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DIGITAL WHITE PAPER

Value-Based Legal Services

(Not Just Estimating Hours at Standard Rates)

by Mike Burks and David A. Rueff, Jr. of Baker Donelson

Attorneys are groomed to equate the value of legal services with the number of hours it takes to do the work. Productivity in a law firm has also been historically based upon the number of hours an attorney can bill in a year. This culture places the working attorney in a state of conflict since law firm expectations are to bill more hours and client expectations are to pay what is reasonable and customary. This can lead to uncomfortable conversations at the closure of a matter to address discounts or write-offs. Inside the firm, attorneys who meet their hourly goals satisfy the firm's expectations, sometimes in conflict with the level of client satisfaction.

Enter the Association of Corporate Counsel (ACC) Value Challenge, an effort to encourage outside counsel to increase the value and reduce the cost of legal services. The challenge is no small task for law firms who continue to live under the billable hour. Many firms are re-evaluating the focus on the billable hour and are now realizing that there are numerous tools to help them meet the ACC challenge. These include streamlining legal processes, improving communications, prioritizing efficiency by advocating a legal project management (LPM) approach and creating value-based fee structures that are not tied to hours at a billable rate, but are more closely aligned with client and market expectations.

Alternative or Value-Based Fee Arrangements

"Alternative fee arrangements" (AFAs) may sound like another term for discounts or reduced fees, but it really means an alternative to the typical pricing and delivery of legal services. Clients want more predictability in their legal spending. By developing an alternative fee structure that more closely aligns with the interests and goals of the client, the law firm must deliver its legal services in the most cost-efficient manner possible. This may mean using contract attorneys where appropriate. It may also mean that research is outsourced to third-party providers.

For firms implementing AFAs, there has been a fundamental shift in strategy. Rather than focusing on how many hours a legal service will take, firms must focus on what value is to be delivered to the client. The approach must include the development of a plan with the client, which gives the firm an opportunity to tailor the engagement to meet client needs. For example, clients must identify their strategy — win at all cost or settle quickly. They must define successes and goals. There is no silver bullet in pricing, as needs and wants and risk tolerances for one client may differ from that of another. Communication, client knowledge and legal expertise are the key components in crafting a successful AFA.

Many clients demand AFAs, so Baker Donelson has developed a robust package of pricing and tracking tools to make it easy for attorneys to develop AFA pricing and to track the actual progress in any case. The firm established an AFA team of attorneys and certified public accountants and purchased a software application, Budget Manager, to price matters and track performance. The AFA team works with the attorneys to develop a pricing model and requires the use of the legal project management (LPM) system, BakerManage, to help accurately plan the work to be performed.

Baker Donelson currently offers 15 pricing alternatives to the billable hour. The process, depending on complexity, can be done with same-day turnaround, but typically requires several days to adequately evaluate a transaction or a proposal for a completely new line of business. The evaluation process implements an LPM assessment by developing a plan with the client to identify the scope of the project, building the task list required to efficiently meet the needs and objectives of the client, identifying how it will be staffed and setting a fee that also meets the financial objectives of the firm.

Matters Best Suited for an AFA

There is a broad range of value-based billing alternatives, and one size does not fit all. Factors that will impact the type of AFA applied are the type of case, the client's strategy, the firm's strategy, the timing of the case, the volume of work and the projected strategy of the adversary.

Repetitive Work: Recurring or repetitive matters that allow for the collection of historical performance data are best suited for fixed-fee pricing. These types of matters include labor and employment litigation, intellectual property, product liability or healthcare litigation, mass real estate loan closings, or a portfolio of similar loan foreclosures or asset recovery matters. These matters have similar legal issues and procedural challenges; therefore, assumptions and risks are more predictable and support the creation of a more reliable fee estimate.

