Crafting Effective, Ethical Client Relationships and Fee Structures That Deliver Value

By: Steve Lauer

The phrase "do more with less" has never rung truer than today for lawyers who represent organizations, whether they practice in law firms or in law departments. Every organization looks to maximize the value that it realizes from its expenditure on legal services whether that be for its in-house counsel or its external lawyers. Meanwhile, lawyers are still challenged with complying with their ethical obligations around how they structure fees, how they structure the scope of their representation, and how they represent to clients the value that they add.

Specifically, ABA Model Rule 1.1 requires that lawyers competently provide counsel; and, Rule 1.2 defines the parameters within which lawyers must work when defining the scope of representation. ABA Model Rule 1.5 provides that lawyers may not charge unreasonable fees yet acknowledges that lawyers should consider the value they are providing which includes the knowledge and experience a lawyer brings to the representation. Further Rule 1.5 does permit lawyers to take into account when agreeing on a fee the fact that a lawyer will not work on other matters as a result of the representation.

In addition to these standards, lawyers must also consider how they communicate their value. For example, ABA Model Rule 7.1 prohibits any statements about legal services that may be false or misleading to a client, even if only by omission. And, ABA Model Rule 7.4 directs that generally, unless practicing patent or admirality law, a lawyer may not represent themselves as a "specialist" but, may indicate their areas of practices.

The pressure from clients to maximize the value of legal services, along with the mandates of the Rules of Professional Responsibility, place lawyers, both in-house and external, in the challenging position of providing exceptional, valuable legal services for a fee that reflects that value yet complies with ethical obligations around competency, scope of representations; and communicating about lawyers’ capabilities.

For example, if a company has an in-house law department, of course, the primary responsibility to wring the most value from the company's legal budget (not to mention the cost of the in-house law department itself) falls on the in-house lawyers as part of their mandate to manage the organization's legal affairs. This challenge becomes even greater for a corporate compliance program. Those responsible for that program must balance the company's need for a program that meets the expectations of regulators that the program include sufficient resources as defined in the Sentencing Guidelines for Organizational Defendants and other operative regulatory regimes with the need to achieve the maximum benefit for the organization at the lowest cost. Successfully balancing those two imperatives, which can seem incompatible, requires careful selection and application of the resources most appropriate for the tasks at hand.

But, it also challenges a lawyer’s compliance with their ethical obligations. For example, organizational clients press lawyers to provide guidance or draft opinions that may assure the client it need not undertake what may be costly and time-consuming measures to comply with the law. Organizational clients may insist that lawyers not spend time that the lawyers believe is necessary to develop a corporate compliance program. Or, an external lawyer may have an organizational client that carves out only a small piece of legal work, keeping the remaining work to be done on the program in-house. This lack of context may challenge the external lawyer to fully appreciate all factors that may impact their counsel.

With the renewed emphasis in organizations on increasing the value that they realize from their efforts in the legal and compliance arenas, how can internal personnel focus their efforts in that regard? What tools exist that can assist them in that endeavor? And, how do both in-house attorneys and their external counsel, accomplish the clients’ objectives, to include managing costs, while complying with their ethical obligations in this setting?

From an operations perspective, though one can find a definition of "value" easily enough, applying that definition to what law firms, law departments and compliance departments do every day has remained a somewhat quixotic exercise. Those departments manage an intangible in pursuit of similarly ephemeral goals, such as the absence of legal or compliance risks.

The Association of Corporate Counsel launched the ACC Value Challenge in 2008 to reconnect value and cost of
legal service. While that initiative has highlighted discrete examples of greater value achieved by individual law departments and law firms, it has not yet led to the emergence of an accepted definition of what value means. The absence of such a definition has limited the impact of that effort.

Similarly, attorneys struggle to define the scope of representation and to provide competent legal advice when pressured by clients to provide “valuable” services within a client-created framework designed to control legal cost. A client’s efforts to control costs may result in limiting a lawyer’s authority to spend time the lawyer believes is necessary to fully evaluate a problem and then to provide competent counsel while receiving adequate compensation for their time, experience, and counsel.

Accordingly, it is vital for the legal profession to explore how "value” can be examined and applied in a more utilitarian way. As part of this, it is important to define and recognize that "value" (as it applies to legal services) varies in a number of ways, depending on the organization and people involved, the context in which the service is provided and other factors. That recognition enables a focus on subsidiary qualities of the legal service that are "value-related qualities" or VRQs that are effective at defining a certainty of delivery and establishing metrics, both of which matter a great deal in the effort to increase the overall value of the service.

Since "value" relates to the entire range of legal services and its delivery, a discussion on value cannot occur without considering the ethical mandates for fee arrangements as defined in ABA Model Rule 1.5; the solicitation and use of clients' perspectives on the scope of services, including the requirement that a lawyer provide competent legal representation (ABA Model Rule 1.1); the requirement that a lawyer and client define the scope of representation (ABA Model Rule 1.2). However, in addition to this, a lawyer both in-house and external should also consider value by evaluating its internal processes as well as clearly communicating their value to clients consistent with ethical obligations.

VRQs can be applied in the context of planning the delivery of legal services (both project planning and strategic planning) in order to achieve more efficient and more effective delivery of the legal service that best addresses the client's need while adhering to the rules of professional conduct. VRQs enable the selection and use of the resource best positioned to achieve the result needed by the client. Finally, VRQs can lead to better relationships between outside counsel and their organizational clients and how the approach that they encapsulate can benefit both in-house and outside counsel and their ethical obligations.
The Value of Legal Services
Best Practices in Providing the Corporate Client The Value It Demands While Abiding By the Rules of Professional Conduct

ABA Business Law Section
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1. THIS IS NOT LEGAL ADVICE – CONSULT WITH AN ATTORNEY FOR LEGAL ADVICE
2. EACH JURISDICTION HAS ITS OWN RULES OF ETHICS
3. DC RULES WILL BE DISCUSSED HERE – THEY ARE NOT UNIVERSALLY APPLICABLE
4. THE ABA STANDARDS ARE JUST THAT SO ARE NOT RULES
Introduction
“Without question, the most basic job of the general counsel (GC) is to determine what is the law and to help shape messages, systems, and processes so that the corporation is compliant and avoids legal risk all across the globe.”

“[The CEO, board of directors, and senior executives] must expect the GC to be a lawyer-statesman who is concerned with not just the question of what is legal but with the ultimate question of what is “right” as seen through the lenses of performance, integrity, and risk.”

Select
D.C. Bar Rules of Professional Conduct
Rule 1.1: Competence

Competence requires a lawyer to:
• provide competent representation to a client
• serve a client with skill and care commensurate with that generally afforded to clients by other lawyers in similar matters.

Competence representation:
Requires the legal knowledge, skill, thoroughness, and preparation reasonably necessary for the representation.
A lawyer’s fee shall be reasonable.  
• Factors when considering whether fees are reasonable:  
  • The time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;  
  • The likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;  
  • The fee customarily charged in the locality for similar legal services  
  • The amount involved and the results obtained  
  • The limitations imposed by the client or by the circumstances;  
  • The nature and length of the professional relationship with the client;  
  • The experience, reputation, and ability of the lawyer or lawyers performing the services; and  
  • Whether the fee is fixed or contingent.
• A fee may be contingent on the outcome of the matter for which the service is rendered, unless a criminal matter or otherwise prohibited by law.
• Contingent fee agreement must:
  • Be in writing
  • State the method by which the fee is to be determined, including the percentage or percentages that accrue to the lawyer in the event of settlement, trial, or appeal, litigation
  • State the expenses to be deducted from the recovery, when expenses will be deducted and whether client is liable for expenses regardless of the outcome
• At the conclusion of a contingent fee matter the lawyer must provide the client with a written statement stating the outcome, and showing the remittance to the client and the method used to determine the amount remitted
Rule 1.6: Attorney-Client Privilege

A lawyer shall not knowingly reveal a client’s confidence or secret

A lawyer may reveal to the extent reasonably necessary:

- to prevent a criminal act that the lawyer reasonably believes is likely to result in death or substantial bodily harm absent disclosure of the client’s secrets or confidences by the lawyer; or
- to prevent the bribery or intimidation of persons involved in proceedings before a tribunal if the lawyer reasonably believes that such acts are likely to result absent disclosure of the client’s confidences or secrets by the lawyer.
When a lawyer reasonably believes a client has used or is using a lawyer’s services to further a crime or fraud, the lawyer may reveal client confidences and secrets, to the extent reasonably necessary:

- to prevent the client from committing the crime or fraud if it is reasonably certain to result in substantial injury to the financial interests or property of another; or
- to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client’s commission of the crime or fraud.
Rule: 1.12: Scope

A lawyer must:
• Abide by a client’s decisions concerning the objectives of representation
• Consult with the client as to the means to be pursued to meet the objective.
• Abide by a client’s decision whether to accept settlement
• Not counsel a client to engage in, or to assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct and may counsel or assist a client to make a good-faith effort to determine the validity, scope, meaning, or application of the law.
• Consult with the client regarding the limitations on the lawyer’s conduct when the lawyer knows that a client expects assistance not permitted by the Rules of Professional Conduct or other law

A lawyer may:
• Take such action on behalf of the client as is impliedly authorized to carry out the representation.
• Limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent.
Rule 1.13: Organization as Client

If a lawyer **knows:**
- An officer, employee, or other person associated with the organization
- Is engaged in action, intends to act, or refuses to act that violates a “legal obligation”
- It is reasonable the act or omission may be imputed to the organization
- Is likely to result in substantial injury to the organization

The lawyer shall proceed as is reasonably necessary in the best interest of the organization to include going to highest authority in organization.
**Rule: 1.16: Terminating Representation**

A lawyer **shall not** represent a client if:
It will result in violating the Rules of Professional Conduct or other law

A lawyer **may withdraw** if:
- The client persists in a course of action involving the lawyer’s services that the lawyer reasonably believes is criminal or fraudulent;
- The client has used the lawyer’s services to perpetrate a crime or fraud;
- The client fails substantially to fulfill an obligation to the lawyer regarding the lawyer’s services and has been given reasonable warning that the lawyer will withdraw unless the obligation is fulfilled
In representing a client, a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social, and political factors, that may be relevant to the client’s situation.
Defining the Value of Legal Services
Legal service exists to serve a specific goal
- Negotiate and/or conclude a transaction
- Represent a party in a dispute (or litigation)
- Advise a client regarding legal risks or opportunities
To the degree the legal service enables the client to achieve the client’s goal more effectively, the service provides positive value for that client
Value must be as defined by the client/business
What Does “Value” Mean?

• The “value” of legal service represents the degree to which that service assists or enables the client to achieve the client’s business goal at an associated, not-disproportionate cost.
• “Value” constitutes the relationship between the costs and benefits associated with that service.
Hurdles to Realizing Greater Value

- Failure to explore and understand the client’s value definition
- Communication failures between in-house and outside counsel
- Failure to fully delineate responsibilities
- Failure to “play well together”
- Legal profession is, by nature, conservative and resistant to change
- Lack of commonly held lexicon for risk
Law firm structures have developed, at least in part, because of the billable-hour fee model.
Compensation, recognition and other intra-firm policies and practices rely on the number of hours billed and the time-based fees collected.
The same service can reflect different values due to the context in which it is delivered
Lawyers’ values reflect their positions and their strategic strengths.
The value added by outside legal resources (including outside counsel) “starts where the in-house focus ends” (General Counsel Survey 2009 by FrahanBlondé, p. 9)

Some strategic strengths of outside counsel:
- No competition for resources
- Sometimes viewed as more entitled to claim privilege
- Representation of multiple clients provides broader view
- More in touch with judicial rules and other procedures
- More resources to stay in touch with legal developments
Highly Valued Attributes of Outside Counsel

- Teamwork
- Reliability
- Flexibility
- Collaboration
  - with in-house attorneys
  - with other outside attorneys
- Cost awareness and cost certainty
- Speed
- Project management expertise
- Knowledge of the client’s business
• The value of legal service varies
  • By client
  • By law firm
• The client’s view must be pre-eminent (ethical overlay?)
• Value can vary over the course of an assignment due to circumstances beyond the control of client and counsel
• The same firm may represent different value propositions in different circumstances
Factors Impacting Value
How well it works with in-house counsel
Do firm’s lawyers understand the importance of a certain and swift resolution?
Do outside lawyers augment law department’s capabilities with minimal duplication?
Will cost outweigh the lawyers’ contribution to achieving business goals?
Does the client ascribe value to the “name”?
Value Varies Even More

- The same firm working with different clients on similar matters may deliver different values.
- The same client working with two firms on similar matters may realize different values from those firms.
- The nature of the work will affect the value delivered (cutting-edge legal issues or well settled law?)
Work-Related Factors That Affect Value

- Level of difficulty or novelty of legal issues
- Potential impacts of the work on the business
- Number of parties
- Geographic scope of the factual situation
- Other factors
  - Potential personal liability of corporate officer
  - Emotional investment in dispute by corporate officer or employee
Value Related Qualities
“Value” is not a single quality; it consists of a constellation of subordinate attributes or qualities the importance of which varies client to client, matter to matter and in other ways.

Overall value represents the sum of the various VRQs that the client considers important for the matter in its context.

“Value” is too amorphous to be of much utility as a measure of the service or as a criterion for selection or evaluation.

