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Alternative Fee Structures Require and Create Better Relationships

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By James L. Palenchar

A seemingly inevitable tension is often built into the relationship between in-house counsel and law firms, and much of it traces back to a single issue: cost predictability. Nothing sours corporate clients more consistently than unexpected or unexpectedly large legal bills.

“The hourly rate doesn’t necessarily encourage outside counsel to prioritize problems. In fact, it provides a financial incentive to see everything as a problem that needs to be fixed—particularly at very high levels of specialization,” says James L. “Jim” Palenchar, a founding partner of Bartlit Beck Herman Palenchar & Scott LLP. “It’s not hard to see how that leads to inefficiency and billing surprises.”

Palenchar recommends an alternative fee structure that combines fixed and variable compensation components. In a litigation matter, for example, a fixed fee might represent 70 percent of the compensation, with the remaining 30 percent paid to the firm only in the event of a successful outcome. In a transactional matter, the variable fee can be tied to meeting specific deadlines as well as to the successful execution of a deal. In either case, in-house counsel go in knowing exactly what they will pay, regardless of outcome.

Cost predictability is by no means the only advantage to alternative fee arrangements, however. Such structures inevitably lead to more collaborative working relationships.

“Lawyers from the top experience level to the bottom are all very hands-on because that’s efficient execution,” Palenchar says. “You can’t have layers of people assigned to a project who aren’t familiar with all aspects of the case or the transaction. From the client’s perspective, this really enhances communication.”

Because the firm’s compensation is tied to effective and efficient delivery of service, outside counsel have every incentive to be actively engaged and build a broad understanding of the client’s business and strategic goals.

“We want to know how our in-house counterpart and the CFO are explaining the deal to senior management and the board,” Palenchar says. “We want to know what the client’s internal deal memo says. We want to see their thinking and figure out what’s important, so that we know we’re spending our own time on what’s important, too.”

Law Firm:
Bartlit Beck Herman Palenchar & Scott LLP

Details:
Bartlit Beck is a firm of trial and deal lawyers, handling all kinds of high-stakes, complex litigation and transactions. The firm has offices in Chicago and Denver.

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Jim Palenchar has over thirty-five years experience as a transactional lawyer, with a focus on mergers and acquisitions, securities regulation, corporate finance, and advising management of business organizations on governance matters and compliance with federal securities laws. He is Peer Review Rated. He co-hosted the December 15, 2011 Counsel to Counsel forum, “Trading Places: A Fresh Look at Practically Managing Inside/Outside Counsel Relationships.”

Furthermore, alternative fee engagements make high leverage ratios all but impossible for law firms. To efficiently staff matters and get predictable results, firms must rely on experienced, capable lawyers. That means clients are never stuck with a bill for training fleets of transient associates.

“Because you’re focused on efficient execution, you don’t have bodies around for the sake of billing hours,” Palenchar says. “As a result, your teams become much smaller.”

In the end, alternative fee structures both require and build trust. Companies and law firms alike must be confident in the value being provided, and merely entering such an engagement demonstrates a level of commitment. Transparency is required, of course, and both sides of the relationship must come to the table willing to be upfront and honest about budgets, costs and expectations. If they can bridge that gap, the structures and behaviors that allow one side to profit at the other’s expense can be eliminated.

“Effective partnering with outside counsel doesn’t happen by accident,” Palenchar says. “It requires both sides to carefully align their objectives and economic interests.”