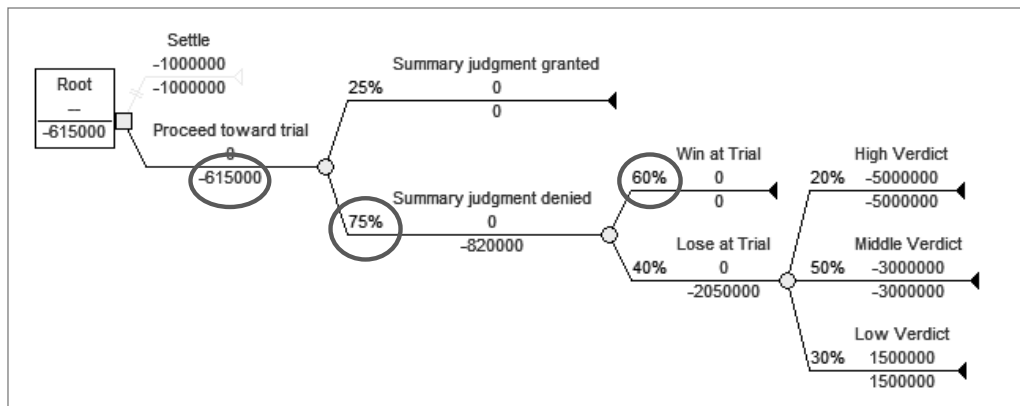


Figure 5: Impact remains the same

settlement meeting, decision trees are of enormous value in forcing an adversary to quantify his analysis in ways that frequently open doors to resolution. If they have misvalued their case, it will become apparent, and the calculation of the odds of winning various decision points is a wonderful way of discussing the point. If your adversary thinks he has a greater chance of winning, plug the number in and see what happens. Frequently, a party is not even offering the amount their own analysis has calculated and they will lose if their view on the odds of winning are borne out – suddenly there is great pressure on them to make an offer or demand a much more favourable number.

Early case assessment

This is not a new tool, but it is an incredibly important and overlooked one. Remember that the easiest way to make money using value fees is to get a great settlement quickly (when the client identifies this as its objective). It is important that everyone values the case similarly, and this tool helps. It also forces key work to be done quickly and helps decide where the best investments can be made in a case, so that return on investment (ROI) is highest. I've

included a screen shot of the early case assessment (ECA) tool Valorem uses, which we developed in a joint effort with Summit Law Group in Seattle – see Figure 6.

Early case mediation

If the parties were unable to resolve a dispute before a lawsuit was filed, it may well be because one side or the other had a flawed view of the facts, circumstances or law related to the case. These are precisely the kinds of problems that can be resolved by mediators. There is rarely a solid reason to delay involving a mediator, save for lawyers' desire to accumulate fees before the matter ends. You've heard (or perhaps even made) some variation of these excuses for delaying mediation:

- "If we can just do these three depositions, we will be in a much better position."
- "If we approach them now, it will be viewed as a sign of weakness."
- "We need to see their side of the story first, so we'd better take some discovery."

These are 'lawyer-speak' excuses. I would venture that most CEOs have never heard an excuse like this and none would cotton

Litigation Assessment

Date First Prepared: _____
Last Updated: _____

SUMMARY:

Claimant Name:	Venue:
In-house Attorney:	Docket No.:
Outside Attorneys Assigned [<i>Firm, Lead Attorney</i>]:	Date Filed [<i>Including Amendment Dates</i>]:
Decision Tree Attached?	
Mediation Candidate?	Judge [<i>Arbitration panel in the case of arbitration</i>]:
Budget Amount:	Opposing Counsel:
Budget Attached?	Settlement Value:

Is there anything that makes this case special or unusual?

From Management's perspective? _____ From the Law Department's perspective? _____
From the business unit's perspective? _____ From a public relations perspective? _____

THE TEAM:

Inside Counsel: _____ Business Unit Responsible _____
Outside Counsel: _____ Business Unit Contact _____

THE CLAIM:

A. Description of Matter: _____

B. Type of Case:

Antitrust Securities Environmental
 Contract Product Liability
 Employment General Tort

C. Named Defendants:

Parent Officers Vendors
 Subsidiary Directors
Which one? _____ Customers

D. Key Issues:

[Identify, with specificity, the critical (outcome determinative) issues in the case]:

RISK MANAGEMENT:

A. All or Any Parties of Claim Insured? ___ Yes ___ No
• Who made the decision? _____

B. If yes, have all potentially applicable policies been located? ___ Yes ___ No

C. If no, who is responsible for locating all potentially applicable policies? _____

D. Has notice been sent to all carriers potentially on the risk? ___ Yes ___ No
• Who sent notice? _____
• On what date? _____

Figure 6: Early case assessment tool

on to them. Strength is doing the right thing on your schedule, not one an adversary imposes or to which your lawyer pushes you so that he can bill a few more hours.

None of these tools is a silver bullet. They are, instead, merely concepts that can be used to bring a sense of business discipline to the handling of legal matters, particularly litigation. They have proven indispensable in non-legal settings and there is no reason to believe these concepts will not be equally valuable for the legal profession.

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Chapter 10: Being a smart buyer of value fees – FAQs

THERE ARE a number of questions that clients frequently ask when considering work performed on a non-hourly basis. These questions are important not only for the specific information sought, but also because they reveal underlying concerns or reservations that have to be satisfied.

How does this value fee compare to what it would cost by the hour?

