

The Sea Change Is Upon Us:
Riding the Alternative Fee Wave

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By: BRUCE H. RAYMOND
Raymond & Bennett, LLC
90 National Drive
Glastonbury, CT 06033
raymond@raymond-bennett.com
(860) 633-0580
www.raymond-bennett.com

BRUCE H. RAYMOND is a founding partner of Raymond & Bennett, LLC, an alternative fee litigation and technology firm based in Connecticut. Attorney Raymond has served as lead counsel in over 1,000 litigated cases in Connecticut, Massachusetts and throughout the United States. He is the founder of the LinkedIn Group Alternative Fee Lawyers and has been nationally recognized for innovative law firm design and creative alternative fee arrangements for clients. He is a former board member of DRI and President of the Connecticut Defense Lawyers Association.

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I. Introduction

*“Full fathom five thy father lies
Of his bones are coral made:
Those pearls that were his eyes:
Nothing of him that doth fade,
But doth suffer a sea change
Into something rich and strange.
Sea-nymphs hourly ring his knell.”*

- William Shakespeare, *The Tempest*, 1610

The phrase “sea change” has its origins in Shakespeare and is defined as: “a profound transformation.” Are you ready for the biggest change in the business of law of your career? Well, it is upon us.

According to a survey conducted by ACC in 2009, 77% of their members would like to consider alternative fee arrangements in work handled by outside counsel. A recently published report indicates that there will be a 50% increase in spending on non-hourly billable arrangements this year. Further, the discussion of alternative fee arrangements has moved from obscure legal publications to mainstream business media. In recent publications, *Fortune* magazine, *The Wall Street Journal*, and *The New York Times* have each covered the movement towards alternative fee arrangements in the law business.

Yes, AFAs (alternative fee arrangements) are here to stay. Although the rumors of the imminent death of the billable hour may have been exaggerated in recent years, there is no question that we are in the midst of the greatest change in law since the invention of the billable hour. Whether you are an inhouse attorney answering to the internal client, or a private outside counsel who desires to run a profitable law practice, all of us in the law profession will be addressing significant change in our relationships with our clients and in the way we do business.

If you are a client – one who hires and manages lawyers, chances are pretty good that you are under intense pressure to cut costs and improve performance. Evidence of the directives inside companies to reduce legal spend is everywhere.

If you are a private, outside lawyer looking to maintain profitability, or even grow your business in today’s changing environment, you had better learn all you can about AFAs and how to best harness this movement to the benefit of your law practice.

II. Step 1: Change The Way We Work

A. Advice For Outside Law Firms.

1. Digitize your documents.

Yes, that means going paperless. If you have not already digitized your law operation, you need to get it done – yesterday. The days when a lawyer could say “I’m technologically challenged” and get away with it are gone.

Today, if you are not digital, what you are saying to your clients is: “I am a cave man. I know that I should be using currently available, inexpensive technology to create, store, and work with documents in electronic form, but I choose not to do so.” Few lawyers desire to make such a proclamation to their existing and potential clients. Lawyers who do not intend to make this type of proclamation should take bold, immediate action.

“Going digital” must include full text searchability of all documents, in all files, across all functions within the law firm. Storing electronic images of paper documents which are not fully text searchable achieves very little. There are many ways to achieve the efficiency of full text searchability. You can do it in-house by using a scanner with OCR (optical character recognition) software and have your staff e-file the documents, or you can outsource it.

This single step – digitizing your documents and rendering them fully text searchable establishes the critical foundation for all other best practices for law firm efficiency.

The main reason I hear people give for not going digital is: “We cannot make the expenditure right now.” This, in a word, is nonsense. The ROI (return on investment) for going paperless is well documented in business literature. The real world has taught us some important lessons concerning the cost of remaining stuck in the less efficient paper world.