**Value-Related Qualities (VRQs)**
Why Use VRQs?

- Focusing on VRQs enables in-house and outside lawyers to discuss specific, comprehensible ways in which legal service does – or does not – meet a client’s needs.
- VRQs are more measurable than “value.”
- VRQs lend themselves more readily to uses that allow for more informed dialogue and for improved relationships between clients and counsel.
Corporate clients are increasingly interested in fee arrangements that are not based on the hourly rate,
But use of alternative fee arrangements lags behind the interest in having alternative fees
Designing a fee arrangement that reflects higher value lies beyond the experience of most in-house and outside lawyers
VRQs enable the design of fee arrangements that are more specific to the client’s business goals and more suited to measurement and monitoring
VRQs and Metrics

• To manage legal service more effectively, in-house lawyers seek useful metrics
• There is little consensus on the metrics that allow for the best decisions in respect of legal-service management
• VRQs are more specific and measurable than many criteria and certainly more measurable than “value” without context
Examples of Useful Metrics

- Speed of resolution
- Budgetary discipline
- Cost predictability
VRQs and Client Reporting

- Agreed-on VRQs serve as the basis for the lawyer reporting to the client that is more responsive to the client’s needs and wishes.
- Because they are more specific and measurable, VRQs enable lawyers to measure a client’s particular needs – what the client values.
VRQs and Client Satisfaction

- The selection of VRQs that matter most to a specific client provides a useful tool with which to measure client satisfaction.
- The more effectively and fully the lawyer meets the agreed-upon VRQs, the more satisfied the client should be, which serves the lawyer’s interests as well.
Fees and Value

- Alternative fee arrangements do not equate with greater value necessarily
- Value might result from the following:
  - Time spent
  - Expertise applied
  - Familiarity with process
• With technology and process redesign, put power to make more decisions in the hands of the client
• Process redesign and technology can reduce the amount of time that senior professionals must devote to completing the work
• Make client wishes (i.e., its VRQs) the focus of the firm and its attorneys and other personnel
Law Firm Should Embrace Value

- When firms bill only on the basis of hourly rates, they invite comparisons among them on that basis alone.
- Delivery of “value” apart from the time devoted to a task enables a firm to positively differentiate itself more uniquely and with less risk of comparison to others.
- Lawyers can “stand out” in the crowd more effectively by using VRQs.
In-house lawyers often express a wish that the outside lawyers with whom they work would collaborate with them more. Why do they want more collaboration? The bottom-line answer to that question is, the bottom line.

In-house attorneys believe, with much justification, that the process of seeking ideas from others, listening to those who have and offer distinct perspectives and incorporating that thinking in one’s own approach (a core essence of what we mean by “collaboration”) improves analysis and decisionmaking. That would positively impact the company’s—and the law department’s—bottom line.

All too often, though, in-house attorneys have seen their external counterparts take actions with insufficient dialogue and coordination with their corporate clients’ staff attorneys. Whether noticing numerous depositions of the clients’ employees in litigation with inadequate coordination or discussion or preparing exhaustive, thirty-page memoranda when an in-house attorney needed a short, declarative recommendation, outside counsel seem programmed to “take the ball and run with it.” The perspective of the lawyers who work for the organization full time—and, consequently, often know it, its management and its ethos intimately—often has minimal impact on how the company’s outside lawyers plan to achieve its objectives. To correct this imbalance, in-house counsel desire more collaboration.

If a company’s in-house attorneys want to achieve greater collaboration with and among the company’s external providers (including law firms), what steps should they take? How might they commence the process and build a more collaborative relationship with those providers? Finally, how can they later assure themselves and their companies’ management teams that they have achieved their goal of more coordination and collaboration so as to improve the results?

The Seeds of Collaboration

Let’s first look at some steps that law departments have taken along the collaboration “journey.” One of the first concrete efforts by a corporate law department to enhance the level of collaboration and coordination between its lawyers and the company’s outside counsel was the DuPont Legal Model, initiated by the DuPont Legal Department in 1992. One of the core principles of that initiative centered around what DuPont called “strategic partnering,” which (according to DuPont) “emphasizes long-term relationships based on mutual trust, sharing of risks and rewards, working collaboratively toward common objectives to the ultimate benefit of [the company] and a mutual commitment to each other’s financial success.” THE NEW REALITY: TURING RISK INTO OPPORTUNITY THROUGH THE DU PON T LEGAL MODEL (5th Edition) (E. I. du Pont de Nemours and Company 2009), p. 2.
Since DuPont Legal began to rewrite the terms of the relationship between law firms and its in-house lawyers, other law departments have followed suit. Corporate legal departments’ “convergence” programs began as an effort to reduce the number of law firms to which a corporate legal department might assign its company’s work. This, in turn, would provide the company’s in-house lawyers greater leverage regarding the cost of that work as well as better control of resources, particularly outside law from resources. It’s easier to manage effort and expenses with a smaller stable of horses to feed.

Convergence has evolved since its early iteration, even in the context of the DuPont Legal Model and other, similar initiatives. It now includes thoughtful inclusion of the legal services provider community. In today’s environment, one law firm is unlikely to be all things to a client. (In fact, some argue that a one-to-one relationship is impractical and perhaps counterproductive if not just plain not workable.) The current version of convergence and partnering incorporates a greater variety of service providers than simply law firms. Every day that passes, more and more entrants to the legal services provider market make it more difficult for law firms that don’t embrace or build relationships with these legal services providers to be as successful as they once might have been and thereby the most value to their clients at the same time.

This phenomenon requires that in-house counsel demonstrate a very different skill. In many ways, in-house attorneys find that they are accountable to corporate management less for the practice of substantive law (though, when push comes to shove, they will be answerable for the substantive outcome of the lawyers’ efforts) and more for the management of legal processes. This shifting responsibility of in-house counsel cries out for collaboration. It also suggests that in larger corporations other corporate operating departments (e.g., IT) will most likely play a role in that collaboration with outside counsel and/or alternative legal services providers (ALSPs).


Collaboration or partnering must now occur among a broader array of relationships; not just between in-house and outside counsel, but also among those two groups and the growing categories and number of ALSPs. It must include greater sharing of information (and much earlier in the process) and collaborative planning (including an approach modeled on and borrowed from project management) and execution.

Collaboration connotes two or more persons or entities working together to achieve a single objective. While the traditional lawyer–client relationship entailed them working together to achieve the client’s purpose for retaining counsel, a collaborative form of the relationship suggests a more complete integration of and cooperation in their efforts. In the relationship that existed for many years, in-house attorneys often retained outside counsel for their companies while only receiving no more than periodic reports of progress. In-house attorneys were afforded very little meaningful opportunity to participate in the hands-on management of the matters and were rarely asked to contribute to the effort substantively. To complicate the relationship further, many outside counsel clearly saw the general counsel as their primary customer.

This led, in conjunction with increased matter-management responsibilities placed on the in-house attorneys, both related and unrelated, to a determination by corporate law departments to establish a more fulsome involvement in the work for their companies.
One of the earliest, most strategic and thought-out efforts was the aforementioned DuPont Legal Model, emulated to one degree or another by other law departments. Today, only a more institutionalized and collaborative relationship will usually suffice.

**The Next Challenge**

This brings us to the next challenge: measuring the degree to which the lawyers and associated professionals working for a company in fact collaborate and, even more critically, the benefits thereby gained by the company. Knowing whether or not collaboration between in-house counsel and a law firm is beneficial for both parties may be difficult to determine. We believe the principal reason for this difficulty is that the parties determine and measure “value” very differently.

Value for in-house counsel has been measured traditionally by the fees paid by the company for legal service. In other words, how much cash went out the door for services rendered and how did that sum compare to the hoped-for benefit of acceptable results? Since a corporate legal department serves a supporting function in a corporation (i.e., it rarely creates revenues for the organization), the core competencies of which may be in product development, research, sales of specific product, etc., the “value” of the legal department has been measured using metrics with a standard financial look and feel. Corporate general counsel now must demonstrate to management the returns on capital investments made in technology, the processes that attract and evaluate performance of investments made in payroll, rigorous controls used to develop budgets and successfully manage to those budgets to name a few of the expectations that they must meet. Effective general counsel make it clear to the in-house attorneys that they have the collective responsibility to manage those types of value drivers as much as they do to practice law. In many ways, corporate attorneys need to be more managers of legal processes and costs than practitioners of law.

On the other hand, billable hours drive a law firm’s performance in most cases. Whether the firm’s metric is hours billed, hours billed less write-offs, or cash collected, the mechanics of the billable hour system, which is still prevalent in law firms, can have a negative (from the vantage point of in-house attorneys) impact on outside counsel’s behavior. This impact has been well documented. Consequently, clients and firms have “agreed to disagree” as to how best to measure the value of the legal service.

Due to that fundamental disagreement, measuring the benefits to both organizations of greater collaboration can be very difficult. This dilemma demands an enhanced framework for defining and measuring value. We suggest that an appropriate and flexible framework revolves around “value-related qualities” (VRQs) and a framework based on that concept that takes into account those divergent views.

Simply put, VRQs are granular components of a client’s motivation to hire a specific firm/attorney or provider; qualities like expertise in the needed area of applicable law, the ability to control costs, a firm’s expertise and processes to learn and understand a client’s culture, predictability, responsiveness, etc. Sure, cost is usually an important VRQ for the client, but you might be surprised at other drivers of value that could be even more important for a client in a particular situation. VRQs can introduce an important balance between corporate law departments and their law firms because of the dialogue needed to establish the VRQ framework.

Establishing a framework of VRQs for both the client and law firm can be the first step in open communication regarding elements of the relationship that are important to each party. Clients can articulate their need for specific seasoned expertise, usage of legal services providers, cost predictability, preferred processes, etc. Law firms can explore
and propose compensation methodologies, balanced staff utilization recommendations, travel budgets, communications preferences, etc. VRQs channel discussions along discrete, measurable traits of the service and the provider.

Establishing a framework of VRQs and using them to set expectations regarding and to shape and evaluate performance can set the stage for more effective relationships between in-house and outside counsel.

**Some Examples of VRQs**

Let’s examine two real examples that demonstrate the usefulness of VRQ frameworks when collaboration between parties providing legal services to a client is essential.

One of the authors served as the sole in-house environmental counsel for the real estate investments of a leading insurance company. In that capacity, he determined to establish a team of law firms to serve as the company’s environmental litigators for those investments. Working with the regional counsel for the business units involved, he identified the qualifications that would matter to the company for those representatives. After establishing those qualities, he collaborated with those regional in-house attorneys to pinpoint firms that satisfied the criteria to which they had agreed. In-person meetings with the candidates enabled the in-house attorneys to choose the firms that best qualified for the role. The criteria against which the firms were measured constituted VRQs (though the company’s attorneys did not use that label at that time).

The VRQs served to channel the discussions among the in-house attorneys along useful axes and to enable them to discuss the firms under consideration using comparable terms of reference. Without that lexicon, their discussions—and their decisions—likely would have been less productive and their decisions less well founded.

In another context, that same author led that law department’s efforts to restructure the external legal service for the entire law department across the range of substantive areas of focus of its hundreds of in-house attorneys. By the issuance of more than 100 requests for proposals (RFPs) for legal service to more than 130 law firms, the department planned to select a much smaller number of firms to handle its legal work prospectively. In light of the challenge of ensuring that the in-house attorneys who would be responsible for reviewing and rating the hundreds of proposals from law firms that the department expected to receive, he developed a system by which the in-house attorneys would apply consistent standards and achieve comparable scoring of those proposals. This required that he develop standards against which those reviewing attorneys would measure the proposals, in essence developing VRQs for the firms’ proposals. The resulting scores enabled the department to make consistent, defensible decisions when selecting firms to which it awarded the work covered by the RFPs.

Another example was a corporate legal department that needed to get its arms around the processing of a specific type of employment matter that was prevalent within the corporation. The corporation had a significant national footprint, which had led to a decentralized handling of those matters. Costs per matter varied wildly, results were inconsistent, communications were more often than not about expensive surprises, and it wasn’t clear who was in charge. The legal department drafted a process that addressed its need to better control costs and outcome. A leading law firm saw an opportunity to satisfy the needs of that corporation while creating a system that would be marketable to other clients and create an opportunity for lawyers seeking a more flexible work schedule. The VRQs included the notion of a partnership in the development of specific software and consideration of special licensing to new clients of the firm.

One of the authors was charged with reducing the discovery costs related to a
significant matter. Costs were spiraling out of control with no end in sight. Outside counsel believed they were in charge and were taking a “scorched earth” approach to the review of millions of electronic documents. In-house counsel, new to their matter management role, didn’t know their boundaries of authority, an ALSP processed home-grown software capable of leading-edge electronic extraction and review of documents, and a newly developed in-house IT staff that reported to the CIO, charged with reducing costs. The IT group was extracting documents from dozens of huge corporate databases and internal websites for review based on specifications provided by outside counsel.

The first problem was that IT was changing the specifications based on its point of view. Not good. The ALSP would take the data and load it on secure servers accessed by outside counsel and in-house counsel. The ALSP used its proprietary software to cull nonresponsive documents and review the resulting pool for outside counsel’s use. The ALSP contracted 100+ attorneys to manually review documents that fit certain criteria. Outside counsel felt they were at risk if they didn’t do their own culling by having their lawyers read each and every document from the resultant pool. Not good. In-house counsel was tasked to explain costs some two to three months after invoices for services rendered. Even after significant cuts to the charges, costs got the CFO’s attention. “Who’s on first anyway?” Not good. Could a framework of VRQs help?

In this particular process, developing shared VRQs, especially ones tied to the resources performing work would have been very helpful. For example, jointly prepared and agreed-upon VRQs would include establishing in-house counsel as the focal point for all decisions impacting the cradle-to-grave process. Regular, open, and direct communications among all parties, subject to a predetermined schedule and especially on an as-needed basis. (Decisions being made by in-house counsel.) The three parties staged a conference of their representatives at the offices of the ALSP. The agenda contained crisp objectives from the corporate legal department’s point of view. Each participant expressed its needs and they reached an agreement on specific shared VRQs. They documented the consensus and developed metrics by which to evaluate performance later.