This question is asked all the time. To answer it, it is essential to know what motivates the question. It could be an academic interest in the comparison, but probably not. It could be a desire to be sure that the amount of the value fee is lower than would be paid under the hourly rate. But this is tricky. A true value-fee firm will not work the same as a firm handling a matter on a billable hour. Both theoretically and practically, it will cut out the fat of the representation. So the question may actually be: 'Why can't I have the benefits of the value-fee approach to the matter, and still pay hourly?' Lastly, the question may really be: 'How much profit will you make on this fee?' At core, all of these questions reflect a suspicion, a trust issue.

The trust issue needs to be addressed directly. Trust must be a two-way street. Valorem shows its trust in two ways. First, we give our clients total control over the holdback bucket. While we frequently discuss benchmarks that the client might use as guidelines, our ultimate goal is a completely satisfied client who will want to hire us again and refer us to friends and other in-house

colleagues. Empowering that person with discretion to pay a significant portion of our fee is indicia of the trust we place in that person, and powerful motivation to make sure that we are doing the things every day that make the person happy with our performance. Fred Bartlit of Bartlit Beck, which does a substantial portion of its work using the holdback bucket fee structure, has spoken frequently of the importance of the idea that the client has discretion over the holdback bucket and that the client knows the outcome of the case at the time it decides whether to pay the bucket. Empowering the client to decide the total fee paid after it knows the value of the lawyer's service is a mark of trust.

My firm, Valorem Law Group, includes on each invoice a value adjustment line (VAL) that allows our client to raise or lower our fee, no questions asked – it looks like Figure 1. This feature is yet another way clients have of assuring themselves of value.

On each bill, even ones where a fixed fee has been agreed to, we invite our clients to adjust the bill if they think they are not



Figure 1: The value adjustment line

getting value for what they are paying. This is an idea conceived of and used for more than a decade by Summit Law Group in Seattle. Obviously if someone abuses this, it will be an indication that there is a trust issue or that we are not the right law firm for this client. In this way, the VAL serves as a canary in the coal mine. It also serves as a monthly reminder to us and to the client that our ultimate goal is the delivery of value.

If, even with these two safeguards, the client has not overcome the trust hurdle, they may not be the type truly interested in value fees, notwithstanding the enormous benefit they provide.

What happens if we settle the matter shortly after we've committed to pay this fixed fee?

The corollary question, never asked by the client, is what happens if this matter doesn't settle and goes all the way to the day of trial? In any fixed-fee arrangement, depending on the point at which a case resolves, there is a point where the profit margin is really high, a point where there is a loss, and points between and along the profitability continuum. At the time of the engagement, the risks of being anywhere on that continuum are roughly equal. This question really says: 'If you have too high a profit margin, I have overpaid.'

A lawyer who quotes a fixed fee hopes for a client who will recognise that even if the lawyer has a very high profit margin, the client received exactly what was promised – a result at a price. The price included an insurance payment against run-away fees. The price included an incentive to get the matter resolved quickly. Would the client prefer that resolution be delayed? And if the client wants insurance against a profit margin that is too high, will it pay additional sums so the profit margin is too low?

But some just can't get past this concern as they venture into the world of AFAs.

In that case, **the easiest thing to do is to structure payments so they occur at set times or upon completion of certain parts of the case**, say at the beginning of the case, the onset of written discovery, depositions and so forth. One of the great attributes is that any structure works so long as the structure addresses the client's concerns. In this instance, **terminating the client's obligation to pay after the settlement should address the issue.**

It bears noting that a lawyer is likely to quote a higher overall price under this arrangement because the lawyer won't have the ability to wager on early settlements as a way of lowering the overall price quoted. Why? Because most cases settle. The only question is when. If outside counsel can push the settlement forward, she can potentially lower overall investment on the case (earlier settlement may mean lower total costs invested). Smart counsel will share these savings with their clients in the form of a lower quoted price. When the opportunity to 'make money on the backend' is taken away, each segment will have to be looked at separately, so the ability to reduce cost is reduced.

Should I have my counsel build in the cost of a trial to a fixed fee?

Never. Virtually all cases settle. Virtually all trials are expensive. So, if a lawyer builds some cost in, it is almost always excessive. The 'estimated trial cost' element is a favoured way to increase the overall price.

If a case does go to trial, your incentives for the fee are different. Winning suddenly takes on new meaning. As a result, the decision to take a case to trial should be based on the real cost and risks of trial, measured at or near the time of trial and

judged at the time the decision to try a case has to be made.

Is there really that much ‘fat’ in the litigation process that you can lower prices without a fall-off in quality?

The premise of this question is that price equates with quality. This shows that the big, expensive firms have succeeded in their efforts to bamboozle the in-house community that big and expensive is better. That may have been true 30 years ago, but even then a good solo plaintiff’s lawyer was frequently able to match resources and wits. Mike Dillion, the former general counsel of Sun Microsystems, has written about big firms going the way of the Mastodon.¹ Particularly in this day and age, small and medium firms have the technological capability that any resource advantage big firms may have enjoyed can be easily overcome. Disaggregating case activity also allows engagement of specific expertise generally at lower cost. So unless you need the argument that the famous brand should shield you from any consequence of poor outcome, the answer is that there are enormous savings to be had just by shifting to smaller firms with lower overhead.

To the merit of the question. There is a fundamental difference between how a lawyer who tries cases will approach the handling of a case and how a lawyer who doesn’t really try cases approaches it. The trial lawyer is always looking to reduce, simplify and target, so she can get ready for trial, to persuade ordinary citizens. The litigator is looking for rabbit holes, motions, research projects and disputes over discovery. Rabbit holes are the litigator’s friend. I know of many lawyers in their firm’s litigation department who have never tried a case. Some have tried one case in decades. Those lawyers simply see the process as a

tool to be used rather than a means to drive resolution quickly.