For instance, it costs \$25,000.00 to fill and maintain a four-drawer filing cabinet. Finding and replacing a misfiled document costs about \$220.00 per document. Storing paper files in commercial space uses up about 12 square feet of space. If you multiply the number of file cabinets in your space by 12 square feet and multiply the square footage by your rent, you will quickly achieve a hard number you can get your arms around. If you want to see the effect of this over time, multiply this number by 10 to reflect your costs over the next decade, even if you do not add any additional paper files in your office.

If you further add staff time to retrieve and replace paper documents each time the document is reviewed by any member of the law firm staff, you can easily see the “hidden” cost of paper.

It is a well established business rule that if your competition is using a chain saw to cut wood, it is time to upgrade from a hand saw if you want to stay in the game.

2. Learn to work electronically.

This takes commitment and discipline. The longer you have been in practice (the older you are?) the harder it is to change from working with paper to working electronically. Start by using the basic annotation tools in common programs you are likely familiar with such as Microsoft Word and Adobe PDF.

If you are not working this way already, you will be surprised to see how quickly you can learn, especially if someone who knows the ropes of working digitally serves as your coach. If you must hand write in order to compose briefs or letters, consider getting a tablet PC which you can write on like paper, or simply scan your handwritten paper documents with some key term text added to facilitate searching and locating the documents after it is e-filed.

3. Use all-in-one software designed for law firms.

If your firm uses many different programs for document management, billing, marketing, etc., consider consolidating all law office functions to one of the many available all-in-one software suites that combine all law office functions to a single interface. Not only is it easier for everyone in your organization to learn how to use the software, but getting your back office functions together with your front office matter management can have magical effects on efficiency and staying on budget which is increasingly important to law firm profitability.

4. Reengineer your staffing – make it scalable, use “just-in-time” cost controls.

Another area for lowering costs and improving profits for law firms is in support staffing. An experienced legal secretary may cost between \$40,000 and \$100,000 when salary, overhead and overtime pay are considered. Law firms desiring to improve profitability should consider outsourcing basic word processing and document management which can be done efficiently, inexpensively and securely.

I do not mean traditional off-shoring where your work is done by unknown persons in third world countries. Few law firms are willing to accept this risk for such core operational functions with materials which are often proprietary and privileged. There presently exist many U.S.-based, law-only companies which can provide excellent service at a low cost for word processing and document management functions. Your key forms such as letterhead and pleading styles are kept on hand and digital sounds files are uploaded to a secure web site for processing. Your completed documents are e-mailed back to you within a few hours.

More importantly, this resource may be scaled to fit the peaks and valleys in your word processing demands without the need to carry the full overhead. There is no reason why law firms cannot employ some “just-in-time” best practices and design in some scalability into law firm operations.

For example, during a large trial there may often be a need for considerable extra secretarial support to generate motions and other documents. Further, much of this work may need to get done after hours and on weekends. Adding substantial amounts of overtime to meet this peak need is not the most efficient or lowest cost way to work.

This is where an outside partner may assist the law firm to inexpensively address a client's need without carrying unneeded extra overhead on a permanent basis. There are many other examples of this type of technique which can be deployed throughout a law firm's operations to improve efficiencies.

5. Reengineer your law firm organization and structure.

Law firms have made some changes to their structures but the changes have been slow and are more reactive and defensive than proactive and forward looking. Changing equity partner track and having fewer owners of law firms only addresses a small part of the problem. Even if your law firm is not one of those which starts new lawyers out of law school in the high \$100's or above, the client's perception of law firms carrying too much overhead and failing to adapt to modern business practices is likely a fair criticism across our profession. Some forward looking law firm leaders have effected what can only be described as a radical change.

Virtual law firms – those with no brick-and-mortar overhead not only exist, but are thriving. For example, take a look at the Axiom Law Firm. <http://www.axiomlegal.com/> It has hundreds of lawyers and works with some pretty big clients of the class any law firm would want to work with. Their lawyers work inhouse at the client's location, or from a home-based office. The firms' annual revenues are up into the tens of millions of dollars. Some of the best academically pedigreed lawyers in the business work there and the principals of this firm have been rewarded for their creative approach to solving unique client problems through a nontraditional means.