Collaboration, as defined above, serves as the driving force when parties execute their responsibilities in the process. No deviation from the articulated project plan without fully vetting changes with all parties and securing in-house counsel approval. Fail to follow this VRQ at your own peril! Parties should also focus on process improvement, particularly as acceptable efficiency opportunities bubble up in the course of time. You could make an argument that shared VRQs imply collaboration.

We’ve covered a lot of ground in this article and we hope that we have illustrated the unquestionable need for legal services providers to collaborate in a more fulsome manner not only with clients but also with each other. The days of outside counsel taking the ball and running with it with no oversight are over. In-house counsel’s role in managing legal matters for their corporations requires project management as much as the substantive practice of the law. They actively seek diverse perspectives and ideas to incorporate into the management of matters under their control.

Collaboration between parties is essential to increasing value for the corporation. Although the productivity measures utilized internally by firms, ALSPs, and corporate legal departments differ greatly, how is value to be determined or measured? A collaboratively developed framework based on VRQs can address the needs not only of the corporation but also those of the other parties working on a matter so as to bridge the above-described gap in a meaningful and easy-to-understand manner. VRQs can introduce a much-needed balance between corporate legal departments and their legal services providers because it requires open and direct communication regarding operational
elements important to all parties. They also lend themselves well to the identification of measurable traits of the service, provider, etc. that can later serve the purpose of evaluation. Collaboration can be evaluated when parties develop a framework of shared VRQs and appropriate measures of success.

—Steven A. Lauer and Kenneth L. Vermilion

Steven A. Lauer assists corporate counsel in delivering maximum value to their clients. His published works include Value-Related Fee Arrangements (Ark Group 2012), The Value-Able Law Department (Ark Group 2010), Managing Your Relationship with External Counsel (Ark Group 2009) and Conditional, Contingent and Other Alternative Fee Arrangements (Monitor Press 1999). He can be reached at slauer@carolina.rr.com.

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Messrs. Lauer and Vermilion co-authored The Value-Able Law Firm: Delivering Client-Focused, Higher-Value Legal Service for Clients and Law Firms (ABA 2018). They also wrote several articles that appeared in Of Counsel on the subject of value-related qualities, including a four-article series, and this article continues the exploration of how to implement that concept in the context of law department and law firm operations.
Getting Away from the Hourly Rate:

An Efficient, Effective Team Maximizes Value

Editor’s Note: The following is the third of a four-part series. The final article in the series will appear in an upcoming Of Counsel issue.

Time-based billing does not serve corporate clients well in respect of their interest in efficient, effective legal service. Clients want the lowest cost possible consistent with achieving their desired outcomes, and they want the highest-value legal service achievable within those parameters.

Although there is a misalignment between what clients want and what time-based billing provides, the latter fee arrangement persists for the great bulk of corporate billings. We have canvassed in prior articles in this series why, in the great majority of situations, fee arrangements still use the amount of time spent by the lawyers as the primary or exclusive basis for calculating those lawyers’ fees.

Despite the hurdles to moving away from time-based billing that we identified in those articles, counsel still need to take a broader view of the work managed by corporate law departments in order to craft alternative fee arrangements (sometimes called “appropriate fee arrangements” and, using either phrase, AFAs) that can assist the clients in reaching those goals. They need to understand the dynamics of that work and how those dynamics might affect the cost and value of the respective contributions of the various team members. Finally, they must explore how in-house attorneys can take that into account in the design and application of AFAs.

Different types of matters overseen or handled by law departments will require different management techniques to control costs. How effectively AFAs are designed will be impacted as a result. Let’s examine some distinct situations.

The Challenge of Managing a Large Portfolio of Similar, Non-Complex Disputes

One company in our experience faced a very large number of similar, non-complex disputes that had arisen throughout the country. The law department’s traditional approach had been to assign such matters regionally, in some instances to regional firms and in other areas to “national” law firms.

Costs for those matters varied widely; the processes that the law firms followed were inconsistent (leading to data that was difficult if not impossible to aggregate because it was collected in disparate fashions), and the results were unpredictable. Within the law department, three attorneys, each working individually with no coordination among them, managed those matters idiosyncratically with no disciplined process, assisted by diverse administrative staff performing similar work in similarly disparate ways.

The department’s technology was not embraced: the data for some matters were entered into the matter management system internally by individuals (still with insufficient discipline), while data entry from other matters was aggregated by the law firm assigned to handle those matters, with no consistency. The lack of clarity regarding use of the technology led to “rogue” use of those tools and the resulting inconsistency in data capture and use.
The company embarked on a cost-reduction initiative, with the law department tasked with managing more effectively the matters entrusted to it. As a first step, the performance of regional firms was evaluated. One firm stood out from the rest when a few key metrics were developed and analyzed: it demonstrated reasonable, consistent turnaround times for the matters that it handled; its invoices included crisp descriptions of the work billed by its timekeepers; and it provided a set of management reports that articulated open matters, closed matters, an inventory of active matters being worked on, key lessons learned, and a “no surprises” unusual-developments analysis. While that firm’s costs were not the lowest among the firms used, it demonstrated a sincere effort to manage the work assigned to it.

The law department brought key members of that firm to the company’s headquarters to generate ideas for better managing the national book of business. The group explored how they might standardize processes, collect reliable data, and reduce costs. The plan they collaboratively developed included the following key components:

- The firm would develop a simple but effective software tool; key elements of data-capture were designed and agreed upon; access to the software was engineered to enable the in-house legal team to access all data housed there; monthly/quarterly/annual management reports were designed; and automated processes were developed to enable the in-house staff to manage the matters by exception rather than having to touch every individual case. Higher-level matter data were bridged into the corporate matter-management system.
- Analysis of the firm’s staffing led to the development of a national team of lawyers within the firm assigned to the portfolio. Those lawyers were allowed to work schedules that suited their personal circumstances because they were held to standards and to achieving results, rather than being measured by the number of hours billed.
- The law department was able to reduce its internal management team for that portfolio to one in-house attorney and three legal assistants.
- The law department and the law firm agreed to a budget that paid actual costs and a reasonable profit margin for the firm.

Creating a Team—A Deliberate Assignment of Responsibilities

Cost control and reduction are most effectively accomplished by a cohesive, well-managed team, the creation of which requires an appreciation for and application of various tools and techniques routinely used in project management. In essence, in order to achieve the client’s goals in the most cost-effective and efficient manner, in-house counsel must for each matter proceed to build a team that harnesses the talents and expertise of its members with minimum overlap of effort as well as coverage equal to the range of tasks necessary to reach that goal.

(We don’t suggest that every matter will justify all of the analysis and techniques that we describe here. Low-risk routine engagements—e.g., routine because of their repetitive, well-understood parameters—may be handled without all of the process described here, and perhaps even without an AFA, because the client’s goals of cost efficiency and speed might be achieved in other ways. On the other hand, such routine engagements might be addressed by treating them as individual components of a portfolio of similar matters covered by a single AFA for all matters in the defined portfolio, as in the above example.)

The members of a team for complex litigation (as an example) should possess (in the aggregate) all the talents required for the representation. If much electronic discovery will be required, and we can’t imagine that in today’s digital world this wouldn’t be the case, the team should include one or more individuals with demonstrated expertise in managing that intricate but critical exercise.
A case with scientific or technical issues will require one or more individuals who understand those issues and their intimate applicability to the legal arguments involved.

In other words, selection of members of a team should be careful, considered, and deliberate. The choices should take into account the needs of the matter (whether a transaction or litigation) as well as the “strategic strengths” of the individuals or firms under consideration. The in-house lawyers may need to ignore traditional organizational boundaries in order to bring together those team members best positioned to effectively advance the client’s interests. In-house counsel might select a senior partner and an associate from one firm to work with an e-discovery team from another firm and a contract-attorney firm in order to constitute a team that incorporates the best capabilities of those respective entities, for example.

Selection of team members must proceed simultaneously with the creation of a plan for managing the work. Each team member’s responsibilities and strengths must be mapped out carefully. The plan, when complete, will provide a roadmap for the team members’ efforts, enabling each to know not only his/her role but also those of the other team members as well as the sequence of efforts necessary to complete the work in an efficient and effective manner.

The plan will enable the manager of the effort (typically, an in-house lawyer) to monitor those efforts, make course corrections, and measure their effectiveness against the expectations set out in that plan.

The following example involving multiple law firms should illustrate this best management practice and its dynamics as well as the cost benefits thereby achieved.

As in-house counsel at a large insurance company, this author was responsible for managing the appeal of a significant adverse jury verdict in a Texas court. Due to the nature of the matter, three law firms, all of significant size and renown, were involved in varying ways. Subsequent to a meeting with attorneys from all three firms to discuss the appellate process, we sent a memorandum to the firms delineating each one’s distinct responsibilities and the selection of issues for the firms grounded in their strategic strengths (location, strength of practice, personnel involved, etc.). Our purpose was to ensure that all the important issues relative to the appeal and the assignment of its various case elements were clear enough to ensure minimal overlap of work even as a maximum breadth of the effort among the firms was simultaneously pursued.

The lead partner at one of the firms called us to object to the terms of the memorandum and the assignments. (Neither of the other firms raised any concerns regarding the memorandum.) In that partner’s view, ethical responsibilities had to override any limitations on the firm’s assignment as expressed in the memorandum. In essence, that partner claimed that his sole professional judgment had to determine whether to research an issue or pursue a factual inquiry or otherwise represent the author’s company in the context of this appeal. His position discounted the fact that two other significant law firms (each of which was one of the largest in its respective state with a favorable reputation)—one of which included among its partners, and the designated primary appellate counsel for the matter, a former chief justice of its state of domicile—and a law department with dozens of lawyers with considerable experience on staff were also involved in the matter.

This effort included no AFAs for any of the firms involved; their fees were calculated on a time-and-expense basis. Would that lawyer’s position have differed if his firm were on the hook for a successful outcome or the cost thereof by means of an AFA? While one cannot know, the cost-related and other implications of three firms independently conducting themselves in such a manner were, to us, unacceptable. Ultimately, the client did achieve a very favorable decision by the state supreme court in the matter and it was successfully concluded.
Another situation exemplifies the use of project management techniques in the context of litigation in which only a single firm represented the company. One partner handled the day-to-day case matters for an environmental case, but an important hearing loomed before the presiding judge. A partner at the firm with greater seniority had much more exposure to, and experience before, that judge, so we determined that the significance of the hearing justified having the more senior partner also appear at the hearing. Even though the more senior member of the firm was somewhat less familiar with the minutiae of the case, his presence at the hearing contributed (at least) to a favorable result.

Subsequently, an outside fee auditor reviewed the billing details for the case and opined that the more senior partner’s time was duplicative of the time spent by the junior partner at that hearing (again, both had attended with our concurrence) and therefore excessive. This view ignored (in our view) the benefit of that senior partner’s involvement in that aspect of the case (but not the rest of it, due to cost-efficiency concerns). The favorable result outweighed any concerns vis-a-vis possible duplication of effort because each partner played a distinct and valuable role at the hearing (as planned).

Selecting a team to handle a matter resembles in some respects the assemblage of a sports team. Each member of the team has a discrete, distinct role. To fulfill that role, each possesses certain talents and strengths. In-house counsel should serve as the team’s coach. Blending those members’ strengths into a cohesive, functioning team requires that the coach have a deft touch, but one worth cultivating, for only such a group of individuals can, in many situations, properly handle all the disparate tasks and assignments that in the aggregate are the typical components of a modern, complex litigation or cutting-edge transaction.

As mentioned above, strategic strengths should play a large role in the process of selecting members of the team and assigning their responsibilities. What do we mean by this? The roles of in-house and outside counsel are inherently distinct, though they serve the same client. Their strategic positions, and their strategic strengths, differ as well, a fact that impacts which tasks they are best positioned to take on in each matter. Different individual attorneys, whether practicing in the same or different firms, also have discrete strengths. An exploration of those issues will assist in developing an approach to the question of developing an AFA.

Let’s turn to that.

**Strategic Strengths to Assemble Cohesive Teams of Complementary Skills**

What are strategic strengths? They are inherent attributes that distinguish one party from others and that contribute value to that party’s performance or role. Those attributes might result from the organizational “place” of the specific person (e.g., inside counsel as opposed to outside counsel). Some of them derive from personal characteristics of the individual (some people being more capable than others of the type of analysis that is necessary in litigation).

If you identify the strategic strengths of the various members of the legal team, you then can harness each member’s strengths so as to achieve more than would otherwise be possible. There also may very well be some identifiable weaknesses for which you need to compensate in your planning. On a properly staffed team, the members’ skills complement each other.

What are examples of the strategic strengths and comparative weaknesses of inside counsel? Inside counsel generally works closely with a company’s business executives and managers on a day-to-day basis. In the course of that daily toil, a staff attorney develops a strong appreciation of the organization’s business strategies and
its corresponding legal needs. In turn, that understanding enables the attorney to anticipate how the company's legal position (in compliance, litigation, or otherwise) might later impact the company's operations. He or she will have a sense of which policies, processes, or cases might be problematic for the corporation because they might have a very adverse precedential impact on those operations. An outside attorney might not be as able to make that determination.

Inside counsel generally enjoys greater proximity to the operational personnel of a company, which can then lead to greater integration in the management team and its processes. That integration can be critical to the in-house attorney's ability to fulfill certain responsibilities, one of which is to counsel the business executives and managers on risk. (After all, it is not enough to simply aspire not to get caught!) This counseling is best administered over time, in large and small doses as the opportunities present themselves, often unexpectedly; as a rule, it is not as effectively accomplished merely by infrequent formal presentations. Gardens respond to continuing, low-volume watering better than they do to infrequent gully washers. A due appreciation for legal concerns should be similarly nurtured.

Generally speaking, the attorneys who make up a company's staff acquire, over time, experience representing the company in a variety of contexts and in connection with a variety of initiatives. Whereas outside counsel are typically retained for discrete assignments (e.g., to handle the sale of a property, to represent a company in connection with a corporate acquisition, to represent the company in a particular case), the role of inside counsel spans all situations that might arise.

