

## **WHITE PAPER: Value-Based Fees and Alternative Fee Arrangements**

### **Collaborating with your Clients to Craft Successful Alternative Fee Arrangements**

Anecdotal evidence shows that many lawyers are uncomfortable with numbers and may suffer from the well-documented malady of “math anxiety.” When faced with the prospect of alternate fee arrangements, some lawyers defensively express having been burned whenever they’ve tried it. Instead of avoiding the opportunity to think creatively, lawyers should tackle this challenge like any other complicated fact pattern - using skills honed as a practicing lawyer.

In order to effectively use alternative fee arrangements, you will surely expand your skills, and you DO need to learn some techniques that were not taught in law school. Just as representing a new client requires you to learn about their culture, company history and industry, successfully using alternative fee arrangements also requires abilities that your clients expect you to master.

Whether you are representing a client in closing a transaction, litigation, crafting a settlement, or complying with a regulatory scheme, you must know the facts and the law, but you must also look at the situation from that client’s unique perspective. This means understanding their business model, appreciating their appetite for risk, mastering the numbers and adapting to corporate budgeting.

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A bit of background is in order. For the last 25 years clients have had corporate CFOs looking over their shoulders on costs as well as outcomes. General Counsel must defend the size of the in-house department, make projections on spending and results, and justify the value of legal spending – of both the in-house legal staff and on law firms. Experienced in-house lawyers are skilled at developing and managing a budget, and reporting to internal finance departments. The assumption in corporations is that lawyers and “legal spending” is an overhead cost that has to be managed – not unlike rent or other non-revenue producing expenses.

Even when lawyers skillfully serve as counselors, support corporate strategy and favorably affect the bottom line, lawyers are also expected to express the economic value of their contribution to corporate business objectives and financial statements. The thoughtful descriptions of excellent legal work that lawyers provide in their firm brochures, practice group descriptions, biographies and in specifically pitching work, are inadequate if they do not express success in quantitative terms that are meaningful to the client.

The momentum for change toward alternative fees is accelerating. The issue is when, not whether, a client will ask you for a replacement to hourly billing. If you are already using alternative arrangements, you need to follow a path that will produce successful economic results for both the firm and the client.

### **Here are a few hints:**

First, make sure you understand your client's legal business model as well as that of your firm.

Then, to make a proposal that satisfies both the client and your firm, you, or someone with the necessary expertise supporting you, must know how to:

- Harness the right data (both yours and your clients')
- Understand the meaning, derivation and application of metrics
- Understand how data is used to produce measures of profitability and costs
- Rethink which lawyers are assigned to perform work on different aspects of an engagement
- Set priorities based on a client's perception of and appetite for risk
- Address how your firm's view of risk meshes or conflicts with its standards of client service

Finally and most critically, build into the arrangement a serious communications plan so that there is a process for confirming or recalibrating assumptions, experience and actions.

### **In-house counsel can teach law firms a few things**

Law firms should take advantage of the considerable efforts that general counsel have invested in learning how to convey the value of legal services to the CFO and CEO. In recent years, domestic and global companies - including many smaller than the Fortune 500 - have installed software called "matter management systems" and deployed e-billing systems. No longer considered sophisticated technology, many clients are using these databases (supported by a robust legal technology vendor community) and employ senior staff with backgrounds in accounting, operations or law. These chief operating officers and law department managers

have staffs (either as part of the legal department's headcount or assigned by the CFO's office) of financial analysts, database managers and technology professionals. General Counsel are thereby able to generate statistics on law firm fees, rate structures and staffing arrangements.

With the assistance of consultants and peer benchmarks, as well as business literacy that General Counsels have developed, clients are able to produce targeted rates for different types of work and tie that profile to the economic value to the business. Legal work is evaluated with the aid of metrics. Financial performance and cost of a law firm is separated from the result of successful representation (in the form of settlements and payouts and their impact on financial reserves) and the quality of risk management (reflected in due diligence, representations and warranties and indemnification provisions in transactions). Relationships and skills are considered separately and many be eclipsed by the numbers.

During the past five years, law firms have begun to take advantage of software and business intelligence tools that produce information on profitability and all of its components. They are now generating this data from many different perspectives – by practice group, office, and lawyer. It is a good start, but if firm management does not report the data properly, it will not be valuable basic business intelligence. Instead, it will be more overwhelming than useful.

Work should be analyzed in a meaningful way -- as a portfolio – producing a total return – not just on a matter-by matter basis. Law firms should also generate data by client, type of matter, and at the matter level. Firms also have the same information as their clients by in the data they are transferring in the electronic invoicing systems. E-billing is a data base tool as well as a means for the transfer of payments.

Lawyers have the ability to learn as much about the way their legal representation may produce profitable business for the firm as the matter management systems that monitor costs have supported clients. It is possible to propose workable fee arrangements that reflect the quantitative measurements used by clients.

If you are able to understand the inputs, acquire a working knowledge of these new tools, and learn the vocabulary and ask the right questions, then you will have taken the crucial first steps in building a framework for alternative billing arrangements that meets a firm's needs as well as those of clients.