Another successful non-brick-and-mortar law firm is Virtual Law Partners or VLP. A short visit to this firm's web site will give you a feel for their innovative methods and spirit. <http://www.virtuallawpartners.com/> This law firm focuses on transactional work and has no brick-and-mortar offices. It has been successful in growing to a significant size and handles substantial matters.

These examples are offered to illustrate the type of creativity that is emerging in the legal marketplace even within our most change-resistant profession. I call your attention to the marketplace reaction to good ideas designed to meet specific client needs. Even if you are not ready to do away with your brick-and-mortar office, considering the radical reengineering these law firms have done may give you ideas that could work well for your firm and your client base as your firm looks to the future. Our firm has a hybrid setup with a mix of brick-and-mortar and virtual associates. <http://www.raymond-bennett.com/>

These examples of outside the box law firm engineers are enabled by the digital nature of law practice today. As long as all documents are digital, any size law firm can blend in some non-brick-and-mortar staffing of attorneys, paralegals and support staff at lower overhead to increase profits and lower costs.

B. Advice For In-House Counsel

1. Check under the hood! Hire digital law firms which leverage technology to reduce costs.

If you are like more companies today, most of your legal spend is still based on hourly billing. If you are paying your outside law firm by the hour to do your legal work, it is imperative that you “check under the hood”. See if your law firm business partners are running a 10 cylinder gas guzzler, or a finely-tuned hybrid engine. There are many law firms that are talking about alternative fee arrangements, but few of them are really designed and set up to successfully execute on these plans. This point cannot be over emphasized.

Let’s take a typical example which may occur in any type of matter. If you have 10,000 pages of documents (a very conservative example) in your outside counsel’s file which need to be read, annotated, summarized and reexamined as new facts and issues arising during the life of a matter, why would you want to pay for a traditional paper process? A digital law firm can search 10,000 pages of documents for a new name or term that just unexpectedly became important in less than a minute. A traditional paper operation will charge many hours of time and will have a higher error rate on completion of this task. It seems plain that no client should pay more for less reliable work.

The take away here is: inhouse attorneys responsible for selecting and managing outside counsel should decide on reasonable minimum requirements for technology as part of your law firm selection and retention process.

2. Consider cloud computing and litigation management collaboration tools.

So a brand new, state-of-the-art litigation management system is not in your budget? In addition to the many established options for electronic billing and bench marking software which are increasingly used by companies to manage the billing side of law practice, new products are available to help manage litigation and other types of outside legal work. These products reside outside your company’s IT infrastructure, secure servers thus the phrase “cloud computing”.

The advantages of this approach to collaboration are many. First, the systems are often paid for by your outside law firm partners on a percentage of legal fees basis as is much of the market for electronic billing software. Since there is little internal cost, and since the programs may be accessed through secure internet connections as opposed to residing within your internal system, you may start working digitally in a very short time at low cost. If you can keep your finance people, IT people and procurement folks all satisfied, then blending in cloud computing matter management and collaboration software may get implemented without the typical delays and barriers.

These programs allow you to mine your data on matter management and remove the need for most phone calls or e-mails to outside counsel to check on routine status. You simply log into the collaboration software and are able to obtain information concerning upcoming case events, status of performed work versus budget, and other important information. This saves time and also reduces the amount of charges no matter how the billing arrangement is set up. This technology can replace the reliance by inhouse

attorneys upon several law firm extranets which may vary among the outside firms you work with. For your outside partners that do not utilize extranets, then this will be a total value add.

