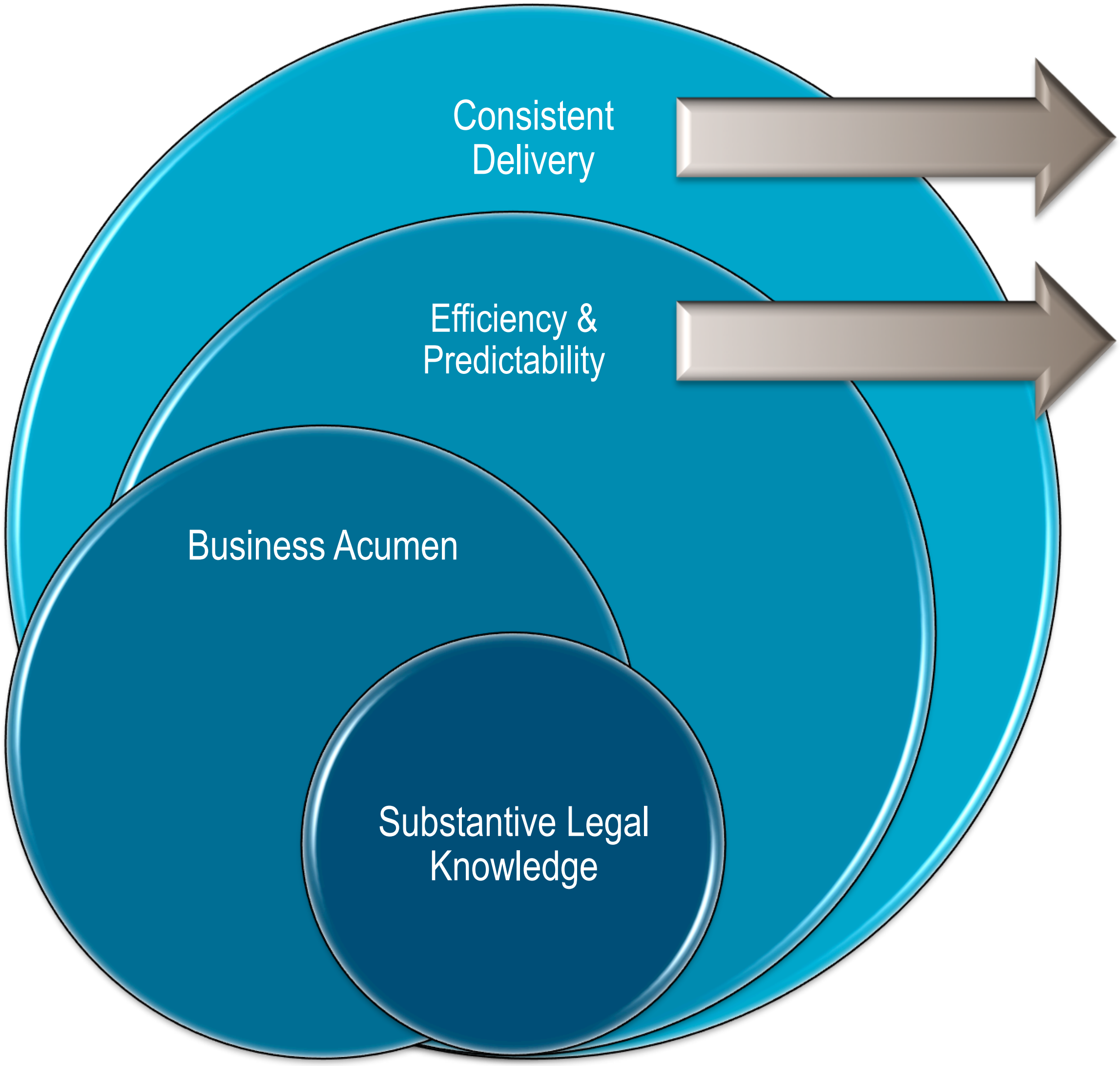
Implementing Value-Based Fees
Practical Advice and a Chance to Practice

Lisa Damon (Seyfarth Shaw)
Steven Greenspan (UTC)
Kathy Kirmayer (AAR)
… and a host of facilitators

