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Forget Hourly Billing – Performance-Based Billing Works

*The Editor interviews **Jeffrey W. Carr**, Vice President, General Counsel and Secretary, FMC Technologies, Inc., and **Glen Silverstein**, Partner, Leader & Berkon LLP.*

Editor: Jeff, please describe your company.

Carr: FMC Technologies, Inc. (NYSE:FTI) is a leading global provider of technology solutions for the energy industry. The Company designs, manufactures and services technologically sophisticated systems and products such as subsea production and processing systems, surface wellhead systems, high pressure fluid control equipment, measurement solutions, and marine loading systems for the oil and gas industry. Named by *Fortune* as America's Most Admired Oil and Gas Equipment, Service Company in 2005, 2006 and 2008, FMC Technologies has approximately 10,000 employees and operates 23 manufacturing facilities in 19 countries.

Editor: Glen, tell us about your firm.

Silverstein: Leader & Berkon is a litigation-only law firm with about 20 attorneys. We handle commercial litigation, securities and products liability work. Being a twenty-first century law firm, we understand that litigation cannot be looked at in isolation. We know that our success in representing our clients requires an in-depth understanding of our clients' businesses and of what our clients seek to achieve in the cases we handle for them. This involves a sharing of risk, communicating effectively with them and a recognition that clients want to pay for performance and not just for "activity."

Jeffrey W. Carr

Glen Silverstein

Editor: What is performance-based billing and why is it so important?

Carr: We believe the compensation of a law firm should be determined by its performance and that performance should be measured by the extent to which the firm achieves the clients' objectives effectively and efficiently. It is not just the summing up of the time spent, but using other measures of value to the client as well.

Silverstein: Jeff and his company have been among the leaders in performance-based billing practices. Certainly, DuPont, for whom we are the New York City-area Primary Law Firm, has also been a pioneer in this approach to attorneys' fees. We have a very definite self-interest in being paid for performance, because we feel that we stand out compared to other firms when results and costs are measured.

Editor: Jeff. You mentioned that sharing of risk is important. Could you explain how that fits into the picture?

Carr: I think we get better advice if the firm has "skin in the game." If you live in a cost-plus world and can bill in a cost-plus way, there is little incentive to reduce your costs. However, if a firm shares in the risk, it has a real incentive to achieve the clients' objectives – this is the goal of performance-based billing. It also helps the law firm involved because it has a greater incentive to achieve what should be the ultimate goal of every firm – namely, to make money by fostering long-term relationships with clients.

Silverstein: As Jeff mentioned, shared risk links to performance-based pay. Our

Please email the interviewees at jeffrey.carr@fmcti.com and gsilverstein@leaderberkon.com with questions about this interview.

willingness to share the risk and to be compensated on a performance basis tends to cause, in the minds of our clients and potential clients, our firm to be judged on merit rather than just size and name recognition. When a client asks us to share the risk, we are more than happy to agree.

Having the proper incentives also makes what we do more fulfilling because our incentives are aligned with the client's business interest. We are rewarded if we win the case early, if we get a great settlement or if we get a result that makes sense in the real world by coming up with a great business solution.

Editor: Jeff, Glen suggested that in addition to "shared risk" there should also be a reward, a carrot, for a good outcome. Do you agree?

Carr: I think it is critically important to provide the carrot. We must put our money where our mouth is. We need to reward outstanding performance – work that brings in money to our bottom line or exceeds our expectations.

It should not be a reward for simply "good" work. We expect all our firms to do that all the time. It's all part of how we align what we think of as divergent interests. Our interest is in achieving a result effectively and efficiently. The law firms' interest is in producing a revenue stream. Our goal is to produce a convergence between those divergent interests that will produce the best result for us while producing a result for the law firms that will enhance their performance-based revenue.

Silverstein: We like to be rewarded for exceptional work, such as proactively developing solutions to litigation. Let me give you an example. We handled a case in which, before massive discovery, we worked with the client to develop a strategy that included meeting with the plaintiff's attorneys early in the case and explaining to them in detail how the chemical in question had been manufactured. We pointed out that the molecules the plaintiff thought were dangerous could not possibly have resulted from the manufacturing process. We volunteered to go through the process with their expert and to demonstrate our position to the satisfaction of the expert. We did that and successfully got our client out of the case considerably before any of the other defendants. On a strict billable hour's basis, our firm would have lost from this approach. With performance-based billing, we earn a substantial bonus for the amount that our innovative approach saved the client. As a general matter, the longer a case goes on the more it costs, so building in an incentive for getting out of cases quickly is win-win for both the firm and the client.

Editor: Jeff, what kinds of performance-based systems do you use?

Carr: We have two. The simplest is called ACES. That system involves an arrangement with the firm, whether it's hourly billing, a retainer or a project-based fee, whereby, when the firm periodically bills us, we pay 80 percent of the invoice and 20 percent is at-risk.

At the end of the engagement or at the end of the project, we give the firm a report card grading it on six factors. Based on its grades, the firm gets between zero and 200 percent of the amount withheld which means that the firm would get between 80 and 120 percent of the amount they billed.

We use a somewhat similar system for more complex litigation. Here too the holdback is 20 percent. We divide a case into five phases, which are time-based not activity-based. We specify what our objective is for the litigation. If the firm achieves the objective, then it receives the amount in the at-risk bucket plus a multiplier. The standard multiplier for the first phase is higher – the firm gets what's in the bucket plus 125 percent. And in the last phase the standard multiplier is what's in the bucket plus 25 percent.

In this second system, the standard multipliers are adjusted for performance against budget. If the original total case budget was $1 million and the case is resolved in the first 90 days and the firm billed us for only $100,000, the multiplier which is applied to what's in the bucket in the first phase would increase by 90 points to 215 percent because the firm has been incredibly efficient. The standard multiplier is also adjusted for what we call deviation from the expected value of the case. If we thought the case had a value of $1 million and it is resolved for $500,000, then the multiplier is increased. Again, if it goes the other way, either in being over the budgeted costs or resulting in a higher settlement, then the multiplier is reduced. Our systems are very case-specific since we don't have the case volume that some other corporations might have.

Silverstein: FMC's system is very advanced and provides improved incentives. We also work with clients using similar principles. We appreciate the opportunity of getting a reward for doing a particularly good job and are willing to live with the risks.

Editor: Do you think that the billable hours are a good reflection of the value of a law firm's services?

Carr: I think that most law firms understand what their costs are as an entity. But, I think that most firms do not have a handle at all on the cost to them of handling a particular matter. They may be able to tell you what they billed for a particular matter but that is not the same thing as saying what it *should* cost. I live in a world where we make highly engineered goods and we sell them on a fixed-price turnkey basis. A lot of our cost is engineering hours, and frankly we absorb that cost if we over-engineer something or if it turns out that we went down the wrong path. In the current law firm model, the law firm does not absorb the costs of its mistakes. They can total up their cost of their payroll, rent and electricity, but that tells you nothing about what their bill to a particular client for a particular matter *should* be.

Silverstein: I think Jeff's concerns are common among businesses that rely on outside counsel. Many of these businesses are now seeking value from firms like Leader & Berkon that take an alternative approach. For example, we are one of the few law firms that use an early case assessment process which is designed to determine what the case *should* cost. We like to build into the discussion a project-management-type approach, which, we think, can greatly benefit the client.