This ongoing presence creates three distinct strengths of inside counsel: the development of institutional memory over time that provides some context and foundation for subsequent situations; the opportunity to measure the company's responses in those varying contexts, providing a more “textured” understanding of the company's needs and preferences; and the opportunity to develop a reputation as a valuable contributor in the development of the tactics that support business strategies. All these strengths animate the inside attorney’s representation of the organization. They allow that attorney to view each problem and situation in relation to other situations in which the company has found itself in the past, in which it finds itself at present, and in which it might find itself in the future.

Another strength of inside counsel, which is related to several of those already mentioned, is that he or she typically has or acquires a greater commonality of perspective with the business client than does outside counsel. This perspective often manifests itself in a greater appreciation for cost-effectiveness or as a sharing of the business goals, by virtue of which the attitude of inside counsel is usually different than that of outside lawyers (this is not a criticism of the latter, merely an observation). In developing that greater commonality of perspective with the business personnel, in-house attorneys gain opportunities to understand how the business operates and to forge relationships with the business personnel that provide those lawyers a “seat at the table” for business strategy and planning sessions. If something needs to be fixed, attorneys in that position will be able to work with the business unit quickly to right the situation.

This appreciation of the business perspective often leads to the attorneys being considered for senior leadership roles within the business organization. When that occurs, collaboration and cooperation between the legal and business “sides of the house” generally improve, which can further improve the organization's compliance and risk-appreciation profiles.

On the other hand, in-house counsel are generally subject to staffing constraints. They are often geographically removed from the courts and agencies with which they deal.
They may lack the bar admissions necessary to fully perform certain assignments, since corporate lawyers generally do not secure admission in all states in which their employers conduct business or in which they might have to avail themselves of the courts. In those situations, companies must retain outside firms that have the requisite admissions.

What are some of the strategic strengths and relative weaknesses of outside counsel? First and perhaps foremost, a law firm exists because of the attorneys who comprise it. As self-evident as that may seem, it has its own significance for this analysis. The attorneys of a firm direct its activities; its structure is designed to support its mission of providing legal service. In the case of litigation, for example, a law firm is configured to participate in the litigation process; a law department, on the other hand, is only part of a company, and the company’s raison d’être is not defined so singularly.

The demands for the services called for in the practice of law are not outweighed at a law firm in the way that they may be in a corporate environment. An inside attorney might have to grapple with corporate procedures and other concerns in order to secure appropriate contract assistance for litigation, for example. Such concerns are less significant for a law firm and the desired ends might therefore be more easily achieved.

The single focus of a firm creates other strategic strengths. Outside counsel is likely to be viewed as functioning solely as a lawyer in respect of corporate clients. Some courts view an inside attorney, on the other hand, as serving the company as a businessperson as well as a lawyer. Here there may therefore be implications for the availability of the attorney/client privilege and the attorney-work-product doctrine (even though the analysis as to the availability of the protection is the same), since the commingling of functions can undercut the protection that some courts will accord communications and materials otherwise protectable.

On the other side of the ledger, the cost of in-house counsel is typically lower than that of outside attorneys. A law firm, like many organizations, is oriented to maximize its own profits. Its client business is intended to provide its owners and members with a return above their subsistence needs. On a purely comparable basis, then, a company should be able to save money by having the same services performed by in-house counsel.

However, there are several qualifying issues relevant to that determination that flow from the differing status of inside and outside attorneys. Indeed, the final determination of whether hiring staff is the cheaper alternative to retaining comparable outside attorneys entails a more complex analysis than simply comparing the relative hourly rates. For example, even though more and more companies are explicitly disavowing any guarantee of employment (often expressing an assurance of employability but not employment), an in-house staff of attorneys represents an ongoing financial commitment. By retaining a law firm instead, a company can preserve greater flexibility for meeting its legal needs. The commitment to pay fees is limited, generally, to the services already performed rather than for employment expectations reaching into the future. The financial obligation to outside counsel may be more easily ended.

Outside counsel often have geographic proximity to entities outside the company that are relevant to the company’s legal affairs. A prime example is the court systems with which we must deal. In-house lawyers are often located at or near the business operations, regardless of whether that is convenient for dealing with courts, government agencies, or any other constituencies that are external to the corporation. Law firms, on the other hand, often locate near the entities with which they must deal. As a result, familiarity with court procedures and the vagaries of administrative interpretations of statutes and regulations is often greater in law firms than it is in law departments.
Inside counsel have reporting mechanisms that are more closely geared to the company’s needs. Whether as to budgeting or as to litigation reserves, management expects timelier reports from inside counsel than they generally do from outside counsel. They often expect the latter to report on a schedule that is less frequent.

Outside lawyers represent multiple clients. Each client benefits from that diversity because lessons learned in one client’s context can be applied in another’s. However, that diversity can also have negative effects for each client. Despite the best of intentions and the most professional approach, a firm’s multiple representations can restrict its pursuit of a particular client’s interests, even unintentionally and perhaps only marginally.

There may be other, less obvious issues that can impact the analysis. For some companies, the costs of inside and outside counsel might have disparate ramifications. For example, companies that manage funds on behalf of third-party investors might be able to charge the time of outside attorneys who handle legal issues for those investments directly to the investment accounts. The internal cost of in-house counsel might not be as easily or certainly reimbursable. Each company might have different preferences as to the size and makeup of its staff. Such complexities aren’t subject to the generalized analysis of a treatment such as this.

For many (if not all) matters entrusted to a corporate law department, the best, most cost-efficient results are achieved only through teamwork. The team typically includes both in-house and outside counsel (and perhaps other service providers as well). It may even include representatives of the law department’s internal business unit clients. Unless the members are carefully selected, though, their talents and strengths may not work together optimally.

Accordingly, careful team assemblage, taking into account a multitude of factors, is critical. Identifying what type(s) of service the company needs, where that service is available, and in what form and how best to meld those services and team members into a high-functioning team, requires a certain deftness of touch. It also requires careful planning and implementation. In short, it requires the application of many project management techniques.

Yet it is by making those applications that in-house counsel lays the groundwork for designing a fee arrangement that serves the company’s value-related goals as well as its substantive objectives. It is a goal worth pursuing. In the final article in this series, we will look more closely at how all these considerations come into play in determining whether an AFA is appropriate and, if so, in designing one.

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Getting Away from the Hourly Rate …

Clearing the Hurdles

Editor’s Note: The following is the first of a multi-article series that will appear in upcoming Of Counsel issues.

The measurable stock in trade of a lawyer is the time that she or he devotes to resolving a client’s problem. While other attributes of the lawyer’s work might bear more directly on the quality of his/her “product,” that measurability has led to the use of expended time as the predominant basis for calculating legal fees. That usually appears in the form of an “hourly rate.”

The hourly rate leads to greater fees for lawyers who spend more time at the assignment, which is one of the strongest objections voiced by in-house attorneys to such time-based fees. Assume that two equally competent attorneys are pursuing similar goals on behalf of distinct clients (or even more starkly, two attorneys laboring on behalf of the same client). If each is paid on the basis of the number of hours “clocked” for the client, the attorney who spends twice as much time on the task is paid twice as much if their hourly rates are equal. It is so even if the additional time results from inefficiency rather than just increased diligence or zeal.

Then there are the low-value administrative activities that generally attach themselves to the hourly rate process. Once the firm has collected the previous month’s timekeeping records and, hopefully, applied technology to the data in the form of initial screenings or audits, often times there are manual reviews performed by more senior lawyers in the firm before invoices are transmitted. Once the invoice is received by the client, another stream of review processes take over that may include a review by technology, by the attorney managing the billed matter, and, depending on the amount of fees in question, possibly by that attorney’s supervisor.

Wouldn’t it be great to eliminate those hours of ‘administrivia’ and invest them in the practice of law?

Pyrrhic Victory

Whether or not attorneys who are paid by the hour intentionally spend excessive periods of time at the job, the conclusion of many in-house attorneys is that time-based billing simply provides wrong incentives to lawyers. Particularly in the current, cost-conscious era, the corporate client often is interested in the cost of achieving a result almost as much as the result itself. Spending too much to reach a goal is often a Pyrrhic victory. There is little consolation in a bankruptcy proceeding from realizing that you achieved your litigation aims while exhausting your capital.

In-house lawyers have other perspectives as well, of course. Many view the billable hour as nothing more than an accounting convention. It is not a measure of the quality or value of the legal service provided during that time. It is, however, a ready measure of how much of the service is provided and, for that reason, it became a substitute for a more precise measure (which has been unavailable to this point).
While conceived as an accounting convention, the hourly rate became more and more common and the entire attorney-fee concept began to reflect the hourly rate. In-house attorneys (even when they might have recognized the imprecision of the approach) became accustomed to the low-value activity of reviewing invoices in which law firms itemized all the time that they devoted to the work. In other words, in-house counsel grew accustomed to the time-based billing paradigm despite its shortcomings.

For law firms, the hourly rate is also a convenient proxy for other more precise measures of what they provide their clients. If a law firm’s revenue is determined by the number of hours its professionals bill to its clients, then the number of hours billed by the various members of the firm can be used to determine the relative “productivity” of those attorneys as well. (We put that word in quotation marks because, for most businesses and for in-house attorneys, greater productivity means spending less time at a task or otherwise consuming less of one’s assets to achieve the same result. Not for law firms, which view greater client billings as equating to greater productivity.)

With the increasing fluidity of the legal profession and the greater restiveness of clients, however, the hourly billings of law firm members are becoming an impediment to development of a more appropriate internal measure for law firms to apply in determining relative compensation of their attorneys. So for law firms too, the negative impacts of the hourly rate manifest themselves more and more clearly.

**Corporate Law Department Perspective**

As a result of those forces, there is a great deal of interest among corporate law departments in alternative fees. By “alternative fee,” we mean a fee that is calculated on a basis other than simply the amount of time spent in the course of the engagement. In other words, alternative fee means any alternative to a time-based fee.

In-house attorneys are naturally interested in minimizing the costs of legal service. Even if they are unable to reduce those costs, their companies’ managements expect them to control fee expenditures much more affirmatively. They are also interested in fee arrangements that avoid the misaligned interests created by the hourly rate. In essence, the client’s goal in seeking an alternative fee is often to create incentives that will cause the outside attorney to think of the cost effectiveness of the representation at the same time as she or he thinks about the quality of the representation.

Another goal of an alternative fee is to provide a risk/reward ratio that will lead to compensation for the attorney that is neither too low nor too high in light of the task and the business goals accomplished. Finally, and this last goal is closely related to the previous ones, an alternative fee is successful (in the mind of the client, at least) if it can redistribute to some extent, between the client and the firm, the risk of an unsuccessful engagement by making counsel’s remuneration more tied to achieving a successful result for the client, however that client might define success in that regard.

The search for alternative fee arrangements (AFAs) is therefore part of a larger effort to
identify an alternative, and more accurate, means of measuring what a company has received when the legal service is complete. Corporate management is no longer content with the answer that the task is complete. Executives want to be sure that the task was efficiently resolved and that the cost of the service was commensurate with the role that it played in achieving the company’s business goals.

Law Firm Perspective

Why might law firms be interested in AFAs?

At first blush, the hourly rate appears to represent the best invoicing mechanism that they can find. It constitutes an objective measure of the amount due the firm. It is a simple method of calculating the legal fee for a service. It also simplifies the calculation, within the firm, of the members’ relative contributions to the firm’s profits. Finally, it eliminates any risk that the attorney will not be compensated for time spent on clients’ assignments and, instead, places that risk on the client.

AFAs might seem to represent an unattractive option for law firms. That may not, in fact, be so.

The legal market is extremely competitive. There are increasing numbers of lawyers in most jurisdictions. Moreover, many corporations have taken to reducing the number of

Another goal of an alternative fee is to provide a risk/reward ratio that will lead to compensation for the attorney that is neither too low nor too high in light of the task and the business goals accomplished.

outside firms they deal with on a day-to-day basis, a process often called “convergence.” As they do so, the fewer “slots” available on their lists of approved outside firms are subject to more and more competition. And it’s not simply a question of eliminating one or two slots at a time—in what is tantamount to a legal service game of musical chairs. Rather, the reductions in the numbers of firms retained by companies are sizeable.

For instance, several years ago The Prudential Insurance Company of America reduced the number of firms on its list of approved counsel from approximately 950 to only 270. That company then proceeded to award approximately 60 percent of its anticipated annual need for outside legal service to only 80 law firms. The DuPont chemical company reduced the firms to which it assigns most of its legal work to 34 firms, which it refers to as its primary law firms. (Over time, that number has fluctuated as DuPont’s legal department reassessed the company’s need for outside legal service and reviewed the performance of the company’s existing service providers.)

Other companies have reduced the number of firms on which they rely for most work. Among the more recognizable ones are AT&T, Chrysler Corporation, and Union Carbide. One insurance company reduced its list of counsel from approximately 4,000 firms to only about 2,000. It’s clear that competition for corporate legal work will intensify further as such efforts multiply.

Further, many companies have recognized that they can reduce their reliance on outside service providers by increasing the size of their law departments. Generally speaking, in-house attorneys “cost” less than do outside counsel, assuming that the need for their services will continue at a certain level to justify the staffing increase. The same work completed by an in-house attorney requires a lower outlay while the in-house attorney may also be able to save the company money by simultaneously managing the work still being undertaken by outside counsel more assiduously.
In such an environment, firms find that it is important to distinguish themselves positively from their competitors in as many ways as they can. AFAs can be an excellent means of doing so. AFAs also represent an approach that is particularly responsive to the clients’ goals as described above.