Evolving Definition of Success



Drives Need for Project & Process Management

Maturing expectations of internal clients

+ Cost reduction pressures

+ Internalizing work

+ Unbundling legal services

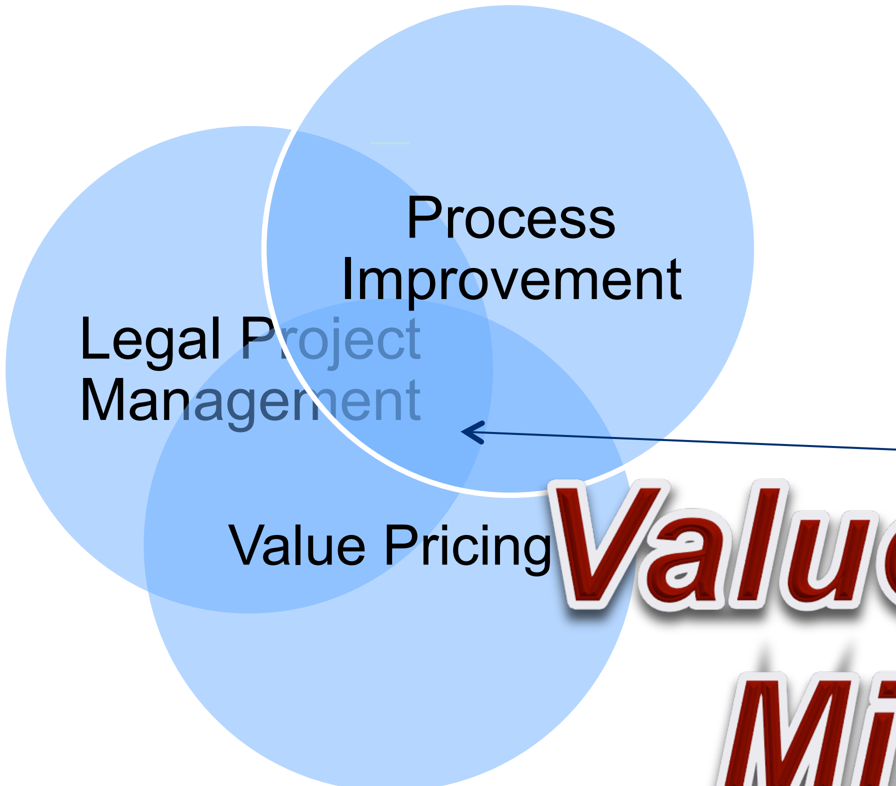
+ Multiple players involved

+ Outside Counsel no longer the General Contractor

= **Law Departments taking a leading role to provide direction, continuity and coordination**

Source: Huron Legal

Getting to Better Outcomes, Faster Cycle Times, Lower Spend



Value: Yours Mine, or Ours?

Value Based Billing
Principles and Structures

VBB Agenda

1. What?
2. Why?
3. How?
4. When?
5. Why Not?

What **is value-based billing?**

Any fee arrangement in which you …

…pay for results, not effort.
(usually abandons rate x hours)

(examples to come)

Focus on "value"

How important is this matter to the business compared to other matters?

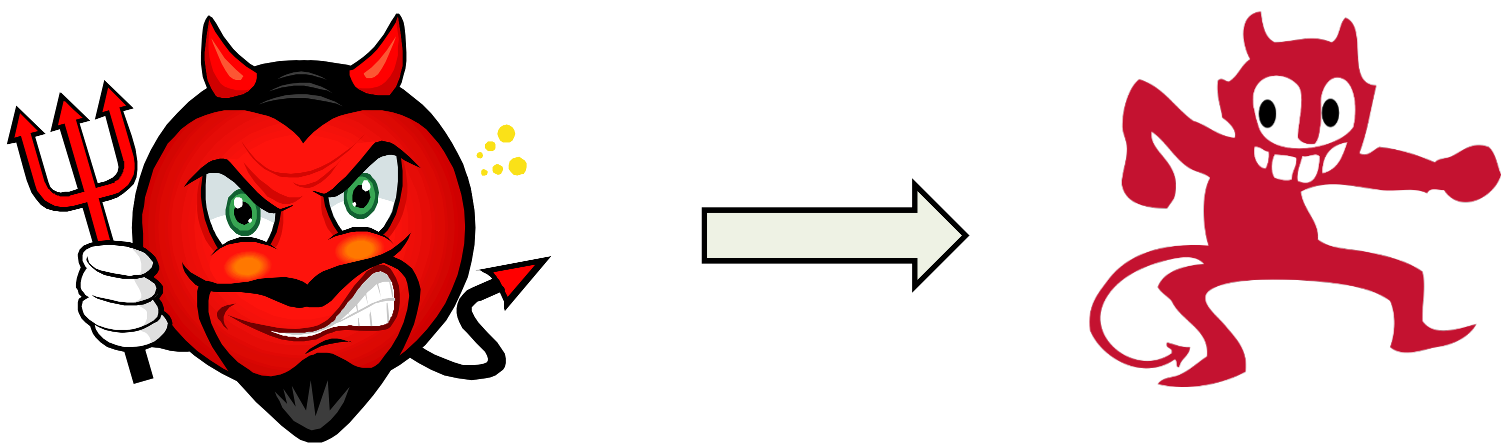
What impact could outcome have on business?