But the trial lawyer/litigator distinction aside, there is strong evidence of the existence of ‘fat’ in the traditional handling of most claims:

- The success of rocket dockets shows that when forced to focus, lawyers can focus; and
- Large consumers of litigation services such as DuPont, Cisco, Levi Strauss and Dynegy have reduced their spend on litigation without fall-off in quality.

In the companies you spoke to that were utilising value fees, did you see any common themes or threads in their motivations and approaches?

In virtually every instance, the general counsel of companies making significant use of alternative fees had decided that he or she needed the following:

- A firm handle on the amount of money spent on ‘ordinary course’ litigation;
- A means to create an incentive for law firms handling ordinary course litigation to reduce the total spend on that type of litigation; and
- Metrics by which he or she could track progress toward the reduction of spend on ordinary course litigation.

Underlying all of these motivations and objectives was a recognition that with the rare exception of true bet-the-company cases, litigation is simply a business problem that can be handled utilising business processes that have proven effective time and again in other aspects of the business.

By way of example, application of basic metrics to the litigation process is a novel concept, but hardly a novel concept with

respect to business operations. Similarly the direct or implied pressure to utilise project-management tools and other business tools such as Lean and Six Sigma is also not novel to business but is relatively unusual when applied to litigation. These businesses were at the vanguard of a movement that has clearly picked up substantial steam and, at this point, those who are not moving toward use of these tools, processes and metrics are in danger of radically overspending on litigation compared to the new normal.

How do I know if I'm getting a fair deal on the quoted fee?

This is referred to as the 'wolf in sheep's clothing' question. **If a law firm quotes a fee that is essentially the same or even higher, than its fee would be under the hourly rate system, the value that should be associated with a value fee is not being provided to the client.**

There are many answers to this question.

The easiest answer is to test the market. If you have three firms propose a fee, at least two will be close. That will give you some powerful insight. But make sure what you are getting is a true proposal to handle the whole matter and not just a lowball number offered to secure the work with the expectation that the number will increase at some opportune time.

Next, if you have data available showing **the price paid for similar cases, the fee quoted should be substantially lower** than the data for prior cases. This is because the data, in all likelihood, is based on hourly rate billing. That billing would have the inefficiencies associated with the billable hour model built in, and would also include all of the firm's profit, locked in on a guaranteed basis. The fee quoted should be lower than the data would suggest. How much lower depends entirely on the matter, the firm, and how aggressive you, as the client, wish to be.

The next answer to the 'am I getting a good deal?' question is to ask the firm how they calculated the fee. Many firms, especially larger firms, tend to use alternative fees as a surrogate for what they would have made on an hourly basis. Thus, calculations generally begin with an estimate of how many hours it would take to handle the project or the matter, the fee that would be charged by the person tasked to do the work and some cushion to be certain that the firm's realisation rate remains high. Thus, any explanation that includes 'we estimated the number of hours' or 'we estimated the amount of time' should cause concern. **The firm has merely disguised its estimated hourly fee and characterised it as an alternative fee, a surrogate for an hourly fee, the so-called wolf in sheep's clothing.** A good follow-up question is to ask how the firm has let the timing of settlement influence their pricing on a case. A smart pricer takes a reasonable, albeit somewhat conservative view of when a case might settle and then works to accelerate that time frame, thus **reducing the cycle time (cost).**

Another important question to ask the firm is how they have restructured the firm as a result of doing work on a value-fee basis. This is important because **firms that are serious about doing value-fee work profitably cannot look the same structurally as firms that do work on a billable-hour basis.** The value-fee firm will have a substantially greater emphasis on experience and a much lower overall body count. Rather than appearing like a pyramid, however slender or expanded, a value-fee firm will look more like a diamond or even a pyramid standing upside down – that is, with the smallest number of individuals being at the junior level and the largest number being at the most senior, experienced level.

Another key factor is when in the process the firm has offered its value-fee proposal. In a traditional hourly rate firm, the client simply sends a case to the firm and the firm begins to work. It is a gradual, evolving process. By contrast, a firm that is committed to value-fee work, especially if the firm is sharing risk, does **substantial due diligence on a case before committing to do the work or setting a price.** It must have significant insight before committing to the kind of value price one is to expect from a value-fee firm. The value-fee firms may spend weeks, or even a month or more, investigating the facts and circumstances associated with the case before offering a price.

Another key indicator is that **true value-fee firms will have developed project-management skills,** as discussed in Chapter 9. These skills are essential to being able to do work efficiently and draw on prior work product and experience so that the firm avoids reinventing the wheel whenever possible. The firm knows that it benefits from those efficiencies because the cost of producing a result is decreased, thus increasing its profit margin. It should be easy enough for the firm to **provide tangible evidence to demonstrate commitment** and competence to this area.

Finally, look at the experience factor on the team for your matter. Loaded up with young lawyers? Worry. The assistant general counsel of United Technologies, a huge consumer of legal services, recently said that first and second year lawyers were “worthless” and it refuses to allow them to be assigned to its matters. Who is going to review documents? Young lawyers? Lawyers without trial experience? Again, you should be worried. I referred earlier to the ‘percolation effect’ when young lawyers are handling document production. This is one of those times where you need to think

about value and return on investment rather than simply cost.

These factors will give you a degree of confidence that the firm is offering a meaningful and informed price, and a price that is thoughtful and designed to provide value and meaningful ROI. If you think the lowest cost provider should win, anyone can make a hiring decision. The purchase decision is about value, and your firm should be able to fully explain the value they offer. At the end of the day, however, if you are uncomfortable with the price quoted, **trust the market.** If you are uncomfortable with the price, it is worth reflecting on how you can’t be anything but **equally uncomfortable** about not knowing the price you will be paying to a firm under the hourly system.