Phased Budgeting: If the entire matter cannot be predicted with a level of certainty, the matter may be estimated by phases. This approach permits the firm and the client to enter into an AFA for preliminary phases of the case, with an agreement to re-evaluate later phases when more facts and information regarding the opposing party's strategy are available. Matters that fit into this category are litigation, mergers and acquisitions, and commercial transactions. Clients benefit from this approach because they do not bear the risk of a windfall to the firm if the matter settles early before completion of all the phases. Conversely, the firm benefits because it is not at risk for a fixed fee prior to gathering valuable information during discovery and motion practice.

Billable Hour with Fee Caps: With matters that are more difficult to predict, the client may be more comfortable with a billable hour arrangement, but the client may still want to cap its legal spending. In this situation, capped pricing is used and the client and the law firm agree that the fee will not exceed a certain dollar amount. Bonuses can also be factored into this approach. If the matter settles before the fee cap is reached, the client only pays for the time it took to settle. This approach involves a true partnership between the client and the law firm because the law firm accepts the risk that the matter will not settle before reaching the fee cap.

Volume or Tiered Discounts: If the law firm and client do not have an existing relationship, and they anticipate a significant volume of work, volume discounts or tiered volume discounts may be appropriate. Once the volume exceeds "X" dollars, the client receives a discount off standard rates for amounts over "X" or, in a tiered volume arrangement, the discount would apply to the entire amount retroactively. Volume discounts allow the client to be billed at reduced hourly rates in return for the client guaranteeing a certain volume of legal work.

In addition to the above arrangements, Baker Donelson also offers the following AFAs:

- **Collar Up:** A "collar up" implies that there is an amount set as the budget. If the firm goes over the limit, it cannot charge for any additional work until it reaches a certain amount over the limit (the collar amount). At that point, the law firm is allowed to charge a certain percentage of the amount over that limit.

  Example: The budget limit is $1,000,000. The collar is $100,000 and the percent is 60. The amount from $1,000,000 to 1,100,000 cannot be billed. If the firm's fees reach $1,200,000, then they can bill the client 60 percent (40 percent discount) of the $100,000 that is over $1,100,000 (or $60,000).

- **Collar Down:** A collar down is the same as a collar up, except it also rewards the firm for being under the limit.

  Example: If the firm only bills $800,000, it would get a bonus of $60,000 or 60 percent of the difference between $800,000 and $900,000.

- **Blended Rates:** A rate is established that will be charged for all timekeepers or a rate for each class of timekeeper — associate, shareholder, paralegal, etc.

Using LPM To Evaluate the Work

Although value-based fee structures, such as fixed fees, have been around for years, they have been fraught with difficulties. Firms did not have the tools to estimate the work accurately or to manage a budget efficiently. The end result has been write-offs that strained the

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firm-client relationship or requests to the client for additional fees prior to the completion of the engagement. Neither of these approaches achieved one of the primary goals of an AFA: predictability.

The key to identifying a predictable fee is confirming the reasonable expectations of the firm and the client. "Reasonable" is the common denominator. Clients normally base their expectation of legal costs upon prior experiences with other attorneys. This is rarely accurate, because it fails to identify the unique aspects of the case at hand or the adversary. Likewise, attorneys who lack the tools and skills to estimate a budget accurately typically rely upon the last two or three engagements they have conducted to derive an estimate.

LPM provides a methodology to estimate fee arrangements and ensure that the legal team operates within the constraints of the arrangement to achieve predictability. Since there is no standard for LPM, Baker Donelson developed its own unique approach: BakerManage. BakerManage is tied to traditional project management principles and includes five easy planning steps which can be implemented to estimate the fee accurately.

Step 1 - Identify the Scope of Services. The project plan for a legal engagement is typically codified in an engagement letter which outlines the scope in one sentence and identifies the timekeepers who will work on the engagement and their rates. In no other industry does such poor planning authorize a professional to expend thousands of dollars on behalf of a client. Rather, the scope of services should be the framework for tailoring the engagement for the client and should include the client's business need and the goals and expectations of the client with regard to timing and cost. The scope of services should also identify what should be excluded from the engagement or what is out of scope. Identifying what is out of scope requires the attorney to demystify all tasks necessary to perform the engagement so that the client can determine what tasks or services can be performed in-house or outsourced at a lower cost.