What are the business risks or potential benefits associated with the matter?

<u>Cost</u> **to provide the service** is one consideration, but not only consideration

What is ***not*** value-based billing?

- Rate discounts (incl. volume discounts)
- Blended rates
- Not-to-exceed fee caps
- Mere budgets



"I bargained for really low hourly rates… …why are my bills still so high…!?"

Efficiency **Risk**

QUICK QUIZ

Q: When is a flat fee really <u>not</u> a value-based fee?

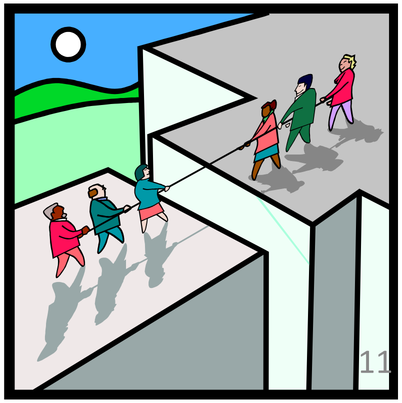
A: When it is calculated based exclusively on predicted SVOT.

Why value-based billing?

A means to a means to some really good ends.

VBB requires…

identification and
alignment of interests…

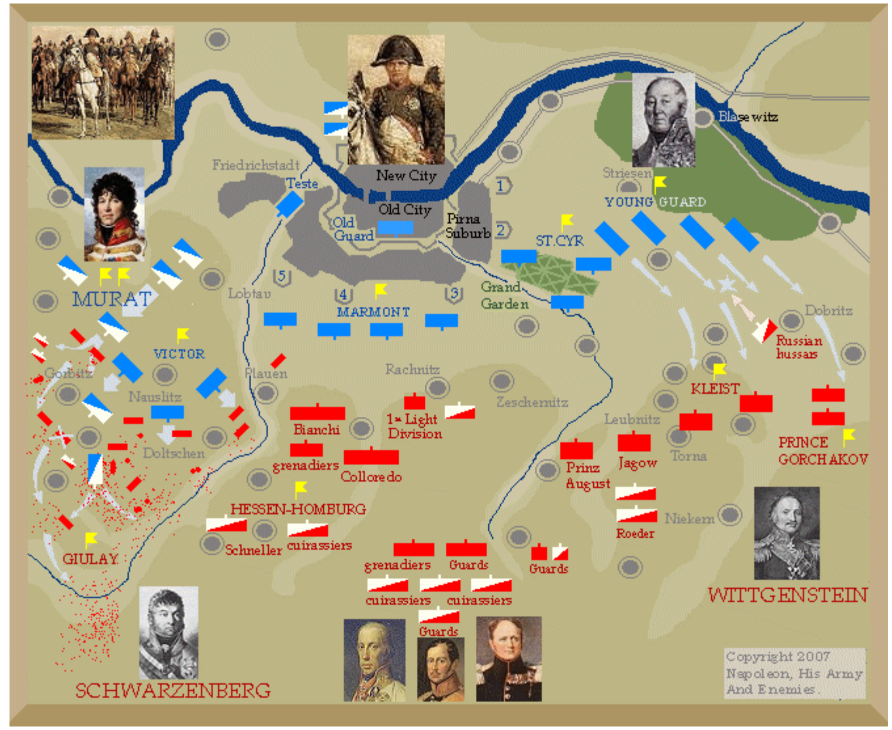


Alignment of interests leads to…

1. Results that match true goals = ***better results.***
2. Incentives to increase efficiency & improve processes = ***sustainable reduction in spend.***
3. ***Risk-sharing***
4. ***Improved relationship***
   – Reduced stress
   – Better-directed management time
   – Increased/deeper partnership

Where does risk fit?