**At first, many lawyers fear that abandoning the hourly rate as the measure of their fees will lead to reduced profit margins as clients squeeze their firms for fee concessions without compensatory benefits. That is not necessarily the result.**

Even beyond that, however, many firms are finding that AFAs can result in higher profit margins. At first, many lawyers fear that abandoning the hourly rate as the measure of their fees will lead to reduced profit margins as clients squeeze their firms for fee concessions without compensatory benefits. That is not necessarily the result.

Law firms find that working within an AFA can cause them to approach assignments differently than they might have otherwise done so (in terms of staffing, tactical decisions, etc.). The result often is that the firms’ efforts are much more targeted and effective, so the amount of time devoted to a project or assignment might be less than would have been the case under an hourly rate arrangement.

The law firm might even take a different, innovative approach to the assignment that is more efficient and effective if the firm has “skin in the game.” The result is that they may actually find that an AFA often leads to an effective hourly rate that is higher than they would otherwise charge.

Finally, an AFA can allow a firm to very effectively demonstrate to its client that it shares the client’s goal of winning the case (if litigation is the context). Since the firm’s fee can depend (at least to some degree and in some fashion) on achieving victory in the lawsuit or success in a transaction, the firm and client have parallel priorities.

**Aligning Interests**

Aligning the distinct (and to some degree inconsistent) interests of the client and counsel, which should be the goal of any fee arrangement to which they agree, requires that the client and its counsel fully understand their respective interests and goals and that each respects (even if it does not share) the interests of the other. This partnership must be in place at the start of the engagement to which the fee arrangement will apply. AFAs must be rooted in a mutually beneficial and respected partnership between the two parties.

**Anticipating possible changes in circumstances in order to avoid pitfalls puts a premium on the fortune-telling abilities of the firm and its client.**

The alignment of interests must also persist throughout the engagement. In some contexts, the in-house and outside lawyers tasked with forging an effective fee arrangement may be able to predict at the start how the arrangement will operate going forward and plan accordingly. The more complex a matter is or the longer it likely will persist, though, the more challenging such a prediction will be.

Anticipating possible changes in circumstances in order to avoid such pitfalls puts a premium on the fortune-telling abilities of the firm and its client. Unless a firm employs capable prognosticators, it should opt for an alternative approach. Luckily, an approach is available that is well within the firm’s grasp. That approach incorporates good and
timely communication with the client on an ongoing basis.

Why do those aspects of the approach matter? First, if circumstances anticipated by the firm and client don’t occur or they change materially, they may undercut the applicability or wisdom of the agreed-upon fee arrangement. In such a case, those parties will need to re-examine the assumptions underlying the arrangement and decide whether they should and can renegotiate the arrangement and, if so, how to do so.

The goal in those discussions would be to ensure that the interests of the client and its counsel remain aligned, since the changed circumstances will adversely impact the alignment that they had established at the start of the engagement.

A Dubious Proxy

Corporate law departments must ensure that the cost of the legal service that their companies purchase from outside providers is proportional to the overall corporate objectives for which the service is deployed.

Though it did serve, to some degree, the interests of both in-house and outside counsel when first conceived decades ago, the hourly rate has several negative impacts on the costs of legal service and on the relationships between in-house and outside lawyers that have become more apparent and less acceptable.

The most significant impact derives from the fact that the fee borne by the client will bear no relationship (other than, perhaps, an entirely fortuitous one) to the value of the legal work delivered because the fee is determined solely by reference to the amount of time devoted to the work. The efficiency or inefficiency of the lawyer(s) whose work is covered by the fee will have a greater impact on the size of the fee than the value that the work bears to the client’s need.

Another significant effect of the hourly rate is that it leads to a zero-sum game in terms of the financial component of the relationship between the client and the outside lawyer, insofar as the client simply wishes a lower fee and the lawyer prefers a higher one. A client that tries to control the costs represented by the time-based fee can only do so by reducing the amount of time for which it pays or by negotiating a reduced hourly rate, often after the time has been expended.

The hourly rate has had adverse effect on the relationship between the client and the outside lawyer and it is a subject that both in-house and outside counsel have frequently tried to avoid in the past.

Each of these approaches leads to less reward for the outside lawyer without changing the dynamics of how that lawyer works and the effort devoted to the assignment by that lawyer. In short, either the lawyer or the client “pays” for the lawyer’s time.

The hourly rate has had adverse effect on the relationship between the client and the outside lawyer and it is a subject that both in-house and outside counsel have frequently tried to avoid in the past. If a client does not want to grant the lawyer and law firm carte blanche to bill inordinate amounts of fees, that client, as mentioned earlier, is oftentimes forced to police counsel by after-the-fact invoice review to assure the accuracy of rates, timekeepers, and agreed-upon activity.

A more acceptable approach would be a prospective, forward looking discussion between the client and counsel to insure alignment as to anticipated activity, fees, resources, and costs for the period in question. Under either approach, however, the
hourly rate undermines the relationship between counsel and client.

The time has come for in-house and outside counsel to develop a structure for developing an AFA (or, more accurately, AFAs) that reflect the client’s goals and the value that the legal service provides to the client more precisely than the time spent by counsel on the assignment. The hourly rate does not serve corporate clients well in that regard. It increasingly disadvantages firms as well.

In future installments of this series, we will explore the value propositions of in-house and outside counsel, how those propositions complement each other, and how those value propositions can provide the basis for approaching the subject of AFAs for both in-house and outside counsel.

This exploration will lead us to a process that both parties will be able to apply in a consistent, effective manner. The result of all their effort should be more widespread use of AFAs that reflect the client’s needs more directly.

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Getting Away from the Hourly Rate:

Ready, Set, Go!

*Editor’s Note: This article is the last of a four-part series.*

The limited success of the efforts to move away from time-based billing leads to the obvious question of “Why?” We believe that the continued longevity of the hourly rate, with its deleterious impacts on corporate clients and the relationships between those clients and their law firms (many of which we have diagnosed in earlier articles in this series), results from a variety of causes. The greatest one, in our view, is the absence of a program or process by which to evaluate, design, and implement fee arrangements that do not rely solely on the amount of time devoted by counsel to determine that counsel’s remuneration.

The term “alternative fee arrangement” (AFA) is not entirely satisfactory. It’s an “alternative” to what? Despite that imprecision and due to its common usage, we continue to use the term alternative fee arrangement to denote a fee arrangement that is not entirely dependent on time-based billing as a measure to determine the fee to be paid by the client to its outside counsel. Some use the same acronym to denote an “appropriate fee arrangement.” In either event, the goal is to achieve a fee arrangement that avoids use of the hourly rate as the exclusive means of computing the fee or circumscribes its use by including some sort of cost control or value-based component in the arrangement. An AFA can be successful only if the parties have developed a relationship with a strong core of mutual trust. Accordingly, an AFA will not work if one either party wants or expects to “beat the system” or “really get a deal,” which necessarily would be at the expense of the other party to the arrangement.

All too often in-house counsel and outside counsel attempt to create a fee arrangement on an *ad hoc* basis, taking into account whatever factors seem appropriate to them at the time. Factors that can be conflicting! Without any training, and absent an approach or defined procedure for that task, the odds that they will succeed in their effort are pretty low.

It’s time to develop an approach that can guide both inside and outside counsel through the minefield that surrounds their desired destination. With many factors to consider and to take into account in the exercise—some factors relate to the client, some to the firm, and some to the matter—most attorneys (whether in-house or outside) would achieve greater success in developing and implementing effective alternative fee arrangements if they followed a set procedure that walked them through specific questions and steps toward their mutual goal.

Before commencing that analysis, though, we need to discuss value in the context of the legal service that business organizations need and that outside service providers (including law firms) provide to those organizations.

**Value and How It Applies to Legal Service**

Value has occupied center stage in discussions within the legal profession (at least in respect of the legal service purchased by and provided to, or on behalf of, business organizations) for a number of years. In 2008, the Association of Corporate Counsel (ACC) launched the ACC Value Challenge “to reconnect the value and cost of legal service.” A primary thrust of the ACC Value Challenge
has been to stimulate the use of AFAs and reduce the prevalence of the hourly rate.

ACC did not define that term; rather, it elected to empower its members and their law firms to discuss the concept and agree on a definition. This bottoms up approach seems to have stalled, however, since the aggregate amount of fees paid without using the hourly rate (as reflected in surveys) seems to have plateaued. Moreover, the absence of a definition of “value” has hindered the profession in its efforts to move toward greater use of AFAs, because each participant in the discussion brings his or her preferences, perspectives, and biases into that conversation. Until disparate meanings of such a key term are harmonized, the discussion cannot lead to a common position.

A similar disparity of meaning has long existed with the word “productive.” For many outside counsel (especially those who are responsible for law firms’ performance and productivity, such as managing partners), the more time a lawyer bills to clients, the more productive that lawyer is. In-house attorneys, on the other hand, think like business professionals (at least, once they’ve been in-house counsel for some time); to them, productive connotes an element of efficiency so that greater productivity means something like getting things done more quickly or with less effort.

Another dynamic that influences the notion of value from in-house counsel’s perspective is driven by their clients, the managers of the business. First, most nonlawyer managers don’t understand why legal service expense can’t be treated like payroll, or fuel, water, and current expenses. When the CFO directs a 5 percent reduction in operating expenses, why is the legal department the first group to the table with reasons they can’t comply?

Confusion also exists among nonlawyers regarding why legal expenses and settlements must negatively impact the manager’s bonus calculations. It’s as if product developers or buyers who infringe on competitors’ trademarks, or operating managers whose organizations fail to comply with applicable laws, believe that, even though their derelict actions cause the business to incur unnecessary costs, legal costs should not be baked into their bonus calculations. They seem to disassociate the cost of legal service from the related or underlying situation because they don’t understand how that service adds (or at least prevents a loss of) value to their operations.

Value does not exist in a vacuum. It is not an immutable physical constant like the speed of light. Instead, it represents the relationship between the cost of something and the benefit that one enjoys from that something.

What a client “enjoys” from legal service will vary; it depends on the context. In some situations, a successful conclusion to a matter may mean little if it took too long. (Think of a company’s concern that a departing executive will deliver its proprietary information to a competitor. A temporary restraining order (TRO) achieved a year after that individual’s departure will mean little; a TRO must be secured within a few days to have practical impact.) The legal effort in a bet-the-company case, while very expensive, will represent great value if successful, but the same effort expended in a slip-and-fall would represent negative value as it would far exceed the risk associated with the injury.

Thus, we need to focus not on value itself, but the subsidiary qualities that comprise it if we wish to apply the concept meaningfully to the subject of fee arrangements. These “value-related qualities” (VRQs) can serve a firm well in an effort to devise AFAs, as we’ll see below.

What is a VRQ? In essence, a VRQ represents a trait or a characteristic of legal service that matters to the client; the more of that trait possessed by a specific service delivery, the more closely the client will achieve its business goals for the engagement. For example, speed may be a critical component of a successful representation, as in the above TRO example. In a bet-the-company
proceeding, cost concerns rank far lower on the client’s wish list than does the certainty of a successful conclusion of the matter.

Both of those traits are VRQs. Here’s a nonexhaustive list of possible VRQs, not all of which matter equally as to every representation:

- Expertise
- Cost
- Consistency of effort or treatment
- Predictability of cost
- Speed of resolution or completion
- Reliability
- Convenience
- Security of data and other information
- Certainty of resolution
- Accountability
- Overall responsiveness
- “No surprises” communication

Each VRQ represents a quality that is more measurable than the general, vague term “value.” Accordingly, each one can be measured to some degree and, perhaps at least as importantly, each can be discussed by client and counsel in a productive fashion. This discussion enables not only measurement of success in meeting the client’s definition of a valuable service by counsel, but it also makes progress more attainable through dialogue.

**Components of the AFA Analysis**

**Step 1: What Is It Worth to You?**

Whether the client needs counsel to work on a transaction or to represent the company in a dispute or litigation, that effort should lead to some value being generated for the client. The value may be a positive one, such as the ability to acquire another company or to purchase real estate for a new factory. In other contexts, the value may be a negative one, in that the assignment relates to preventing a loss, such as disputing a claim against the client by a counter-party or a lawsuit to challenge another party’s assertion of a right in property claimed by the client. In either situation, the client needs counsel to assist it in adding to or preventing a reduction in the assets of the company.

The value that the client places on the project will provide the context for the discussion by client and counsel about the legal service itself. Without that context, any discussion of the legal service (and the fee for that service) will represent mere guesses that have little if any relationship to the purpose of the representation.

**Step 2: How Big a Role Does the Legal Service Play?**

Recognizing the need for representation in such a context enables the client and its counsel to reach an understanding as to how that legal service will enable the client to realize that value. For different types of matters, the legal service constitutes a differing proportion of the effort required to achieve the objective. For example, in the negotiation of a simple commoditized contractual relationship like the purchase of a copier, the legal effort, if any, will be very limited in scope and complexity and might be effected by means of a fill-in-the-blanks purchase order with legal review solely to ensure that the parties to that agreement are in good standing or otherwise able to complete and enforce the transaction.

On the other hand, an ongoing relationship between two organizations by means of which one organization will provide copying services to the other, including providing the equipment, personnel, and other support services, would require a more complex document that follows lengthy negotiations involving the parties’ lawyers, among others. This transaction obviously would require more involvement and more complex legal service than the former. The legal service would also occupy a much more critical position in the negotiations.

Understanding the criticality of the legal service to achievement of the client’s business goals allows for a meaningful discussion of what the legal service will mean for the
client. Sometimes the legal service occupies a central function in that business plan and the plan cannot be achieved without the lawyers’ efforts. Even in that instance, however, the cost of the legal service must bear a reasonable relationship to the overall benefit to the client of reaching its objectives, as determined in Step 1 above.

