

GC

New York

NOVEMBER 14, 2005

IN-HOUSE & OUTSIDE COUNSEL

Beyond The **Billable** Hour

True partnering makes alternative fee arrangements work.

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IN EXPLORING the issue of how in-house and outside counsel can work better together, you can talk about many things. Primarily, it is imperative that the outside attorney create an atmosphere of trust such that in-house counsel believes and, more importantly, knows that he can rely on his outside counsel for all of their mutual client's needs. The outside firm must demonstrate that its lawyers will be there when the client requires legal assistance 24 hours a day seven days a week. Always "being there" for the in-house counsel, therefore, is outside counsel's mandate. One way in which outside counsel can "be there" for the client is to proactively address the ever-growing demands on the in-house counsel to control and minimize the cost of legal services.

The pressure on in-house counsel to reduce costs has never been greater. As a result, in-house counsel have utilized a number of tools that help achieve the goal of cost reduction. Virtually all in-house counsel are looking at different, more efficient ways in which they can provide their services to their internal clients. They are examining the organization of their legal departments, the number of outside law firms to be included on the "approved" list and the nature of the outsourced services that are required. More than ever before long-term relationships with law firms are being scrutinized and there is a greater than ever need to move away from the old way of doing things and strict adherence to the billable hour as a way of charging and paying for legal services. Business as usual is just not good business.

When pitching a new relationship or seeking to expand an existing client's business, virtually every outside firm explains to the in-house counsel that the firm is willing to "partner" with the client to meet the client's legal spending needs. During this dialogue, the in-house counsel laments that the law firm's legal fees and hourly rates are too high and, in response, the outside counsel cries that the pressure to keep the firm's rates down and provide substantial

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discounts is squeezing the profit out of the relationship. Against the backdrop of the active efforts by in-house lawyers to reduce outside counsel fees on the one hand and the pressure on outside counsel to remain profitable on the other, this article explores some alternative billing arrangements that have worked because both sides' needs are met.

True 'Partnering'

The truth is that, traditionally, in-house and outside counsel usually agree upon reduced billing rates or fees discounted by some percentage with neither side being truly satisfied by these options. But true "partnering" in an ideal setting means that both the client and the law firm are satisfied by the agreed upon arrangement. In practice, this is easier said than done, and the in-house counsel and the service provider must be very creative to find ways to do things more efficiently and at a lower cost without compromising the quality of the representation or the law firm's profits. The true evil is the billable

hour, and any way that the client and firm can move away from this form of compensation for services rendered has to be viewed as progress.

The number of potential billing arrangements is limited only by the time, imagination and willingness of the participants. Most importantly, the billing arrangement must be customized to meet the client's needs. Therefore, if outside counsel is proposing a billing alternative, the law firm must know and understand the client's business.

Whether the legal work is transactional in nature or litigation is also important. Different billing alternatives are available in the transactional realm where estimates and/or fixed price options can be utilized. Within the transactional area, distinctions can also be made by discipline. For example, different billing arrangements may be more appropriate in the intellectual property arena than in the real estate context. The litigation area, which is the focus of this article, provides even different opportunities. In litigation, arrangements other than traditional straight hourly billing rates and discounted

hourly rates include: (1) blended rates; (2) bonus based on outcome; (3) contingency fee; (4) flat fee; (5) retainer; and (6) the holdback. This article is not meant to break ground in this area but simply to highlight how these alternative billing arrangements can work successfully for both in-house and outside counsel.

1. Blended Rates: Under this scenario, all of the outside counsel's time, no matter the level of the attorney, is billed at the same hourly rate. Therefore, a partner, counsel or associate will be billed at the same amount. Here, the client pays a lower hourly rate for the law firm's senior lawyers. As a result, the outside counsel is inclined to use more junior lawyers on the project.

The advantage of this system is that the clients will pay a lower hourly rate for more senior attorneys' time. The obvious drawback for the client is that it may be paying more for a junior attorney's time, and because the parties are still using an hours-based system, there may be an incentive for the law firm to work less efficiently. This method generally works best for the parties when the matter is a routine one and does not require complete partner involvement. Combining the blended rate with a performance bonus (described below), is an attractive alternative.

2. Bonus Based on Outcome: In this engagement, at the outset of the case, the client and firm agree to a fee based on reduced, blended or discounted hourly rates. At the conclusion of the matter, the outside counsel is paid a "bonus" or reward based on the objectives that were achieved as defined by the client and firm at the commencement of the engagement and set forth in the retainer agreement. For this alternative to work well, the firm and client must, early on, have a very specific dialogue about the client's objectives.

