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What Will It Take To Make Non-Hourly Pricing A Real Fee Alternative?

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Is the alternative fee discussion taking place at legal conferences and in the blogosphere a sign of a real sea change in the approach to valuation of legal services or is it just an adjustment to the vocabulary of traditional billing practices reflecting temporary fallout from the current recession?

General counsel are talking about it because their departments are faced with tighter cost controls, legal department budget decreases, and increased litigation case loads. Most law firms now seem to offer some form of "alternative" fees, but most have not made the process changes to support a real shift to non-billable-hour-based fees.

Anecdotal evidence supports almost any facet of the argument:

- In a 2007 Billing Rates & Practices ALM survey research report, 88 percent of the respondents from mid-sized and small firms said they offered "alternatives" to the billable hour; 69 percent reported offering "variations." Among these respondents approximately 30 percent of revenues came from these fees.
- In the 2009 AmLaw survey, 92 percent of large firm leaders said client pressure for discounted fees is increasing and 45 percent said they already offer top clients discounts. 77 percent said they expected to raise their billing rates by 5 percent or less in 2010.
- Legal leaders discussing the demise of the billable hour include the American Bar Association, the Association of Corporate Counsel, and some U.S. Supreme Court Justices.
- Yet, in the 2009 Altman Weil Chief Legal Officer Survey, only 8.7 percent of legal departments responding to the survey reported that more than 20 percent of fees paid in 2008 were for non-hourly work, which increased but only to 16 percent for fees to be paid in 2009. Further, the poll revealed a legal department perception that less than 20 percent of law firms were moderately to very serious "about changing their legal service delivery model to provide greater value to clients (as opposed to simply cutting costs)."

Clearly the debate is far from settled. However, as demonstrated from the above survey results, the focus of the conversation seems misdirected. Most conversation seems to focus on discounted versions of billable hour fees rather than on a new fee structure keyed to the value of services for both legal departments and law firms. This begs the question: are we talking about different packaging for the same billable hour or will there really be a paradigm shift away from thinking about the billable hour or variations on the theme to a different model rooted more in the business analytics of work force utilization, leverage, and law firm-legal department partnering? What issues are blocking the move to real shared-risk fee structures? How is the lag in developing a "business of law" infrastructure impeding the movement to value-based billing options?

Alternative Fee Arrangements Take Many Forms

There are many forms of alternative fees. The most frequently used arrangements are simple discounted hourly billing, volume discounts, hybrid fees or blended rates. Yet these arrangements necessarily require the survival of the billable hour and the same old inefficiencies and inherent disincentives many complain derive from that model.

Indeed, in a talk at the December 2009 ALM Conference on Controlling Legal Costs, research from the General Counsel Roundtable ("GCR") revealed that seven of the top ten outside counsel management practices with the highest return on investment were alternative fee arrangements. However, the GCR's findings also demonstrated a significant difference between perceived effectiveness and actual impact on decreasing legal spend. In fact, while legal departments ranked volume discounts as perceived to be the most effective in reducing costs, analysis of the data showed just the opposite – volume discounts were the least effective of the alternative fee structures in reducing costs, while fixed fees (defined as a set fee "for all work in a given subject area for a period of time"), risk sharing, and flat fees (defined as a set fee for a particular matter) were the most effective, in that order.

Management Prerequisites For Effective Use Of Alternative Fee Arrangements

GCR's research showed that there was no one "Cure-All Alternative Fee Arrangement" that yielded "both a significant increase in quality and reduction in

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cost." Further, the apparent discrepancy between perception and reality of the effectiveness of different billing practices creates further confusion and distrust of significant change to true value-based billing.

Often legal departments remain with the billable hour because their billing systems and supervisory arrangements are not positioned to deal with the perceived complexities of alternative fee arrangements. Others balance predictability against the insurance factor of a brand name firm or a well-liked incumbent.

If companies truly feel that the billable hour has the much maligned problems, and a new valuation model for the delivery of legal services is not only appealing, but necessary, legal departments must be prepared to embrace a new way of thinking about such valuation without treating legal services wholly as a commodity.

Legal Department Changes

Legal departments have become more management-focused, adapting vendor management techniques such as sophisticated budgeting and forecasting, metrics analysis, and project planning to the management of law firms. They are using more robust technology for tracking and billing. Data from the 2009 *Managing Partner Outside Counsel Survey Report*, fielded by the Association of Corporate Counsel and Serengeti, confirm the following:

- In-house counsel are using more specific terms of retention in agreements outlining what they expect from outside counsel.
- They expect high levels of communication including regular discussions, reports documenting progress against an agreed-upon plan, and participation in decisions on major developments. Some also want a post-engagement summary of results achieved and lessons learned.
- Many use Internet-based systems to work directly with outside counsel and prefer the firms that have compatible software systems.
- Management techniques focused on controlling outside legal spending include requiring outside counsel to provide budgets, setting minimum levels of associate experience, implementing convergence, and discounting early payment of legal bills.

If in-house counsel want to integrate alternative fees into their hiring process and pricing policies, they will need to offer:

- clear guidelines and precise instructions as to what is and is not covered by the alternative fee arrangement;
- a partnership attitude and willingness to share information that will enable the outside firm to make a fair bid;
- guidelines for measuring and rewarding excellent results and good track records.

Law Firm Changes

If alternative fee arrangements are a reality and not just talk to satisfy executive suite pressure for cost control, then law firms must also be prepared to adopt the new paradigm and those behind the curve should face stiff competition to retain business. To move toward true shared-value/performance-based fees, outside counsel need to view this discussion in the context of other client-counsel initiatives that create a real partnership, including:

- an understanding of the in-house counsel's situation: what is expected of the legal department, the challenges facing the company, an understanding of and appreciation for industry trends or new laws that will impact the legal department and the company;
- effective early case assessment and anticipation of possible initiatives by the adverse parties;
- timely, honest communication to avoid surprises;
- agreed-upon benchmarks to measure progress;
- proactive law firm initiatives focused on cost-effective resource management;
- law firm openness regarding how they arrive at alternative fee arrangements.

Trust Is Key

There can be no true change in the approach to valuation of the delivery of legal services, which has been the focus of so much discussion but far less action, without a relationship built on trust. In order to get beyond the traditional knocks against value-based, alternative fee arrangements (e.g., in-house counsel fear that law firms will cut corners to generate the equivalent of more dollars per hour and that they will push work down to unseasoned attorneys or in other ways affect the quality of the work product; or outside counsel are concerned that they will be blindsided by unanticipated events), both legal departments and firms need to carefully assess their business goals and where they intersect. While there is no easy turn-key solution, it is clear that law firms can remain profitable and deliver higher-quality results at lower cost to their clients with the right combination of alternative billing elements.

Win-win Opportunities

In today's economic climate, it is imperative to return the focus to a discussion of value. Alternative fee arrangements meet the need for value-focused work, shared risk, and a working partnership between in-house counsel and their outside law firms. While hourly billing will probably remain the most common form of billing well into the next decade, alternative arrangements should continue to grow and challenge the billable hour's dominance in the legal field.