At this stage in the discussion, however, the client and its counsel should be in a position to agree on an estimate for a fee that would reasonably compensate counsel for the service needed to allow the client to reach its goal. Reaching that estimate might require that they agree on various assumptions and aspects of the representation that will be beyond their direct influence. Nonetheless, this estimate (even with the uncertainty attendant to those assumptions) should serve as the anchor for a fee arrangement.

**Step 3: How Should Counsel’s Positive Contribution Be Rewarded?**

One of the goals of in-house counsel in discussions about various types of AFAs is to align more directly the incentives of outside counsel with the client’s business goals in the engagement. For example, a client that is very concerned about uncontrolled costs will react negatively when time-based billing rewards the billing professional for spending more time on the assignment regardless of how well that time contributes to achieving the objective. Accordingly, it’s entirely appropriate to build into the fee arrangement a mechanism by which counsel will be rewarded for achieving the benchmarks set by the client and even penalized for failing to achieve those benchmarks.

In that regard, the base fee agreed to by the client and counsel can be enhanced or reduced to reflect counsel’s success (or lack thereof) in helping the client achieve the latter’s business objectives in the matter. How to do so will, of course, vary from engagement to engagement and it will depend on how well the client and counsel can measure the achievement of those benchmarks.

**Step 4: How Do We Know If Counsel Has Satisfied the Goals of the Engagement?**

If a fee arrangement that the client and counsel contemplate will provide that a portion or all of the fee is to be paid to counsel only upon attaining certain benchmarks, those parties must obviously determine what those benchmarks will be. Without specifying those terms, the parties will allow their arrangement to create a difference of opinion (at least) when the fee comes due (assuming satisfaction of the requirements in the mind of one or the other of them).

An AFA generally contemplates some form of “value arrangement.” It is in recognition of the criticism of time-based billing that it divorces the fees charged by outside counsel from the degree to which their effort advances the clients’ interests. “Value” for purposes of this discussion must be viewed from the client’s perspective because (i) the lawyer’s role is to serve the client by advancing or protecting the latter’s legal interests, and (ii) the client pays the lawyer for his/her service. Accordingly, the client’s definition of “value,” as expressed in the VRQs that matter to that client for the specific matter, must be accepted and used to measure the success of counsel’s efforts for the client’s purposes.

**Pulling It All Together**

The steps described above may seem somewhat esoteric and hard to apply on a day-to-day basis. Let’s run through these questions again and drill down toward a more practical explanation in each instance.

Determining “what it’s worth to you”. In order to develop an AFA that serves both their interests, client and counsel must start with an understanding of the client’s business goals. That understanding must be informed by an equivalent appreciation of the work that will be needed to achieve those goals. As to the former, the questions above will allow them to commence the analysis. Does the client have a slip-and-fall case to defend?
Does it face a bet-the-company proceeding? Is the transaction a simple vendor agreement, or does it encompass a merger of two multinational organizations each of which operates many and varied lines of business in dozens of jurisdictions?

Does the legal service merely effectuate and document a transaction, the parameters and risks of which are well understood by the parties and the overall size of which is easily quantifiable? Or is the legal service an integral and indispensable element of a business deal that is of indeterminate scope, such as a groundbreaking transaction that has no precedent?

In addition to those transaction-focused questions, client and counsel should also attempt to measure the effort that will be required. For this analysis, data will be critical. Data-rich matter-management and e-billing systems should contain a wealth of detail regarding prior work that, to one degree or another, may be comparable to that being contemplated. Parsing and analyzing those data will enable the parties to frame and hone their thinking about the effort that will be necessary. Obviously, the more the examined past work resembles the current project, the more reliably that past data can be relied upon for this purpose.

Some data types that might be of use in this analysis are the following (some may be more relevant to litigation or to transactional work):

- Jurisdiction (state, type of presiding entity)
- Law firm(s), lawyer(s) who worked on the prior matters and their roles(s) and rate(s)
- Analyses of the prior work, such as decision trees, project plans, etc.
- Outcomes of the comparable past efforts
- Lessons learned from the past work
- How comparable are the matters (past and contemplated) in terms of complexity?

With such information, and having performed that analysis, the parties must consider how the work can be accomplished in the most efficient and effective manner. These criteria relate to the assemblage of a team (as previously discussed in an earlier installment of this series). The disparate roles of the team members should be reflected in their respective base fees.

Addressing the “how big a role does the legal service play” question. Mark A. Robertson and James A. Calloway discuss the notion of a Value Curve in their book *Winning Alternatives to the Billable Hour* (American Bar Association 2008) (see pages 19–23). While their Value Curve is designed to illustrate the relative value of services versus the volume of work available to the firm, it sets out four general classifications of legal services:

- Unique
- Experiential
- Brand name
- Commodity

If we think about Unique services being the kind that involves C-suite authorizations and participation, and Commodity services being straightforward junior partner or second/third-year attorney type of work, we can begin to assess the role that the legal service plays in the specific matter at hand.

For example, suppose a company has been found to be violating federal laws by not securing the appropriate certifications and inspections for a core process or product that represents 60 percent of the company’s sales volume and corresponding profit. To further complicate the violation, penalties are extreme and apply to each brick-and-mortar operating unit in the organization. Add the re-engineering costs of the process and suddenly the shareholders are at risk of serious stock price erosion.

Juxtapose this situation with the routine drafting of contracts for the purchase of services, products, or raw materials, IP registration and protection, or the processing of paperwork for employees from other
countries to work in this country. Each situation requires quality legal services, but the risk profiles for the matters vary wildly. That risk profile can be a significant driver of the value and affect how central the legal services are to the business objective. Higher risk suggests greater cost of legal services; lower risk suggests lower costs.

**How should counsel be rewarded for a successful representation?** Once counsel and client have agreed on how much the legal service will benefit the client upon successful completion of the assignment, they need to determine whether the fee arrangement should include incentives to force counsel’s representation to incorporate and further the VRQs that constitute the client’s definition of high-value legal service. To ensure that the client’s “value” definition is significantly reflected in the service as delivered, they will want to design into the fee arrangement some incentives that will reward behavior by outside counsel consistent with the client’s VRQ-based goals and/or penalize behavior that is not.

Once counsel and client agree, in Step 2, on a baseline estimate of what an appropriate fee might be (which could take into account the firm’s financial needs related to the expected effort it will expend and the relative contributions of other members of the service team, even if from disparate organizations), they can focus on how to use the fee to create incentives for the lawyers to meet the client’s definition of high-value legal service. That definition should be expressed for the specific context by explicit reference to the VRQs.

The incentives for counsel might consist of a “holdback” of some portion of the agreed-upon fee, payable upon counsel meeting those VRQ-related goals, or they may call for a premium (above the agreed-upon fee) payable on similar terms. Speed to completion or resolution could be incentivized, for example, with a straightforward cash bonus if the transaction or litigation is successfully concluded earlier than expected. A better-than-expected settlement could entitle counsel to a percentage of the favorable variance to the expected result. Bonus payments could be made available based on feedback provided by key executives who worked with outside counsel or in-house’s counsel evaluation of performance.

While VRQs can be very effective motivators if they are achievable and unambiguous, behavioral risks are ever present. Counsel need to be very careful. There will be a temptation to staff the engagement to maximize short-term profits to the firm. Doing so might result in inappropriately junior staff being used to perform activities more suited to senior staff. That said, don’t overlook possible development opportunities that may make sense within the scope of the AFA. One of the key “rewards” is the promise of future business.

Assuming the financial agreement reached up front is adequate from both parties’ viewpoints, staying focused on the goals established as success factors, and expressed in the agreed-upon VRQs, is key. Client and counsel must clearly express their respective expectations and they must agree to those in coming to terms on a fee arrangement as well as the measures of goal achievement. VRQs can be pivotal in the measuring of overall value.

**How can you measure whether counsel has satisfied the terms of a value-based arrangement?** If the fee arrangement sets out the client’s value definition for the engagement in terms of measurable VRQs, the in-house and outside attorneys can develop metrics by which to determine the degree to which the latter has met the client’s value-related expectations (e.g., speed of resolution, cost certainty, etc.). This section of the fee arrangement should be structured to avoid, as much as possible, later disagreement regarding the evaluation of counsel’s performance and the impact of that performance on possible financial outcomes. We can’t emphasize this enough. Metrics need to result in clear “yes” or “no” answers with
of risk, process, procedure, and the value generated for both parties. As soon as one party, for whatever reason, sees its interests as represented in the fee arrangement negatively impacted, crisp and immediate conversations should occur for mid-course corrections.

Third, improved predictability of costs/revenue should enhance each party’s ability to harness resources required to deliver results in an orderly manner.

By using this approach, law departments and law firms derive respective benefit. Law departments will receive higher-value legal work (as defined by the client) from outside counsel. Further, this approach will require more fulsome discussions between client and counsel regarding goals, expectations, etc. In-house attorneys will realize a greater ability to demonstrate to corporate executives how well they manage work, thanks to more meaningful metrics that are directly linked to value. Clients will see a fuller and more specific alignment of their counsels’ interests with their own value-related goals for the engagements.

AFAs also, typically, reduce a great deal of administrative effort associated with the processing of monthly invoices that would now usually be broken down in task code format (whether those codes are drawn from the Uniform Task-Based Management System or some other source). While data processing impacts may be minimal, to the degree monthly invoices are subjected to mechanical or human reviews, time previously devoted to performing these reviews can be reinvested in high-value work. Eliminated is the volleying back and forth of dialogue surrounding billing adjustments. (Note: Today most invoice processing systems have the flexibility to handle AFAs routinely.)

Law firms will discover that meeting the client’s own expressed value-related goals in a measurable manner will lead to higher client satisfaction. The use of client-satisfaction surveys should reflect that and should
likewise serve as a basis for internal compensation and other decisions. Those data will also allow for greater comparability (in measuring individual lawyers’ contributions to the firm’s success) for those decisions despite the variability of the AFAs themselves. Law firms will also realize administrative savings from the elimination of some invoice processing as clients will more clearly see the correlation between what they pay and what they receive.

AFAs should cause law firms to review their structures and practices in order to eliminate inefficiencies because they will become more responsible for the financial impact of their work on clients. Greater efficiency will, in turn, result in lower cost. It should lead to more nimble law firms. In light of the changing dynamics of the legal profession, nimbleness is a positive market differentiator indeed.

The current state of affairs regarding fee arrangements for counsel to business organizations has led to client satisfaction crises for some law firms and their clients. Other firms may not have faced such a crisis yet, but many of them will if client satisfaction continues to drop.

While numerous law firms claim in their marketing that their clients lie at the core of their service mentality, their billing methods belie that claim by continued dominance of time-based billing. The increasing fluidity of the market for legal service—clients seeking lower costs by changing firms or by looking to legal service outsourcing companies and other non-law firm vendors—has contributed to the uncertainty.

Creating AFAs, collaboratively with its clients, allows a firm to refocus (or in some cases focus for the first time) on the client’s own “value” definition, which will likely lead to a reorientation of law firms’ priorities. The astute firm will see this change as a grand opportunity to evaluate their service model and improve on efficiencies while being more mindful of their clients’ value perceptions and needs. Greater client satisfaction should increase client-retention rates and a more stable environment for all.

—Steven A. Lauer and Kenneth L. Vermilion

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Getting Away from the Hourly Rate:

The Counterproductive Effects of Billing Time

Editor’s Note: The following is the second of a multi-article series that will continue to appear in upcoming Of Counsel issues.

Whether services are purchased based on an hourly-rate-and-expenses basis or through a creative alternative fee arrangement (AFA), the concept of value serves as the foundation for assigning monetary amounts to be exchanged. Therefore, exploring how different constituents think about value is important.

“Value” has always been a subjective term. In fact, it isn’t a stretch to suggest “value” is in the eye of the beholder. When applied to an intangible such as legal service, though, it becomes even more subjective, since its components are also intangibles. “Value” as seen through the eyes of CEOs, CFOs, GCs, in-house lawyers, or outside counsel can be based on a wide variety of diverse components that may be difficult to align, particularly if there are differing levels of understanding about how legal services contribute to achieving a corporation’s overall strategic objectives.

Defining Value

Professional services differ, as an example, from an automobile, which has a value attributable to its mechanical and physical components (e.g., the steel of the car’s body and engine, the effort required to manufacture its systems, etc.) as well as the value attributable to its pedigree (was it manufactured by Lamborghini, by Volkswagen, or by Yuko?). The latter component of the car’s value is, of course, more subjective than the former.

The efforts of corporate clients to realize greater value from expenditures for legal service needed to accomplish their business objectives triggered the current debate over “value.” (See, e.g., the ACC Value Challenge launched in 2008 by the Association of Corporate Counsel, at www.acc.com/valuechallenge.) Over the years, in-house attorneys have observed the continuing rise of hourly rates charged by law firms, often with little or no economic justification, even as the budgets of corporate law departments have decreased from repeated reductions and constraints imposed by corporate management.

Those in-house attorneys realized more and more that the fees charged by outside counsel often bear only a nebulous relationship to the degree to which those fees contributed to the achievement of their companies’ goals. Thus, the cost of the legal service and the perceived value of that service, at least in the eyes of corporate management and corporate law departments, diverged to an ever greater degree as time passed.

Efforts such as the ACC Value Challenge attempt to establish a more direct relationship between the fees and billings from law firms and the value of the legal service than those clients perceived to be the case in recent years. The issue has been cast as one of determining how in-house counsel view the efforts of their outside compatriots.

In essence, the value of the service is to be determined by the corporate client whose goal constitutes the underlying purpose of engaging the outside lawyer. To the degree
that service enables the client to achieve their goal without imposing a cost disproportionate to that goal, it represents positive value for the client. If, on the other hand, the client achieves its business objective only after spending more on fees than the objective is worth to the business, the client has lost ground from a business perspective.

For the client, then, the value of the legal service can only be measured in relation to its utility in reaching the client’s goal. Any other measure possesses an intellectual value but no more.