Old World



Friedrichstadt
Teste
New City
Old City
Old Guard
Pirna Suburb
Blasewitz
Striesen
YOUNG GUARD
ST.CYR
Grand Garden
MURAT
Lobtau
MARMONT
VICTOR
Plauen
Racknitz
Dobritz
Russian hussars
KLEIST
Leubnitz
Torna
PRINCE GORCHAKOV
Bianchi
1st Light Division
grenadiers
Colloredo
Prinz August
Jagow
HESSEN-HOMBURG
Schneller
cuirassiers
Nickern
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GIULAY
grenadiers
Guards
cuirassiers
cuirassiers
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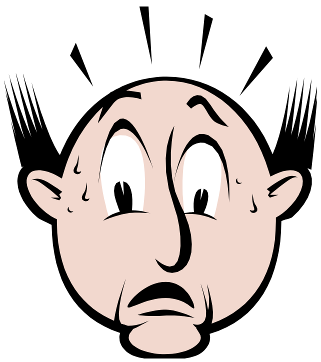
New World-
Risk Judo

- Use risk-sharing to achieve alignment
- ***Conscious and explicit*** outcome and cost risk allocation
  - Identify risks
    - Who defines?
  - Identify options
  - *Make choices and allocate risks.*
  - Then price accordingly.
  - Commit to stand by choice.

[Why] is "why" still a question?

- It Ain't Broke.
  - Don't mess with success…2d guessing…support from The Top…?
- We Here At [x] Don't Do VBB.
  - My law firms hate it/never raise it/won't do it.
- How to define success…no "should cost" data…?
- Bad first-date experiences*
- Lack of training or tools (models, templates, how-to's)
- No time

…and…..



[Why] is "why" still a question?

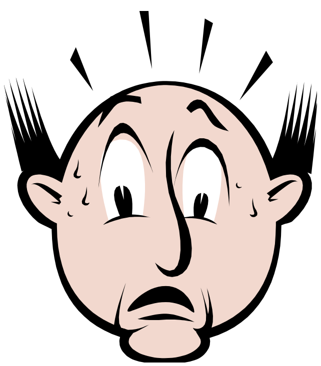
"VBB may be fine for commodity work, but *my matter* is too…

…unpredictable

…complicated

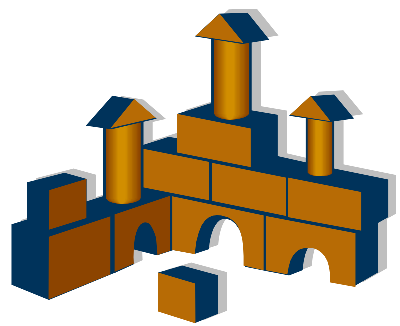
…important and risky

…unique."



HOW??

VBB Structures
(and real world examples)



1. Flat Fees

- For time period (e.g., month)*
- For scope (phase**)
- For life of matter
- For portfolio of like matters (over time; for LOM)
- For broader portfolio***

How Do You Get to the "Right" Flat Fee

- Historical hourly rate data
- Specific task-based fee buildup
- Historical case volume
- Litigation risk portfolio
- Demand cost savings as product of law firm experience and efficiencies
- "Success" fee component - creative measures of success
- Buyer's market – don't be reluctant to demand better value.
- Law firm profits are driven by efficiency and project management

Flat Fee Example

Annual Fee for Commercial Litigation Portfolio:

- Flat fee of $12M for all U.S. litigation cases for a Fortune 500 company

  - Client began as an hourly client and moved into a flat fee model once a baseline had been developed
  - Docket varies with new cases added and other cases resolved
  - Flat fee amount changes annually (on a prospective basis only) to account for the anticipated case load for the coming year
  - Client pays the fee at $1M per month – set monthly payment serves both in-house budgeting needs and law firm cash flow