Step 2 - Identify Stakeholders. Most engagement letters are the result of a conversation with one representative of the client who is typically in the legal department. Rarely is the business unit given the opportunity to outline their expectations with regard to the management of the engagement. This can leave a huge gap in the plan. A good LPM regimen encourages the evaluation of scope with all stakeholders who have an interest in the successful outcome of the engagement.

Step 3 - Develop Tasks. Task list (or process map) development must be tailored for the specific engagement and can be designed using templates developed by practice groups within the firm. If this resource is not available, attorneys can evaluate historical matters to derive a reliable list of tasks. This is a much simpler process if historical matters utilized phase and task coding rather than block billing. This stage also requires attorneys and the client to identify assumptions which can result in omitted tasks for factual, procedural or strategic assumptions. Clearly communicating these assumptions is a critical element to deriving a reliable value-based fee.

Risks should also be identified at this stage. This is the point at which an engagement moves from being simply a best guess of the hours necessary to complete the engagement to a fee arrangement that provides the client with predictability. The firm and the client must decide who will bear the risks of changes in the engagement. A firm with good historical information regarding past risks and costs related to those risks will be better positioned to provide the client with a fee estimate that mitigates or covers as many risks as possible.

Step 4 - Identify Resources. A reliable estimate can only be derived if the appropriate resources are assigned to the appropriate tasks. Partners should not perform tasks that can be performed by an associate, and associates should not be assigned tasks that are more appropriately performed by a paralegal. This step in the process not only helps identify a reasonable estimate, but also forms the baseline for what tasks timekeepers or staff will perform once the matter is executed.

Step 5 - Develop a Budget. Most budgets are based upon the tasks, the number of hours to complete the tasks and the rate of the resources performing the tasks. This is only an estimate and should be compared against historical matters to confirm the estimate is reasonable. The tasks to be performed should also be shared with the client to provide them with a clear understanding of the nature of the work. Once completed, the budget is now a clear road map for the legal team to follow. Legal team members who historically billed time without constraints now have guidelines for a reasonable amount of time necessary to complete their tasks.

However, law firms should not stop there. A value-based fee requires some assumption of risk. This responsibility is solely on the shoulders of the firm. The client must rely upon the firm's expertise to identify potential risks in like engagements. The firm must first clearly identify and communicate potential risks to the client and then confirm which risks will be assumed in the value-based fee. Firms can only achieve this step if they have good historical information upon which to base the fee. There will be some wins and some losses in this approach, but each matter will add to the firm's organizational assets and enable the firm to improve the fee arrangement on subsequent matters.

Monitoring Performance Against the Value-Based Fee

Clients may want to monitor performance against the budget to evaluate the reasonableness of the fee estimate. An LPM system should include tools to monitor schedules, key milestones, resource allocation and performance against the fee estimate or budget. The collection of this information also enables an LPM system to provide clients, managing attorneys and team members with alerts and automated reports on performance. This is a vast improvement over the standard billing system, which only provides clients with performance metrics on a 30-day window.

An Increase in AFA Volume

Baker Donelson has definitely seen a steady increase in the volume of AFA evaluations since the program began in December 2010. Initially, the evaluation process was more reactive, working only with those attorneys who were aggressively seeking out AFAs. However, as the repository of task lists, budgets and experience has grown, the AFA team has become more proactive with all attorneys within the firm. AFA implementation includes large corporate clients as well as one-off cases for small companies and individuals where they are seeking to cap exposure and legal spending. We envision AFAs will continue to increase and become an even more integral part of the firm's business in the future.

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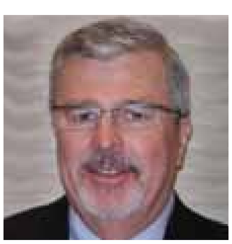

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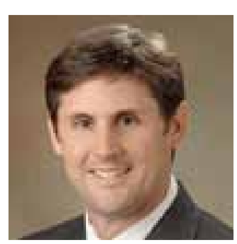

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