Unfortunately, outside lawyers see their task as identifying and eliminating all possible risks attendant to the client’s situation, even when those risks might be extremely unlikely or very minor in the context of the transaction or the dispute. Whether it results from their training in law school or from their personality types, this approach leads external counsel to spend billable time on matters that, to the business client, will have minimal or no effect on the client’s business position.

We believe that the process of negotiating and designing AFAs can lead to better understandings between corporate clients and outside counsel and therefore a closer alignment of needed activities designed to create more value for both parties.

Let’s revisit issues related to the use of the hourly rate as the basis for legal services.

**Inertia-Driven Approach**

Time-based billing serves neither the corporate client nor the law firm well (though for differing reasons). Yet most fee arrangements between law firms and their corporate clients still utilize the hourly rate to compute the amount of fees due the former by the latter. In part, it’s an effect of inertia, since the hourly rate has been with us for over 50 years.

The hourly rate’s appearance of objectivity and ubiquitous applicability also provides it with a sheen of legitimacy that contributes to its longevity. Finally, the absence of a clear, well understood alternative has also allowed the hourly rate to overstay its welcome (certainly among corporate law departments).

The persistence of the hourly rate deserves a closer examination. Has the time arrived to move away from it more forcefully? Does its detrimental impact on corporate clients and their law firms finally outweigh its putative benefits?

**Negative Impact on Law Firms**

What negative effects does the hourly rate have on law firms? We identify at least the following:

- It causes the firms and their lawyers to view their “product” as the time that they devote to their clients’ matters. The achievement of their clients’ business goals becomes an indirect result of spending time on those matters.
- It leads to the use by firms of internal metrics and measures of their lawyers’ contributions to the firms’ success that are based on the number of hours that those lawyers bill the clients. The firms consider as more “productive” those lawyers who bill greater numbers of hours than their compatriots within the firms. The number of billed hours counts more for the firms than does the achievement of the clients’ business goals.
- The hourly rate distorts the focus of the lawyers in a law firm. Rather than the client and client service, lawyers tend to direct their attention to the work as an end in itself.
- It creates a false sense of ability to manage the work effectively. Instead, firms manage the number of hours, often by reviewing draft bills and marking down the amount of time therein represented if it “feels” like too much. In this way, the firms indirectly manage the efforts of their lawyers. This after-the-fact review of the work does not contribute
to achieving the client’s goals or assist the law firm in reaching its own financial and other targets.

• Firms do not know how their work on behalf of distinct clients or on each client’s various matters compares from one to the next, other than in terms of the amount of time. Not taken into account are the myriad qualities of those distinct representations that also affect the work and, in that way, the clients’ matters.

• In the firms’ marketing efforts, hourly rates steal the spotlight from more meaningful comparisons among firms. Clients end up comparing firms primarily on the basis of their respective rate structures rather than on less clear, but perhaps more meaningful measures of the firms’ “fit” in their needs for outside legal service.

• Hourly rates serve as the basis of a “cost-plus” method of billing that eliminates any risk for the law firm of efforts failing to achieve the client’s business goals. This distorts the economic “contract” between the client and its lawyers, enabling the lawyers to “take their eyes off the prize” when the client expects cost consciousness to play a part in their approach to the work.

**Negative Impact on Clients**

The hourly rate also detrimentally impacts corporate clients in several ways.

• The only means by which in-house counsel can manage the firms that they retain on behalf of their companies is the number of hours logged by the attorneys in those firms. Unfortunately, despite the development of technology tools that collect, collate, and present the billing data to the in-house attorneys on their computer screens, those attorneys still are able to manage the work of law firms with those tools only retrospectively. By the time an in-house lawyer reviews the firm’s invoice, the work has already been completed and the client is able only to mark down the amount of time for which the company will pay.

• With the increased emphasis within corporate law departments on effective management of outside legal service due to budgetary constraints, corporate general counsel have no clear line of sight into the bases for those costs; the only metrics available to them relate to the hourly rate and the amount of time actually devoted to the work. Once again, retroactive review of time-based invoices and fees constitutes the only management tool available to them.

• In-house lawyers share the view of their internal clients that productivity is directly proportional to how quickly and efficiently a task is completed. The less time it takes to complete a given task, the more productive the worker who completed it. Since firms incentivize billing professionals based on the hours billed to clients, the hourly rate format (subject to constraints such as a figure in authority, such as a partner, writing down the amount of time to be billed) works inversely to the common in-house perspective and dis-incentivizes professionals to apply efficiencies learned over time.

• In the absence of other common metrics, when seeking outside legal service, the in-house attorney is able to compare providers most readily on the basis of their respective hourly rates. Whether each provider is the most appropriate selection can be a decision left to ill-defined, subjective determination rarely expressed or agreed to.

• The hourly rate and the invoices based on it have focused the attention of in-house lawyers on the cost of the legal service rather than more meaningful examination of its contribution to the companies’ business goals. It has led to phenomena such as well-drafted “outside counsel guidelines” and well-intended audits of legal invoices. Both of these purported safeguards have negatively affected the relationship between in-house and outside counsel because the fee arrangements and the law firms’ billings constitute a zero sum game played by counsel and client. For one to gain, the other must lose.
Moreover, because such guidelines regulate items like costs that may (or may not) be passed through to the client by the firm or the manner in which they may be passed through (e.g., with or without an administrative “upcharge”), they do no more than nibble at the edges of the cost structure of the legal service. Whether it pays a charge for faxing material or not, the client’s bill will not vary materially; focusing on the time spent and how well those efforts contributed to achieving the client’s goals would constitute a much more financially meaningful effort by the in-house attorney.

- The need to review invoices full of details about time spent diverts in-house counsel’s attention from the strategic goals of the engagement. They’re inspecting the trees rather than assessing the forest. In other words, time devoted to reviewing invoices is time not spent attending to the substance of the company’s legal needs and, to some extent, time wasted (relatively speaking).

- Because time-based fee invoices require intensive review and authorization by one or (frequently) more in-house attorneys, they often lead to an us/them confrontation. The zero-sum nature of that relationship does not serve the client’s interests well, since trust and collaboration represent such critical elements of how successful client-and-counsel relationships work. The introduction of fee auditors in the 1990s represented a very destructive development in many cases by leading to much second-guessing by those auditors of strategy as well as billings. That is but one way in which time-based billing negatively affects the client-counsel relationship.

**Moving Forward**

In light of the many deleterious effects of the hourly rate on clients and firms, why not discard it? What underlies its persistence?

In addition to its advanced age, the hourly rate does serve some goals of both clients and law firms. Those goals, however, were established in a far different economic and budgetary environment and, in the view of many (if not most) in-house attorneys, they have been superseded by the need for greater cost consciousness, greater focus on strategic goals, and the need for corporate clients to realize greater value from their investment in legal service. In addition, corporate law departments have evolved considerably since the hourly rate’s appearance; they have become more capable substantively and much more advanced in the use of managerial techniques.

In order to move successfully from time-based fees and billing to AFAs, though, both clients and their counsel must have a more certain path in view. That has been lacking to this point. Unfortunately, most AFA-oriented discussions by corporate clients and their outside counsel so far have been ad hoc and matter-specific rather than programmatic. As a result, those discussions probably often create challenges and confusion rather than lead to well-designed AFAs.

Is there a better way? While the answer to that question is affirmative, we first must go back and analyze the concept of “value” in the context of legal service. Only then will we be able to chart a course toward AFAs that serves the interests of corporate clients and their law firms. How does this fundamental notion of value determine what client and law firm must actually do?

First, client and law firm should take into account the disparate ways in which they view and value the service that the latter provides in light of factors such as those detailed above. If they don’t do that, the AFAs will have a much lower probability of working than their designers expect or want.

Second, they should design those AFAs on the basis of the respective contributions to the value of the legal service by the various contributors to that service. For example, in some situations or for some matters, a corporate law department will rely entirely
on outside counsel to provide the legal service; for other matters, on the other hand, more of the work will be completed by the in-house lawyers. Sometimes, the client will incorporate the work of service providers that are not law firms, expecting those providers (such as expert consultants or vendors of technology-based services) to work with its law firm.

Which work is performed by the various members of the team should be reflected in those members’ compensation and in the structure of the AFA. One should take into account the value of those members’ contributions accordingly.

In the next installment of this series, we will examine the respective values of in-house counsel and their external counterparts, how those values differ, and how they are similar, along with the implications of that analysis for the design of an AFA. The series will conclude by delineating a process by which corporate law departments will be able to approach the design and negotiation of AFAs so as to maximize the likelihood of (i) reaching an agreement with outside counsel on an AFA, and (ii) designing an AFA that advances the client’s business goals by creating incentives for counsel that lead in the same direction as the business wishes to go.

—Steven A. Lauer and Kenneth L. Vermilion

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The legal profession is changing. In making that statement, we do not refer to the increasing penetration of technology into how lawyers practice (although that is certainly the case), nor do we refer to the continuing consolidation within the ranks of law firms as regional and mid-size firms merge or create or join networks to compete with the larger firms. We refer instead to the changing dynamics of the relationships between in-house law departments and their external providers of legal service, including law firms.

The emergence and growth of corporate law departments as an ongoing fixture in the legal firmament remains one of the primary indicators—and the primary cause—of change in the legal profession with respect to corporate clients over the past few decades. As companies created and increased the size of their law departments (the largest law departments now include over 1,000 professionals), they have also improved the professional competencies of those departments to include considerable expertise in areas besides just those substantive specialties pertinent to the companies’ business operations. For some time, the in-house bar has been pursuing greater and greater sophistication in the application of business concepts and methodologies to their management of legal service. For example, where they once asked law firms for invoices with detailed time-entry data (often receiving considerable push-back when they did), law departments now expect such firms to apply sophisticated project-management techniques and other tools to their company’s matters.

They have also revisited their selection and retention of outside counsel. Data-driven selection methods (e.g., requests for proposals for legal service, seeking and using experiential information from candidate firms) now represent an accepted methodology. Perhaps more relevant for our purposes is the “convergence” movement, which seems to continue unabated. “Convergence” denotes the disciplined reduction by a law department in the number of law firms with which it works in an effort to forge greater efficiencies and closer relationships with the firms remaining on its “roster.”

By reducing the number of law firms with which it works, a corporate law department creates greater leverage in its dealings with the firms that remain. This leverage enables the law department to achieve several things: (1) it can assure itself of the technical competence of those remaining firms by utilizing that competence as the “price of admission to the dance”; (2) it can design the parameters of the relationship it wishes to have with those firms, secure in the belief that they will be willing and able to bear some costs associated with recalibrating the relationship; and (3) it can design better metrics for the management of legal service due to the smaller number of firms—and lawyers—with which it will work and manage going forward.

All of this means that the selection and retention of law firms by corporate law departments increasingly will revolve around “relationship issues.” By “relationship issues,” we do not mean to suggest that developing personal friendships with in-house lawyers by offering entertainment in the form of invitations to professional sporting events, musical performances, or high-priced dinner discussions will lead to greater business for law firms. Rather, corporate law departments increasingly will select those law firms that “get it” and demonstrate a willingness to work with their in-house compatriots as equal partners and in the way that each specific law department wants, even if that differs from how those firms work with their other clients.

The Implications of Change

What does this portend for the law profession and, in particular, for law firms? First,
the future likely will involve much greater competition for a company’s business and, specifically, for its billings. Such competition will be different in terms of both quality and quantity because the inelasticity of the time-based billing paradigm has caused corporate clients, led by the in-house bar, to explore alternative means of delivering legal counsel and related services that their business operations need. Second (and this is related to the first point), the client’s substantive needs and service-focused preferences will dominate the selection process. The choice of which service provider to use increasingly will revolve around the relationship issues discussed above as expressed by the client. How can law firms successfully address those issues? The short answer is that they must make the client’s service preferences the central focus of their service delivery.

“The Value” — What Do Clients Want and What Does It Mean?

The Association of Corporate Counsel (ACC) launched the ACC Value Challenge in 2008 “to reconnect the value and the cost of legal services.” ACC determined not to provide in the ACC Value Challenge a single definition of “value,” opting instead to exhort ACC members to discuss the issue with their outside legal-service providers and develop their own definitions of the term to suit their respective company’s needs. In the context of legal service, of course, the term “value” has not had a clear-cut or easily measurable meaning. Slightly more than one year after ACC launched the ACC Value Challenge, one commentator wrote, “[m]uch remains confused and unclear about that term.” R. Morrison, Making Some Sense Out of the Value Gap, Nat’l L. J. (Nov. 9, 2009).

Although a single definition remains elusive (at least at this stage of the dialogue within the profession), we can identify some traits or characteristics of higher-value legal service that could help us to forge something approaching a working definition. These traits (referred to herein as value-related qualities, or VRQs) may not comprise a definition in the pure sense of that word. They may, however, allow in-house and outside attorneys to develop a shared language to assist the company’s in-house and outside lawyers to provide legal service that more closely mirrors its value-related needs and expectations. In light of the variation among clients’ perceptions of value, perhaps we should not seek a single definition of “value,” but instead a framework or approach with which to construct a context-specific definition of the term.

VRQs can enable in-house and outside counsel to engage in a collaborative process to determine fee structures that more closely align outside counsel’s interests with those of their clients. Simultaneously, VRQs can provide the basis for more specific measures of the success of those arrangements and other aspects of the client-counsel relationship, including some that are less tangible. In short, VRQs can serve as that framework or approach to the conundrum represented by value.

In light of the confusion and uncertainty surrounding the concept of value, how can we successfully approach the challenge of defining and delivering high-value legal service? We must begin with the basics, recognizing that value does not exist in a vacuum and is not an immutable constant like the speed of light. Rather, it represents the relationship between the “cost” of something and the “benefit” that one enjoys from it. The cost may include more than out-of-pocket expense, and the benefit may be expressed in other than monetary terms.

