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Fees and Billing

Embracing Alternative Billing

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Finding a Win-Win Solution

Hearing the words "alternative billing" often creates spine shivers for lawyers, however, law firm clients and prospects are increasingly inquiring about such fee arrangements. Lawyers need to be prepared for such inquiries and to be able to assess whether an alternative fee structure will more likely than not result in a "win-win" outcome for both the lawyer and the client.

Regardless of the negative connotations which many lawyers often attach to such arrangements, alternative or value based billing does not have to mean that a lawyer is being engaged to perform services at a discount to traditional profit margins. Lawyers and their clients should be able to consider any number of billing arrangements and allocate appropriate amounts of risk and reward so that the arrangement makes sense for all involved. If the relative levels of risk and reward are acceptable to both the provider of the services and the end user, then the proposed billing arrangements should be "commercial" by definition and, accordingly, should make sense for both the lawyer and the client.

Alternative Billing is Not Entirely New

Although there may be a growing interest of clients considering value based billing arrangements as alternatives to the traditional hourly billing arrangements, such arrangements are not entirely new. There are numerous services that lawyers provide that are not traditionally based on hourly billing arrangements, including: plaintiff's personal injury, collections and worker's compensation contingency fees arrangements; percentage based fee arrangements in connection with personal services contracts for athletes, entertainers and authors; flat fee arrangements for simple wills and residential real estate closings; and percentage of deal or enterprise value arrangements in connection with certain unique merger and acquisition, and IPO matters.

Traditional hourly billing arrangements are actually a relatively "modern" phenomenon, becoming the more accepted practice over the course of the last five or six decades (prior to that, value based billing was more the norm). For clients, these arrangements allow for easy review of the billing back-up, and for law firms, the arrangements are helpful when measuring individual attorney productivity in connection with compensation decisions. For these and other reasons, traditional hourly billing will likely continue to be a factor in fee arrangements for the foreseeable future.

However, as clients become more interested in assessing legal fees and services on a value and return basis, alternative fee arrangements will likely continue to grow in popularity. These arrangements often are attractive to clients because they have a greater likelihood of matching a client's perceived value expectations for the engagement with the fee to be charged. For a given service, the lawyer should be able to assess the cost of a service to be provided and, accordingly, determine whether the proposed alternative billing arrangement would work in that situation.

Forms of Alternative Fee Arrangements

There are many forms of alternative fee arrangements. Some such arrangements are preferred by clients because they shift much of the cost risk to the attorney. Examples of such arrangements are capped fee arrangements and contingent fee arrangements. Both capped fee and contingent fee arrangements provide certainty of cost to the client by shifting overage risk and magnitude of the project risk to the lawyer. Capped fees provide for a maximum fee to be agreed upon in advance of the engagement (if the actual fee exceeds the cap, the amount of the excess is written off; if the actual fee is less than the maximum, the client is only responsible for the lesser fee). In the case of a contingency fee, the attorney will only get paid a fee equal to an agreed upon percentage of a recovery. Accordingly, if there is no recovery, or a recovery upon which the agreed upon percentage results in a lower pay-out than the attorney would have otherwise realized if an hourly fee arrangement were used, then the risk to the attorney is that the contingency arrangement will pay less than an hourly fee arrangement.

Another alternative fee arrangement provides for a courtesy or preferred client discount on the firm's traditional hourly rate, or alternatively, a blended rate where the client pays a single hourly rate, regardless of whether a senior or junior attorney is providing the service. These arrangements are less risky to the attorney because, although the profit margins may be smaller, he will be compensated for each hour spent on the matter, and does not run the risk, as with capped fees, that the matter will be more involved than initially projected. In effect, risks are shared between the client and the attorney.

Arguably, the most commercial of the alternative fee arrangements are fixed fee and value billing arrangements. A fixed fee arrangement is similar to a prepared budget in that it is based on what similar matters have historically cost. However, it requires the attorney to stand behind the amount estimated based on the assumptions and other variables associated with the matter in question (which both the client and attorney agree are in play in advance of the engagement). Experience is a terrific tool to predict likely fee outcomes on a given matter. Fees charged for similar matters, as well as the variables that historically have caused fees to be greater than the average fee for similar matters, are both key predictors which can and should be relied upon in order to handicap properly what an appropriate fixed fee might be. The principal risk, borne by the law firm, is whether the cost variables have been prudently considered and factored into the fee. Ideally, from the law firm's perspective, the agreed upon fee will include a buffer so that the attorney can "win" even if the actual time involved is on the high end of the assessed range. The upside of a fixed fee to the client, of course, is certainty of cost. The upside to the attorney is that if the matter proves to be either consistent with the cost assumptions or is more efficiently executed, there is the potential for a better profit margin on that matter.

Value billing similarly treats both the client and attorney as two business persons negotiating at arms length to agree upon a fixed fee, but ties the amounts agreed upon to specific outcomes (so there is some variability depending on the outcome achieved). In these arrangements, in addition to the client having certainty of cost, the interests of both parties are ultimately aligned (the better the outcome or result, the more significant the fee for the lawyer).

There are numerous variations on the themes described above. The variations are really limitless. What they all have in common is that they are not tied into traditional hourly billing, and they share or shift risk between the client and the attorney.

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Both lawyer and client can win with alternative fee arrangements. Such arrangements provide a terrific opportunity for an iterative dialogue between lawyer and client which can result in shared expectations and a better communication channel between the attorney and the client. At the end of the day, it is all about securing fair value for services rendered, and delivering on the client's value expectations. In a world where clients may value certainty of cost more than they traditionally have, alternative fee arrangements can provide such certainty and nonetheless reward the lawyer at a similar or even better profit margin than those enjoyed with more traditional billing arrangements.

One cautionary note: the focus of this article has been on how alternative billing arrangements can work for clients and lawyers; attorneys within law firms must also ultimately navigate how they assess individual attorney productivity for compensation purposes as they shift away from a pure hourly billing fee dynamic as a key indicator of production.

The bottom line is that there is no need to fear alternative fee arrangements. However, like any business arrangement, careful consideration must be given to the specific dynamics of each proposed arrangement so that it can be successfully navigated.

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