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Law Firms and GCs Finding Value in Alternative Billing

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It's been over 20 years since corporate legal departments publicly asked for alternative fees when DuPont Legal began the trend with its convergence model. The former general counsel for DuPont and current partner at Ballard Spahr, Tom Sager, was the frontrunner in implementing alternative fee arrangements, or AFAs, and said "the impetus for this was a mass tort explosion confronting DuPont and with it the compelling need to drive efficiency, reduce costs and incentivize the firms for outstanding results." During his time at DuPont, Sager's team converted 70 percent of its matters at its high-water mark, he said. These were not discounted hourly rates; instead, the AFAs were either a flat fee or a flat fee with a holdback and contingency bonus. Over time, some companies followed DuPont's lead, but the real push for AFAs occurred after the 2008 financial crisis and recession. Since then, corporations have become increasingly more budget-conscious and have requested value-based billing.

Although there has been some hesitancy throughout the legal community to disengage from the billable hour, many corporations and law firms are finding that AFAs enhance the relationship between, and create value for, both law firms and in-house counsel. AFAs press law firms to handle work efficiently, enabling them to compete more effectively. Law firms have responded by offering flat fees, fixed fees with collars, reverse contingent fees, success fees and performance-based holdbacks, among other creative billing methods. Sager said that in this competitive legal market, offering AFAs continues to be an opportunity lost by many firms. Engaging in conversations with corporate clients leads to "greater alignment and a better relationship," he said.

Most major corporations are rolling out AFA programs. In 2014, Shell began implementing its value-based billing program, termed "appropriate fee arrangements." Gordon McCue, Shell's associate general counsel, explained that Shell's legal department met with its outside law firms to begin executing appropriate fee arrangements. Each matter was examined to determine an appropriate fee. They determined that the most common arrangement was fixed fee by phase of matter. For this method, each phase—for example, motion to dismiss, discovery or trial—was billed at a fixed rate.

Vince Cordo, who recently joined Shell as a legal department global sourcing officer, indicated that other AFAs include fixed fees with collars, success fees and performance-based holdbacks. Under fixed fees with collars, the parties agree to a fixed fee as well as a collar that is set as a percentage of the fixed fee. The collar acts as a buffer in the event unexpected developments occur. With a success fee, if a particular result or milestone is achieved, such as summary judgment, the bonus will be awarded. Cordo suggested that a traditional performance-based holdback equates to various ranges, in some cases 10 to 15 percent of the budget. This is applied to traditional hourly or fixed-fee billing and is usually broader than a success fee.

The holdback can be assessed on service excellence, successful outcome, use of cost-saving metrics or any combination. Shell uses a scorecard to evaluate its outside counsel in these areas, as well as diversity and inclusion.

So far, the appropriate fee arrangements are working for Shell and its outside law firms. The firms have realized that they need appropriate resources to manage their budgets according to the AFAs. As a result, they are putting tools into place to utilize legal process management to support their lawyers to be more competitive while minimizing markdowns and write-offs and improving their profitability.

Creating Efficiency

In order for AFAs to align with a firm's profitability, the firm must be expert at staffing and case management. Sager said AFAs are only effective if the firm knows the resources it needs to get the job done. DuPont's preferred law firms use a Lean Six Sigma process improvement and project management approach to drive efficiency hand-in-hand with creating AFAs. The more disciplined a firm is regarding matter management, the more accurate and profitable the fee is. Additionally, firms committed to financial success were awarded more business by DuPont. Shell's Cordo explained that firms that tie legal project management with pricing are more likely to be successful, saying that "if there is not careful management between time and billing, this cannot be managed efficiently."

Bartlit Beck Herman Palenchar & Scott is a firm that handles value-based billing expertly. All of the firm's matters are AFA-based. Partner Adam Hoeflich said success-based fees better align clients' incentives and their lawyers' goals. When they consider how to charge, they take into account opportunity costs, time limitations, the amount at stake for the client, the difficulty of the case, and the required experience, reputation and abilities of the firm. They are willing to assume the risk of a contingency fee and focus on obtaining a positive result for the client. Bartlit Beck thrives with a model in which it earns more if it wins and less if it loses. The firm's AFAs include monthly flat fees with holdbacks, success bonuses contingent on outcomes, contingency fees and fixed fees based upon the phase of litigation.

Hoeflich mentioned that in addition to attracting clients, there are many other benefits to AFAs. The firm's structure and culture are enhanced by the AFA model. Bartlit Beck has hired 12 Supreme Court clerks, he said, and the vast majority of associates are promoted to partner. The environment is mentoring, and associates are trained to learn their craft, not to bill as many hours as possible. If a task takes 45 minutes or requires four hours in order to master the assignment, the time is irrelevant. Hoeflich "does not want to be in a world where they reward someone because they spend more time doing things."

Bartlit Beck focuses on cases that make sense for its practice, complex matters requiring exceptional courtroom skills. The firm is run efficiently by one partner, Skip Herman, a former practicing lawyer, and has no committees.

Resource Utilization and Implementation

In order to execute AFAs profitably, it's imperative that law firms understand how to manage their resources within a matter's budget. Rob Rhatigan, director of business operations and strategic initiatives at Ballard Spahr, indicated that although nonhourly fee arrangements still represent a minority of the firm's billings, every request for proposal has an AFA component. In order to manage AFAs, Ballard Spahr has a proprietary AFA system that helps during the budget-setting process. It also uses a flexible approach to billing, keeping in mind what works best for each client's business. The flat fee by stage of case is the most common AFA for litigation matters. Similar matters are tracked, and task code data is used to create the budget. Once the budget is in place, billing partners have real-time access to where they stand relative to budget. Rhatigan explained that flat fees work best for repetitive work, such as predictable types of litigation, employment charges and patent applications.

Cordo indicated that Shell law firms "shadow bill" along with AFAs, so that each appropriate billing arrangement can be analyzed against the fee arrangement while monitoring key performance indicators. For example, using this methodology, its firms are encouraged to leverage the partner-to-associate ratio appropriately and to allocate time to the suitable phase and task code budgeted in the AFA.

While the billable hour remains the most prevalent fee structure, law firms that embrace the AFA will be able to thrive in the competitive legal market. As demonstrated by Ballard Spahr and Bartlit Beck, not only are client relationships improved, law firm culture and internal processes are also enhanced.

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