Flat Fees
Managing Common Pitfalls

Pitfalls	**Remedies**
OC gets "quick win"	Provide for collars and shared savings; use portfolio
OC mis-budgets and works too much "for free"	Break fees into phases; apply analytics to budgets; build data; use portfolio
Parties "mis-scope" project	Establish regular check-ins to monitor scope; front-end competitions to get different views on scoping
OC staffs with cheaper timekeepers; client doesn't get senior partner attention	Use holdback and/or success fees; incorporate staffing plan into project and have reporting against plan
OC overworks to justify higher flat fee	Get new OC

2. Budgets+Collars
(aka flat fees with training wheels)

Fee = $100,000

If $85,000 - SVOT - $115,000 = no adjustment

If SVOT < $85,000, law firm refunds 75% of $ between SVOT and $85,000

If SVOT > $115,000, client pays 75% of the $ between $115,000 and SVOT

Budget+Collars

Why: Material variances in expected fee are not always product of inefficiencies, but often can be product of truly unexpected tasks.

Pro: Some risk, some protection

- If work within expected zone, efficiencies rewarded; inefficiencies penalized
- Windfalls and disasters avoided

Con: Requires shadow billing

- What is lawfirm's incentive? What will next fee be?
- Removes some major bonuses of VBB (no hourly bills to prepare and review! No unexpected bills!)

Budget + Collars Example

Annual Fee for Litigation Claims Work:

- Target Budget of $5M for one year
  - Based on two year history of hourly billing, and projected work.
  - The budget fee is $5M unless the tracking fees at the client's rates are less than 90% of $5M ($4.5M) or exceed 110% of $5M ($5.5M)
    - 75% of savings below 90% returned to client; overruns above the 110% level paid by client at 75% of client's rates
    - Example 1 Savings Scenario: SVOT-based fees are $4.0M. Firm returns to client $375,000.
    - Example 2 Overrun Scenario: SVOT-based fees are $6.0M. Client pays firm a total of $5.125 million (half of overrun above collar)

3. Performance Holdbacks

- Client or OC ***holds*** funds in reserve to ***grade*** law firm's performance
- Only partially a success-based payment (or not at all)
- Explicitly linked to client satisfaction with OC's overall performance:

e.g.:

- Final resolution of case
- Accuracy of budget
- Achievement of case objectives on time/under budget
- Communications performance
- Right staffing performance – right level; right team; compliance with client goals (e.g., diversity; development of vertical client team)
- Value added services – CLEs; pro-active risk and cost reduction opportunities

Holdback Example

- Flat fee for all pre-trial proceedings of $2.4M, to be paid at monthly rate of $100,000 over 24 months. $25,000 of each monthly fee retained by client as "holdback." If case resolved by settlement before trial, law firm paid multiples of the holdback balance, based on certain established targets.
- Flat fee deal with client provided for payment of 90% of agreed fees for 12 month period for class action case, with 10% holdback payable based solely in client's discretion.
- These VBB arrangements can be used for plaintiff or defendant.

4. Flat fees with success awards

- Identify multiple victories, large and small, possible throughout life of matter
- Not all are case-ending
  - Desired schedule
  - Discovery limit (e.g., no APEX dep)
  - Reduction in damages claimed
- Reward counsel for achieving victories
- Reduce upside on flat fee
- Flat fee alone vs. flat fee with victories

Flat Fee plus Success Example

Antitrust defense:

1. Flat fee of $X for MTD
   - Set at 50% of average price
2. Plus success fee of additional $X + 10% of 2X if MTD wins
   - Results in premium of 110% of average price
3. Flat fee of $Y for SJ
4. Plus success fee of $Y plus 30% of 2Y if SJ wins
   - Results in premium of 130% of average price, less loss at MTD phase

5. Contingent Fees

- Explicitly links OC compensation to outcome
  - Full contingent fee or reduced flat fee coupled with contingent fee
  - May include total cap on recovery varying at stage of "success"
  - Can be used as "reverse" contingency for defense work
- Ultimate "value" based fee
- Companies in a strong financial position generally not interested in pure contingency fees as a plaintiff – goal of VBB is to drive efficiency, not to shift upside value of recovery.

Why Not?

What are the limitations on your ability to implement VBBs?

Questions?

For a deeper dive

ACC Legal Service Management Workshop

www.acc.com/legalservicemanagement

Project Management
Process Improvement
Value-Based Fees
Change Management