This software enables you to do some game changing analysis such as: Tracking success rates with a particular ADR professional within a certain jurisdiction, or examining the delta between the initial demand and the take number on cases settled with a particular high volume plaintiff lawyer. You may wind up learning more from data mining about the outside plaintiff's lawyer than he or she knows about their own patterns in this settling cases.

Through these two examples, you can readily imagine many other data points that this type of collaboration tool and data mining could permit.

3. Try some hybrid arrangements with your outside counsel.

Many inhouse or staff counsel take an all-or-nothing approach on work assignments to outside law firm partners. Look for opportunities to take hybrid approaches to blend appropriate resources for a matter. As one example, many insurance companies limit use of staff counsel to save costs for smaller cases or matters where there is no excess exposure above the policy limits of an insured defendant. For larger cases, it may be appropriate to hire an outside senior attorney to prepare a case strategy and to take expert depositions, but staff attorneys may perform legal research and address discovery issues.

There are many ways to use technology to blend resources among different law firms for a matter, or to blend an appropriate team to get the job done using a combination of inhouse and outside law firm attorneys in the same matter.

4. Be willing to share some numbers.

A current best practice involves a higher level of trust and sharing of internal data concerning legal spend in order to facilitate improvements. Inhouse attorneys should consider disclosing, under a confidentiality agreement, enough information about the company's legal spend in certain areas to allow creative law firms to make proposals that can improve your performance including reducing your costs. It's not just outside lawyers who advocate this approach. The Association of Corporate Counsel (ACC) Value Challenge materials are available on their web site <http://www.acc.com/valuechallenge/index.cfm> and advocate a more open dialogue and sharing of information as a great means to the end of achieving a "win-win" result. This may be a significant departure from your past practices, but can lead to insightful input from your outside counsel who should be genuinely motivated to lower your costs if possible and earn a greater share of your assigned work in the process.

III. Change the Way Lawyers Get Paid For Their Work

Now that we have underscored the importance of changing the way law gets done to make it more efficient, we can address some alternative fee arrangements currently in use by lawyers and their clients. The emphasis here should be on two related elements:

- (1) An alternative fee should have a risk/reward element, the so-called “skin in the game” for the outside lawyer and;
- (2) If the lawyer is successful in delivering value, the lawyer should be paid more.

Since there are many more detailed discussions concerning particular alternative fee arrangements in these course materials, I will mention just two to introduce some specifics to this discussion.

1. The guaranteed phase budget, or fixed fee per phase model.

Under this model, the lawyer and the client work together to define goals for the engagement. Success is defined and the scope of work for an initial set of tasks is identified. The lawyer submits, and the client approves, a fixed budget for the base work and the lawyer and the client also agree on a success fee if the client’s result is obtained and the cost is at, or below budget.

This is an improvement over hourly billing, but does not require extreme risk on either side. This model can be suitable for larger matters which are less predictable so that adjustments can be made as the matter progresses and additional details concerning the scope of needed work are learned. This approach may also be appropriate for more predictable work such as a 50-state survey on a regulatory issue.

2. The retainer model for portfolio. or line of business work.

This is a more radical departure from traditional hourly billing and requires a certain volume of work for it to work well for both sides. Under this model, a company may award a qualified law firm all of their work in a particular state or market for a fixed annual fee. That number is divided by 12 and the law firm does all the work for one monthly price. The key to making this AFA a success is a willingness on both sides to share some numbers. The client gets predictability in its base cost, and the law firm gets guaranteed cash flow and can identify and dedicate a certain level of staffing and resources to do the job well.

Like other successful AFAs, specific goals and metrics should be applied to define success and reward delivered value to the client.

IV. Conclusion

The discussion of the death of the billable hour may have been exaggerated but the volume of the discussion has been amped up from a whisper to a roar. In this sea change which is upon us, great opportunities exist for law firm profitability and improvements in overall legal spend by our clients. The challenge is for law firms and clients to find the rights ways to work together to change the way law gets done and the way lawyers get paid for their work so that we can achieve a “win-win.”