The benefit of this arrangement is clear. The law firm moves away from concentrating on billable hours and focuses on achieving quickly the results desired by the client. In this model, there must be some risk sharing. Therefore, a law firm should be willing to offer a reduced, discounted or blended hourly rate. It is very likely that this method will incentivize the firm to resolve the matter as quickly as possible. This arrangement works best when the outcome can be accurately predicted. The potential downside of this arrangement is that the law firm may not be able to achieve the predicted outcome or if the law firm achieves the predicted outcome very quickly, the client may believe it has overcompensated the outside counsel.

3. Contingency Fee: This is a variation on the old model. Under this scenario, outside counsel and client agree to pay the law firm reduced, blended or discounted fees or, alternatively, no hourly fees at all

and the law firm agrees to share in a percentage of the recovery. This differs from the bonus system described above in that at the outset of the case the client and law firm agree that the firm will share in a percentage of the recovery and not some other defined objective. This may be strictly a mathematical exercise. In this setting, the law firm may assume most of the risk. As a result, it may make sense to incorporate a blended, reduced or discounted hourly rate and agree that the contingent portion of the fee is a reimbursement of the amount of the fee reduction or discount. In so doing, the risk can be truly shared with the client. Before agreeing to

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this alternative, the law firm should make an educated optimistic assessment of the outcome of the matter.

4. Flat Fee: In this model, at the outset of the case, the in-house counsel and the law firm agree to provide specific services at a set price. In the litigation setting, in-house counsel and the law firm often agree to have the outside counsel perform an "early case assessment" or initial investigation for a specific price. Thereafter, the client and law firm can agree on certain milestones in the litigation. For example, the in-house and outside counsel might agree on what the total cost of discovery should be. They would need to know how many witnesses are to be deposed, how many documents are to be reviewed, etc. Next, they could predict the cost of a motion for summary judgment and agree on the cost for the preparation of that motion.

Here, the fee is not based on hourly rates. This lends certainty to the client's legal costs, and outside counsel is encouraged to work efficiently. Obviously, the law firm is assuming some degree of risk because litigation is by its nature inherently unpredictable. Therefore, there must be a tremendous amount of analysis and discussion up front so that all contingencies are anticipated. Neither the client nor the firm will be served by the tension that will inevitably develop between the client and the firm over the firm's perceived lack of effort on a matter or the deployment of less senior personnel to work on the case. The flat fee scenario could also include the bonus scenario discussed above to ameliorate some of the possible tension.

5. Retainer: One of the themes in this article is to find a way to charge for legal services in a manner other than by the billable hour. Retainers are a way to accomplish this. Under this scenario, the client engages the firm to handle all litigation for an agreed upon price either by matter or by time period. The client agrees to pay the law firm a fixed sum for the law firm's services. The benefit to clients is that they can achieve certainty in their legal costs; the law firm can avoid collection and profitability issues if the firm handles the matter efficiently. There is no question that this method requires an analysis of the potential costs at the outset of the engagement. As the relationship progresses, the in-house and outside counsel will develop a degree of trust indicative of a strong partnership.

6. The Holdback: Under this model, the client and law firm agree that the client will pay the firm's standard rates. Payment of an agreed upon percentage of the fees billed is made after each monthly invoice with the client "holding back" a percentage (e.g., 10 percent) of the fee. At the conclusion of the case, the client and law firm discuss, with the advantage of 20/20 hindsight, how much of the holdback will be paid by the client. Under this scenario, the parties to the agreement have a complete picture of the matter. The client will know whether it was successful in the case, the amount of legal fees it paid and whether it was satisfied with the firm's performance. This model requires an atmosphere of complete trust and is a model of true "partnering."

Conclusion

Although the alternatives outlined above have been around for a number of years, many outside counsel and in-house counsel are still very much tied to the billable hour. As the ground rules of the relationships between law firms and clients continue to change, the ability to "partner" on how legal services are paid for will be critical and in everyone's best interest.

Not all of these scenarios will work in every setting. For example, a law firm will be reluctant to offer these alternatives to a new client or to less sophisticated purchasers of legal services. Similarly, if an in-house counsel has not yet convinced her supervising lawyers of the wisdom of a bonus or reward, that alternative will be unavailable. For any partnership to work, trust, understanding, communication and, often, creativity are critical.

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