I believe value fees are the right way to go, but my boss, the general counsel, believes big firms provide both quality and a measure of ‘cover’ in case something goes wrong. Our big firms won’t share risk and won’t offer value fees since we don’t require them. Thoughts?

We refer to this as the ‘brand’ issue. I understand the desire to have the safety of a brand on a bet-the-company case. Boardroom politics and the care and feeding of directors are tricky enough without going into a demanding situation adding to the situation by trying out a new, unproven law firm. I get that, and I agree that the ‘safe’ approach is generally the right one in these extraordinary circumstances. But let’s face reality. The number of cases that fit this description is small. Many companies never have a bet-the-company case. But the ‘brand’ argument is still made by general counsel in some of these companies, and it is made by general counsel in some companies that do experience bet-the-

company cases about the rest of their regular litigation portfolio. So what gives?

The general counsel of one client told me once that GCs who pay for brand are failing their obligation to their shareholders. It was a strong statement. But when you think about it (as he had), it's true. The reason general counsel are overspending (and they are, by a lot) is that they are trying to protect themselves. Their interest is placed ahead of the company's.

Of course, no GC would ever admit that. They would simply talk about the tough judgment they had to make, or the familiarity the big, safe, branded firm had with the company.

In some circumstances, there may be no way to persuade the GC that the **brand bias is bad business**. But it sure seems that GCs should be open to testing things. Lawyers from a big firm doing the company's work who leave the big firm aren't suddenly less qualified to do it when they start their own firm. So if there are circumstances where the company would use an unbranded firm, perhaps the right approach is to test the value received by comparing the performance and value of unbranded versus branded. Try the unbranded firm on one case. **The experimentation approach – the challenge to test the brand hypothesis – seems to be the best response to the brand bias.**

Of course, the other option these GCs have is to wait for the time many have recently experienced when law department budgets are slashed and decide then whether brand is worth the price.

If I use a fixed fee or portfolio fee, how do I make sure that work quality doesn't suffer?

Remember the maxim that you get what you pay for. **So make sure quality is one of the things you pay for.** How? **Share the**

outcome risk. As I outlined in Chapter 2, you should hold back part of the fee paid to your lawyers until the end, when you are in the best possible position to judge the value of what they have done. If the quality is there, pay the holdback bucket. If your lawyers hit a home run, pay more than the holdback bucket. The holdback bucket represents your lawyer's investment in the matter. If you get a better-than-expected return (outcome), so should your lawyer. But I promise you, every lawyer who has used the holdback bucket concept will testify under oath that he or she does whatever can be done to earn that bucket.

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Chapter 11: How to be a smarter seller of value fees – FAQs

LAWYERS WHO are considering offering value fees have asked many questions in the two-plus years since Valorem opened its doors and our commitment to offering value fees for litigation matters became widely publicised. Those questions fall into several categories, and in this chapter, I will attempt to answer the more common questions raised.

So I've quoted a fixed fee and have been hired. Now what do I do to ensure this is a profitable engagement?

The first key to maximising your profit margin is to recognise that everything you have done in your career as a lawyer to date has trained you to do things the wrong way. Picture in your mind the perfect swing of a professional golfer and recognise that he or she has practised that swing hundreds of thousands of times so that it is reproduced, exactly the same way, every time their backswing begins. Muscle memory is a critical component to execution in any sport. The same is true in the practise of law except it is our mental muscle, the brain, which has been incorrectly trained.

Every time you think about doing something, you must force yourself to ask: 'Is this going to make a difference to the outcome of this case?' If you answer that question honestly, you will find that many things done by rote are unnecessary activities. For example, it is common to take advantage of the opportunity for

written discovery to ask questions as broadly as possible, seeking to corral as much information as is possible in the hope of finding some hidden gem. A true value-fee lawyer is much more targeted in her discovery efforts. Interrogatories are used only to identify specific facts rather than a lawyer's interpretation of events. The request for documents is also much more focused because the value-fee lawyer recognises that she will have to spend time reading through the mountains of irrelevant documents produced in response to overly broad discovery requests. If you start with the trial of a case in your mind and recognise that most cases are tried with a paltry few documents being offered into evidence, the key is to figure out the most efficient way to identify those particular documents. This may mean that you spend time with a consulting expert learning terminology so that your requests can be highly targeted, or that you take third-party discovery before you take discovery of your opposing party. Certainly there are a variety of alternative approaches that will produce return.

Next, the deposition process should be a sprint, not a marathon. Generally your review of documents will inform you as to who the key witnesses are. Many times in the past, you will have rationalised taking many other depositions to 'prepare' for those key depositions or to elicit salient facts. Virtually none of these types of witnesses, however, see the light of day at trial. Therefore, if they are not going to make a

difference to the outcome of the case, they should not be deposed.

It is also critical to aggressively study and implement project-management skills. A true project-management approach will ensure that every member of the team is doing only mission-critical work and is doing it within a specified amount of time. For example, there should be no open-ended research projects.

Basic research should be farmed out to contract lawyers who can do the basics with follow-up being conducted by a member of your team. Don't have contract lawyers write research memos, have them provide you the cases in a highlighted form since you will want to read the cases anyway even if a memo is provided.

It is critical that prior work product be accessible so that wheels need not be reinvented. For example, if you have removed one case, you have the necessary forms to remove virtually every other case once those documents are tailored. But in any event, the basic form and notices should be immediately accessible to team members without having to spend time searching or recreating the document.

These are just a few of the ways in which a value-fee lawyer will approach a matter differently. Be sensitive to the timing of events. Analyse the true value of the case from a decision-tree standpoint early and engage in every effort to resolve the case on terms favourable to your client or at least acceptable to your client as early as possible. There is nothing worse on a fixed-fee than settling the case late after the transactional costs are high and your profit margin has been eroded.

You mentioned that it is hard or impossible for a firm to be both a value-fee firm and a traditional billable-hour firm. My firm seems

intent on trying to do both. What would you suggest?

The simple answer is to leave the firm and seek your fortune elsewhere. I offer that advice recognising that many people will find it difficult or impossible to walk away from friendships that have developed over the course of many years or who are economically tied to their firm in ways that cannot be easily unwound. But if leaving is an option, it will be the best one. The transition from a traditional firm to a value-fee firm will be painful and perhaps long, depending on how quickly partners in the firm embrace the move on a widespread basis.

But however difficult the transition is, the effort to stand in both worlds will be the undoing of firms that attempt that feat. As has been discussed in Chapter 3, the standards by which people are judged and the behaviours that are valued in the various systems are different. Firms cannot look to reward the inherent inefficiency associated with hourly work and at the same time plan to reward the efficient work done on a value-fee basis. This report does not delve into the compensation difficulties that will arise in these circumstances, but suffice to say that the compensation difficulties will be monumental. For years, revenue and realisation have been the critical numbers on which most partners have been compensated rather than on profit margin and cost. If one partner can build a highly efficient profitable practice by using offshore resources, but the firm's associate capacity is high, there will be institutional pressure to make use of the higher-priced higher-cost firm associates instead of using lower-priced offshore resources. That approach, while beneficial for the firm, will jeopardise the profit margin of that partner's work. This simple illustration demonstrates the tension that will exist between 'the old way' and 'the new way'.

If I have data showing the cost to perform certain work for us on similar matters, how should I use that data to price a value-fee proposal?

With the obvious caveat that every situation is unique and that individual circumstances may make this answer incorrect, my sense is that in most circumstances a fee proposal should be in the area of 30-40 per cent lower than an actual fee paid on an hourly basis provided that the actual fee is in the recent past. I arrive at this figure by recognising that most firms have a profit margin of approximately 35-40 per cent or at least they did. This substantial profit margin is what allowed the high profits-per-partner number to flourish in earlier years of this decade.

On top of the profit margin, there are the inefficiencies associated with the billable hour highlighted in this book. Those are difficult to quantify and may well depend on the size of the team involved. But to the extent there are younger lawyers involved, my belief is that more experienced partners can handle matters much more efficiently, leading to an estimate of another ten per cent or so. This may well be the profit margin on the value-fee proposal.

What do I do on cases where I put more into a case than I am being paid?

You need to know going in that this is going to happen. Every business invests in prototypes that don't pan out. Some drill wells that are dry. You cannot be guaranteed a profit on every matter. No business can – except the legal profession when clients allowed lawyers to put all of the risk of any negative outcome on the client.

Isn't the real question not what do you on those cases, but rather how do you avoid having a case become a loser? To minimise

the risk of a case becoming a loser, you need to become an expert project manager and use the discipline of the process, along with things like Lean and Six Sigma. You have to creatively push to reduce the cycle time of the case, to move settlement from later to earlier in the process. And you have to make sure you do only those things needed to win, nothing more, and only those things within the scope of your engagement.

Should my engagement letter build in some kind of protection if the case gets out of hand, say my opponent engages in scorched earth tactics?

I am not in favour of openers. Here's why. This is telling the client that you want the client to protect you from something bad. This should, in the normal course, cause the client to ask you if you are going to protect it in the event that something happens and you earn a windfall. When you agree to share risk with a client, *there actually is risk!* If you settle the case early and get paid a lot more than you would have under an hourly arrangement, some clients will feel like they have overpaid. The answer in that circumstance is that the deal is the deal, and they should not care how much it cost you to get the result. It is entirely appropriate that the client gives the same answer here.

A client has called and asked us to propose a value fee on a matter. What should our process be to do so?

Due diligence. It's an investment decision. Treat it like one.

How long should I spend on my due-diligence investigation?

As long as it takes to get the facts needed to evaluate the quality of the case. So, going

into it, you need to know you will spend a longer period of time investigating the case than you probably ever have before. It is a bad thing to take a case only to figure out part way through that the case is a dog and there may be no real upside. For us, it's normal to interview the client and others, perhaps with three or four of our partners (and there are only five) involved in each of those meetings. And there are usually a couple of meetings – an initial one to get the basic details and documents, and then investigation of facts and the law, and internal discussions about where we can add value and how. We then have follow-up meetings with the client to share our initial impressions and challenge them further on weaknesses in the case. We've declined cases at the end of that process simply because we can't get comfortable that there is a realistic upside. If they are listening, the client learns a lot about its case when people refuse to invest in it.

That's a lot of time to invest in due diligence. Can I charge for it?

You can try, but I would advise against it. First, if you propose to bill the client for your investigation efforts, the client may well test the market because there are plenty of firms smart enough not to do so. If you investigate the case and agree to a value fee to handle it, presumably the amount of the fee will cover the cost of investigation as well as the cost of the representation. If you don't end up taking the case, you've avoided a bad investment, and that's a good thing.

Think about it like this. When a retailer is selling a product, is there a charge added at every step of the way? When the stock person brings it from the back of the store to the shelf, is an additional charge added to the price? No, the price charged covers the cost of stocking, shipping and everything

else. It also covers the cost of returns and products made but never purchased.

This is really an issue of pricing sophistication. There is no law, rule or regulation that says lawyers are entitled to earn profit on every minute they spend doing something. Clients have finally caught on. I think attempting to charge on this, in many circumstances at least, will be counterproductive.

Having said that, there are circumstances where the information needed to truly evaluate a case is not in the client's possession, where you need to get into the case and seek information by way of discovery. Those circumstances are different, and it is entirely appropriate to reach an interim agreement on fees for the period prior to your being able to access essential information.

Will I be suffering a loss if my fee is less than I would have earned had I handled the case on an hourly basis?

If that is so, what conclusion should you draw? Before drawing any, I would need to know whether you did anything to reduce the cost of handling the case and whether you handled it differently than you would have. After all, one of the principles of value pricing is that you will do less work more efficiently. If you didn't, it may not be a pricing problem as much as it is a case-handling issue.

I also need to know whether you have skin in the game and an outcome is still pending. It is almost a given that you will make less during the pendency of a case, but that successful performance and being awarded the risk bucket will change the value proposition.

All that said, keep in mind that you might not have got the work if your fee proposal was straight hourly at your standard fees. If a

manufacturer is forced to discount goods to sell them, it doesn't do much good to lament that "we would have made more if we sold the same number of goods at a higher price". Revenue is the beginning of the profit equation. Are you focusing enough on cost?

What metrics are you using in order to gauge performance?

I could tell you, but then I would have to kill you.

On a serious note, this is one of the toughest things to dissect. What data makes a difference? It cannot be the same old stuff. So here is what we look at. **What is our cost of operations per full-time (FT) lawyer? Per person in our office?** Keep in mind that you may hire a non-lawyer who can help drive up revenue in unique ways since you're not billing by the hour. We keep track of revenue per FT person and per FT lawyer. We look at bucket totals. We look at our fixed revenue base per month and compare that to our fixed cost per month. We look at the number of contingency matters we have, and what portion of our capacity those cases are consuming. They are an investment, but we don't want everyone defaulting to spending time on those cases, a holdover bad habit.

We have also begun to track our performance on things that we think help our efficiency. What percentage of our cases have project-management plans that are being followed and kept current? What percentage of our lawyers prepare and turn in **project-management plans** on a current basis? What percentage of our cases have completed **early case assessments** and **decision trees**? These business tools are things we believe will dramatically streamline our work process, meaning we will be substantially more efficient in securing results – lower cost of goods sold, in accounting parlance.

Chapter 12: Collateral benefits and damage

Personnel shifts

The move to value fees is a disruptive change to the legal profession. In any kind of disruptive change event, there are unexpected benefits and consequences, and this transition is no different. A number of these unanticipated benefits and consequences have, by now, started to become apparent. Whether the changes are benefits or consequences in many cases depends entirely on your position in the profession.

The first casualty of the move to value fees is the pyramid structure most law firms have used as a structure goal. **Body count and leverage is out. Experience is in. This is bad news for young associates.** Time spent reviewing documents or researching arcane legal issues will count for nothing, and these young lawyers will fall victim to firms shrinking the size of their associate ranks in order to narrow the base of the pyramid.

At the same time, this shrinking of the associate base at many firms is bad news for law students. The number of job openings is decreasing as this group is entering the market. And it's not just that the number of jobs is shrinking, but also that clients are recognising that law schools have done a poor job of preparing students for their careers. The assistant general counsel of one major US corporation recently told a group of educators and others that first and second year lawyers are "worthless" because they do not get proper training in school. His company refuses to let first or second-year lawyers work on its matters because businesses "are not

going to pay for people who can't add value". He identified among the shortcomings of law schools their failure to teach financial literacy, business-management skills and effective executive communication.

There will be winners, though, in this realignment. If firms decide to end the insanity of up-or-out advancement practices, associates who survive may actually achieve an element of job security. Fred Bartlit of Bartlit Beck frequently asks audiences to identify any other business where management spends years developing an employee only to push them out the door once they know what they are doing. There are, of course, none. No business worth its salt follows this recipe. Except lawyers. For years, this up-or-out practice has forced most lawyers out of a law firm by the time they are in their fifth or sixth year, just when they are experienced enough to be of value.

There is no reason why there has to be perpetual advancement. Many businesses have middle managers who are really good at what they are doing but who would be bad if they tried to handle their boss' job. So they don't get promoted. In law firms, though, we operate under the assumption that if you're a really good third-year lawyer, then you'll also be really good as a fourth-year lawyer. That's nonsense. Some do have what it takes to advance, but most hit a plateau, where they are good. Why should they be forced to leave just because they can't be good at something more? The system makes no sense, and as firms move

to a structure that places a premium on experience, the firms will recognise that 'out' part of their former model needs to change.

Training

I frequently ask audiences at the beginning of speeches if anyone, faced with a significant personal legal problem, would opt for cheap and inexperienced or cheap and experienced. Everyone chose the latter. Then I ask about the choice between cheap and inexperienced or more expensive and more experienced. Again, people choose the latter. Experience trumps because people intuitively know that an experienced lawyer is more likely to achieve a better outcome than an inexperienced lawyer.

Because experience is more valuable than a lack of experience, firms will have huge financial incentive to train their lawyers so they generate greater value rather than less, and more value sooner rather than later. It may have been a while since most law firms have effectively trained their lawyers and years since partners have actually mentored any junior lawyers, but it is a skill and commitment that will be rekindled swiftly once the financial benefits of making the commitment become clear. I always tell law students to never believe what a lawyer tells you. Instead, look to see if there is a financial motive to behave in the way the lawyer is claiming lawyers in his or her firm behave. If there is, you can expect to see that behaviour, whether in training or mentoring or anything else. If, on the other hand, there is no financial motive, ask yourself whether you are willing to trust the altruistic motives of lawyers as a group. I know I wouldn't.

Better results

Experienced lawyers get better results. I know of no data on this point, but most lawyers who work with senior lawyers believe this to

be true. I believe the reason it is true relates to the 'percolation effect'. Let's look at an example. Your adversary produces lots and lots of documents. Clients concerned about the black hole of discovery and law firms wishing to find work for their young lawyers unknowingly conspire to have a critical task – identifying important documents – done by people who have never tried a case and, in most cases, have never even been in court or deposed a witness. The reviewers are not invested in the outcome and don't fully understand the strategy of the case. Important documents are missed, and those documents never make it up the ladder to more senior reviewers. The end result is that the partner who will try the case gets a file of 'hot documents' and a deposition outline.

Contrast that normal behaviour with how a firm invested in the outcome of the case handles a document review. Senior lawyers have an incentive to be involved in this critical part of the case. They know what they are looking for, and they also know they will recognise hidden nuggets that younger lawyers lack the knowledge and experience to appreciate. This is called immersion, and it certainly seems that immersion will produce better outcomes than percolation.

Highest and best use

If you are an in-house lawyer, think about what you could do with the time you presently spend reviewing invoices. Coachman, a manufacturer of motor homes, trailers and modular housing, is a \$500m company. It began utilising data-driven fixed fees and found that it saved 100 hours of scarce lawyer time each year by eliminating the need to review invoices.

So, inside counsel, do you contribute more value to the company by reviewing invoices or doing other things that utilise your unique insights and knowledge?

Creating virtuous circles for expenses

When you are being paid a fixed fee, every dollar you spend on real estate, bottled water, box seats and other expenses is money out of your pocket. When you can't just raise your hourly rates any more, it's not easy to just pass along rising expenses to your client. In these circumstances, you find out what things are necessary for optimal organisational performance and what expenses are merely ego gratification. Perhaps you will track the number of clients who come to your office. Do you need class A real estate for everyone? Do partners need large offices? After all, don't most meetings take place in conference rooms?

An interesting thing happens. Firms find ways to materially lower their costs. I don't mean merely terminating scores of associates. I mean going after the fat in the partnership, eliminating the memberships, really getting radical on the efficient use of space and other similar drastic changes. Then you start thinking about expenses such as air travel – do you need to be present in person for a deposition or can you do it by phone? And so forth. Firms can make a real dent in the overhead.

What happens when you make that dent? You can quote a lower price. You improve your chance of besting your competitor which also is trying to lower its cost structure. You make clients happy.

Then you start the process again of reviewing even more expenses.

Doing the business of your business

Let's face it, few businesses are in the business of litigating. My client Jeff Carr of FMC Technologies makes certain that every lawyer representing the company knows that the company is in the business of making and selling complex pieces of equipment

that sit on the ocean floor and allow oil to be pumped to the surface, along with other things. The company is not, he emphasises, in the business of litigating. It is a distraction, taking away attention from the focus on making and selling the things the company makes and sells.

We previously discussed the importance of reducing the number of days a file is open. When cycle times are lowered, lawyers enhance their profit margin on the case. But the company benefits because the distraction goes away faster and focus can remain on the making and selling of the things the company makes and sells.

Avoiding bad litigation

Everyone has heard of a lawsuit that goes on interminably and then settles on the courthouse steps for an amount that could have resolved the case at the outset. Why did it take until the end of the process, after the transaction costs are fully incurred, before anyone realised this? To ask the question is to answer it. It's hard to tell how often this happens, but we know that it happens enough that everyone seems to have stories galore to tell.

When I was a child, my dad used an ingenious method for ensuring that pie cutting was fair. And I mean pie cutting literally, not in the profit-sharing sense. If there was a piece left and both my sister and I wanted it, he would tell one of us to cut, but with the caveat that the other got to make first choice. That piece of pie was sliced into pieces that were perfectly equal, to the calorie.

The application of this story in the legal world? If clients want to know whether a case has any value or a defence has any merit, they must ask lawyers to invest in the outcome. You'll suddenly find early case assessments being made in a far more discriminating manner, and clients will be able to avoid needless fights.

Chapter 13: Toward a new normal

FOR THE past 50 years, every law firm serving corporate clients has utilised the same business model. Revenue was driven by the chosen rate, the number of hours worked or the number of timekeepers employed. When firms needed to increase revenue, they had to increase one of those drivers. Firms competing on 'price' were actually competing on only one of those drivers. When forced to offer discounts on rates, the number of hours being billed had a tendency to increase. When firms needed to increase profits, there was only one place to look – clients. If firms increased their profits, it was only because they had increased their revenue. Revenue grew only because clients paid more. It was a zero sum game. This was the old normal.

The old normal, the billable hour, is not dead, but it certainly is in decline. It was in decline before the economic crisis, but that turmoil accelerated the decline. There is a huge volume of evidence that confirms this truth, only some of which is addressed in this report. Those who refuse to concede this truth are living in a fantasy world. The old normal is dead. The billable hour heyday, in all its glory, is not coming back.

Paul Lippe, the brilliant CEO of Legal OnRamp, has illustrated the 'old normal' as shown in Figure 1.¹

The points are simple, the key drivers being 'more is better' and 'prices go up', and the resistance drivers being 'if it ain't broke' and 'how it's always been done'.

This 'law normal' stands in marked juxtaposition to the 'enterprise normal' that



Figure 1: Law normal



Figure 2: Enterprise normal

illustrates the manner of operation in the business world – see Figure 2.

In the enterprise normal, information is the key, prices are going down and 'somewhere a 26 year-old' is figuring out how to use technology to do what you're doing better, faster and cheaper. That, in turn, triggers endless pressure to improve. Think of Google as an example: 12 years

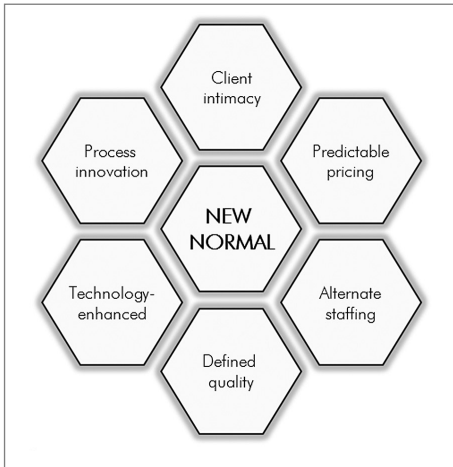


Figure 3: New normal

ago, there was no Google, and now there are more than 200 million Google searches per day, all for free. The pace of change has been breathtaking. We’ve gone from not living with it (Google) to not being able to live without it in less than a decade.

The same normal that has driven innovation in business is becoming the new normal in law, and at a pace similar to Google’s emergence. Lippe illustrates the ‘new normal’ in Figure 3.

This ‘new normal’ brings the tools of business and the pressures to improve the law. Things that can be measured will be, and the processes used to generate those measurables will constantly be improved. Technology will drive down the cost of the process parts of the practice. We’re already seeing this in the e-discovery realm, for example. But the other critical pieces of the new normal are predictable pricing and use of the cheapest staffing options to get the job accomplished. In the new normal world, contract lawyers and legal process outsourcing providers will play a growing and critical role.

There is much in Lippe’s new normal that tracks the future predicted by the renowned

author and Professor Richard Susskind, author of *The End of Lawyers?*², predicts that technology and pricing pressures will drive down the cost of the process and content parts of what we do. Why, after all, should a client pay a lawyer to learn the black letter law in an area when someone else somewhere else has already done so? It should simply be a matter of finding that earlier work. **The value add for lawyers is in the counselling and advocacy realms, when judgment and insight take on value.** Those traits are the ‘client intimacy’ piece of Lippe’s new normal, though the latter includes much more in that description.

Consider this final overlay on what the future may be. Ray Kurzweil, who has been described variously as “the restless genius” by the *Wall Street Journal* and “the rightful heir to Thomas Edison” by Forbes, wrote at the beginning of 2001:³

“An analysis of the history of technology shows that technological change is exponential, contrary to the common-sense ‘intuitive linear’ view. So we won’t experience 100 years of progress in the 21st century – it will be more like 20,000 years of progress (at today’s rate). The ‘returns’, such as chip speed and cost-effectiveness, also increase exponentially. There’s even exponential growth in the rate of exponential growth.”

Even if Kurzweil is off by a large margin, it is certainly true that we are experiencing change in today’s world at a faster pace than ever before. That means that businesses, our clients, are experiencing change at a super-accelerated rate. With that pace of change as overlay to what the legal industry has been experiencing, it is hard to fathom an argument that anything other than major change is on our horizon for the foreseeable future.

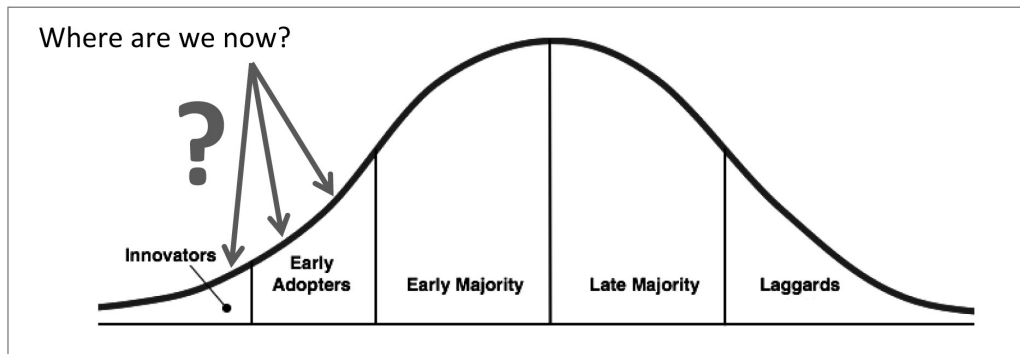


Figure 4: Adoption of the new normal

The change the legal industry is experiencing is ‘disruptive’, meaning that it will improve our service in ways the market does not expect. Certainly Lippe, Susskind and others are imagining a future for the profession where cost of doing most things done in law should shrink rather than grow, and that clients will be the beneficiaries of these efficiencies, among other things.

Disruptive change is inevitable. Indeed, it is happening now. The challenge for every lawyer and every law firm is whether one will shape one’s future or merely hold on to the rollercoaster hoping not to get thrown off. Consider the way changing technology is viewed – see Figure 4.

There is no reason to think that a graph that looks much like this will not be what legal historians use to describe how change occurred in the first part of the 21st century. Former Army Chief-of-Staff Eric Shinseki has famously said that “if you don’t like change, you’ll like irrelevance even less”. That sentiment is especially true for lawyers today.

The new normal is not one thing. We are used to one version of normal – the billable hour and all that it entails. But there will be no single fee structure or manner of providing service to clients that supplants the billable hour. The new normal will be one where variety rules, and where clients learn

to pick and choose fee structures that will allow them to more effectively and efficiently accomplish their specific objectives for that particular matter. To thrive in the new normal, lawyers will have to know their cost structure and utilise skill-sets previously unknown to them in order to control the cost of producing the outcome sought by the client.

The transformation required of currently practising lawyers will be nothing short of heroic, and the challenge to law schools to produce lawyers capable of surviving in the new normal is unprecedented.

Now that you have reached this end point, I hope you are excited about the endless opportunities each of us has to shape the new normal, and provide solutions and a level of problem-solving service that were previously unknown. The future is there to be created. Find your vision and make it so.

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