In this way, the ACC Value Challenge really represents an effort to “recalibrate” value and cost, rather than to “reconnect” them. A connection between value and cost has always existed, but the relationship between them has become more and more attenuated and unsatisfactory as in-house counsel frequently have experienced instances where the cost outweighed the benefit. They have increasingly come to view the hourly rate as an incentive for outside counsel that does not coincide with clients’ interests in cost-effective service.

The benefit that a company derives from legal service can flow from several sources. Some transactions, such as real-estate-secured loans, simply cannot be effected without addressing legal matters; the legal service is integral to achieving the business goal. The resolution of business disputes typically involves the disputants’ lawyers, although companies can and do resolve their differences without much lawyering in many instances. Concluding such transactions and disputes so as to advance one or both parties’ business interests constitutes the benefit realized.

In other situations, legal service may be less central to the business activity, but by expediting that activity, preventing law-related complications, or taking advantage of opportunities that exist by virtue of statutory or regulatory structures, legal service can serve an important supportive role in achieving the business’s goals, allowing the company to realize more business benefit from the situation than it would have without the lawyers’ involvement. It might even add some value to the parties’ exertions distinct from their primary business-oriented focus.

What sort of “costs” might a client realize or incur in the context of legal service? (These include some costs that can arise from the purpose for securing legal service, such as litigation, rather than just as a direct result of the legal service itself.) Although some costs are “hard” costs (like legal fees, transaction-associated costs, expert fees and other out-of-pocket expense), others are less measureable, but just as real. They can include:

• reputational harm
• diversion of corporate executives’ attention from the business
• heightened regulatory scrutiny
• poisoned business relationships
• distraction of company personnel aware of, but not primarily involved in, the matter

When assessing the value of legal service, one should account for as many costs associated with the matter as possible. The ultimate determination of the value of that service should reflect its net impact on the client’s position. If that position has improved, taking into account both costs and benefits realized from the representation, then the legal service provided positive val-
ue to the client. If that position has deteriorated, the legal service may have subtracted value from the business or the transaction.

When developing a framework with which to define value in the context of legal services, keep in mind that the determination of the value of the legal service ultimately is the client’s to make. The primary determinant should consist of the degree to which legal service contributes to the client’s achievement of its business goals for the assignment. Inasmuch as the client retains counsel in order to achieve its goals with minimal law-related complications and such counsel should serve the client’s interests, the value of that service must be measured in the same context. Ultimately, then, value lies in the eyes of the client (or, for in-house counsel, the in-house clients with whom they work).

For each client, each law-related matter or project represents an often vastly different set of issues and risks. Each client’s appetite for risk varies from those of other business organizations. The legal-service provider must take this into account when delivering legal service. A client that willingly assumes a high level of risk may opt for legal service that elevates cost control to a higher plane even though “cutting corners” might invite greater legal scrutiny and risk. A client that cannot afford or does not want any law-related exposure, on the other hand, might be willing to pay some form of premium for the assurance that such will not occur. Satisfying clients with such disparate attitudes requires a finer calibration of effort by the lawyers (even without the lawyers knowingly assuming high risk).

Understanding how different VRQs matter to the client in a particular set of circumstances can provide the grounding needed to render that calibration. Is cost control the most important aspect of the work to the client at that time? Is a rapid resolution of the issue of greatest concern? Is complete vindication of its position in a dispute the only possible outcome the client would accept?

VRQs can also serve as the basis for a more informed discussion by client and counsel of possible alternatives to the hourly rate as the means of calculating a fee arrangement. Despite a great deal of discussion over the years of the “evils” of the hourly rate and a recognition that it can distort the efforts of client and counsel to reach a common vision with respect to cost control and budgetary certainty, it continues to serve as the basis for the great bulk of legal fees paid by business clients. For a discussion of the incentives of the hourly rate that disserve clients, see P. Lamb, ALTERNATIVE FEE ARRANGEMENTS: VALUE FEES AND THE CHANGING LEGAL MARKET ch. 2 (Ark Group 2011) (“You get what you pay for.”).

How do VRQs do so? By enabling counsel to focus on more discrete, measureable elements of value rather than the somewhat vague, nebulous term in its full scope. VRQs allow the dialogue of client and counsel to advance in such a way as to allow for more meaningful application of VRQs to that client’s situation. Rather than design a fee arrangement that delivers greater value to the client, VRQs permit the design of fee arrangements that align the thinking of in-house and outside counsel on particular criteria that, in the client’s eyes, represent ways in which the legal service can yield it greater business benefit. The incentives in that arrangement, based on VRQs, should lead to behavior by the lawyers that more directly reflect the client’s value-related expectations.

**Satisfying Client Demands and Meeting Expectations**

Understanding value and its subsidiary components (i.e., VRQs) intellectually and applying those terms to the daily practice of law require a thorough familiarity with both client demands and expectations. We suggest the following framework to reach that understanding.

Figure 1 helps the reader visualize the relationship between VRQs and client expectations. In that figure, specific VRQs are grouped to reflect typical, overarching, value-related goals of a corporate client to which they relate (the points of the pentagon). The internal triangle identifies the usual parties involved in handling a legal matter (illustrated by the triangle within the pentagon) can influence the achievement of value or a failure to do so. The points on the triangle remain the same for the majority of legal engagements. Depending on the client’s identified VRQs for the engagement, however, the roles of the entities on the points of the triangle might differ from those for another engagement, as could the impact each entity has on satisfying the identified VRQs. In the majority of cases, the role of in-house counsel will be that of project manager in addition to legal counsel for the business unit.
When thinking about what value means to a client and using Figure 1 as a framework for discussion, one quickly sees that several VRQs could be made part of an engagement. One VRQ can structure an understanding of the cost-management expectation, e.g., budgets, predictability and “no surprises.” Level-of-service elements can emphasize teamwork, urgency, communications, and innovation. Elements around corporate goals, expertise, and resolution will also frame the value equation for this matter.

These VRQs do not stand alone or act independently. They are related and should be integrated and balanced. In some situations, cost management may trump all other VRQs, whereas resolution and urgency might outweigh cost in others. Corporate goals around reputation could very well be the key VRQ. Acknowledging the complex nature of legal services today, it is essential in every situation that counsel always demonstrate teamwork and innovation. Once the VRQ framework has been established for any one engagement, the appropriate roles and responsibilities become more evident.

In the center of the VRQ balancing act stands the in-house counsel. He or she serves as the quarterback of the team. Achieving the goal of each particular play (that play’s VRQ) requires engaging the disparate talents of all members of the team in the right sequence. Experienced project management and communication skills are keys to success. Let’s look at an example.

Corporation A has been served with a lawsuit that involves sifting through years of electronic media, such as e-mail, memos, internal policies, and referenced websites. Approximately half of the data that must be reviewed resides on headquarters servers, whereas the other half is spread across multiple field servers. The request covers 15 years of material. How can VRQs help shape the e-discovery effort of this matter?

Tackling e-discovery clearly requires teamwork if cost goals are to be achieved. The first steps of identifying where the data resides within the corporate IT structure and establishing a strategy for collecting it could be varied in approach. The task might be assigned to a third-party data-processing vendor and priced by the terabyte, but the vendor’s learning curve could be protracted, and missteps along the way are possible. What about using the company’s IT professionals to do the initial data gathering? Have them partner with the third-party service provider at every step of the way. Alternatively, if requisite software is available in house, assign an IT manager to execute the gathering per specifications agreed to by all counsel.

What if, during the contract attorney review, the responsive document hit rate seems extraordinarily low? Full speed ahead? Probably not. VRQs designed to address level of service would suggest that the results-driven component of the model is not being achieved. Perhaps additional expertise is required for the review of the criteria used to identify potentially responsive documents. Efficient communications and “no surprises” expectations again come into play. The attorney in charge serves as a project manager in order to get the project back on track, and the existence of the VRQ framework plays an important role in evaluating performance and value attainment by all involved.

Another example involves a company with a national footprint. Initially, a decentralized approach was deemed the best model to address a portfolio of relatively predictable and routine legal disputes. One firm’s performance stood above the rest. Thinking about the previous reference to convergence, the company’s law department initiated discussions to determine whether there was a model that would reduce the costs of managing the portfolio. Each of the models suggested required the development of specialized software. Thinking about a firm’s willingness to bear some of the costs associated with recalibrating and expanding their relationship with this client, one firm offered to assume the development costs for the software and was willing to host the software behind its firewall. That firm’s willingness demonstrated a best-foot-forward approach to the client’s work by investing in the relationship. Doing so served the client’s stated VRQs of reasonable cost and greater consistency among matters. Complete, transparent, and reasonable cost estimates were provided the client for decision-making purposes, and the law firm was able to identify a new competency in its marketing materials for other and potential clients. In this case, VRQs related to Level of Service, Corporate Goals, Expertise, and Cost Management were drivers of the recalibrated relationship.

Now, how do we know everyone is dancing to the same beat? In both examples, cost management was an evident VRQ. Costs related to e-discovery can be and often are unpredictable, unless the client has a grasp of previous experience. Still, the range of cost projections can be extreme. Agreeing to track costs on a per-document basis for variable costs and identifying elements of fixed cost, no matter the volume, should be achievable. Monthly reporting? Probably not frequent enough for variable costs. Expectations based on volume can be projected, and ranges can be established. Weekly variable costs can be reported, unless something drives cost outside of projected ranges, e.g., too many hits, interesting observations, etc. Then, pick up the phone!

Level of service can be evaluated based on feedback from key constituencies. A survey can be an effective way to solicit feedback if the survey is crisp, does not give the responder a clear line of sight to “no hum” responses, and gives the responder an opportunity to expand on concerns and to make suggestions for improvement. (Responders that take the time to write additional feedback must be specifically acknowledged.) Expertise can also be subjected to feedback surveys.

One of the co-authors was responsible for the appeal of an adverse jury verdict. Due to the nature of the case and its implications on a portfolio-wide basis, three law firms were involved in the appeal. Soon after that verdict, the co-author called a meeting of the three firms to be held in the state in which the verdict was rendered (one of the three firms was based in that state, and the other two were based elsewhere). The host firm was represented by three attorneys (one associate and two partners—one of whom had been responsible for the matter during the
trial phase, and the other of whom was a former chief justice of that state that the client had selected to “quarterback” the appeal). The second firm sent a senior partner and a senior associate, and the third firm sent one senior associate.

During the meeting, the senior partner of the second firm tried to take charge of the meeting, despite the presence of the host firm’s senior partners. After the meeting concluded and upon returning to the office, the author sent the three firms a memorandum assigning each firm a role during the appeal with delineated responsibilities. The author of the memorandum wanted to reduce redundant efforts and potentially overlooked issues that could result when three firms operate somewhat independently. The senior partner of the second firm (who had tried to run the planning meeting) objected to the memorandum, claiming that he had an ethical obligation to consider any issue that he deemed significant despite the other firms’ involvement. The presence of three eminently qualified firms (and a corporate law department with several hundred in-house attorneys) did not sway him from his view. Did that attorney’s actions demonstrate a sensitivity to and appreciation of the client’s VRQs and its desire for close collaboration among the firms? Decidedly not. Once an agreement has been reached regarding VRQs, determining a feedback mechanism or evaluative metric should be relatively easy. If it is not, perhaps the VRQ needs refinement.

We have been discussing VRQs as they apply to the management of legal matters; however, they also can be used to improve the general management of the corporate legal department. How many firms still casually send annual rate increase letters to their clients? Too many, we suspect.

Those letters usually attempt to justify increasing baseline rates or to recognize associates who have broken through to another billing level or status. The baseline increase in rates generally bears no resemblance to overall economic growth and inflation. (For years, corporate America provided two- to four-percent salary increases, and the U.S. economy struggled to keep pace. What was the rationale that many firms used to ask clients for across-the-board, 10-percent increases in hourly rates?) In some cases, clients fire a preemptive shot across the bow of the ship in the form of a letter such as this:

Dear Firm: We will not accept across-the-board rate increases for the next fiscal year. For those associates you deem entitled to an increase due to achievement, please provide us your firm’s specific performance rationale. We will then solicit input from our professional(s) in charge of the matters on which this associate works, analyze historical rate increases, and let you know if we find the increase appropriate.

Does such a process make sense? Does it feel client-centric? We believe that the answer is obvious.

We are not suggesting that rate increases are never justified. We are suggesting that the VRQ framework can help firms and clients arrive collaboratively at a mutually suitable rate structure, even if a firm is still wedded to the hourly rate methodology as a representation of the value of its legal service. A couple of VRQs jump off the page as particularly useful when discussing firm rate increases: expertise, communications, budgets, “no surprises,” and appropriate cost are examples. If the client is truly your focus, especially from the “long-term relationship” perspective, the model will help in other, nonmatter-specific business processes. Let us look at a couple and hypothesize how thinking differently about rate increases helps a firm become more client-centric.

Communications. How do you think a client would feel about receiving a thoughtful letter from the relationship partner seeking feedback about the services provided during the past fiscal period, feedback regarding specific attorney performance, and feedback suggesting how the firm could improve its overall performance in the next fiscal period? Specific performance data reflective of the client’s expressed VRQs enables you to negotiate from an informed position of strength in terms consistent with the client’s needs and expectations. Where increases may be warranted, the request can be effectively tailored using VRQs.

Budget Consciousness. Managing costs against a budget is a corporate mantra. Being over budget should signal an immediate problem for the relationship your firm enjoys with its client. Typically, professionals do not simply wake up one morning and find key matters suddenly over the budget set with the client. Potential cost overruns usually build over time. Do alarms go off if 50 percent of an annual budget has been spent during the first three months of a fiscal period? Do a firm’s systems allow it to monitor costs similarly to its client’s methodology? Is it a crime to be over budget? Clearly so, if a firm and its client do not know why! Keeping track of expenditures against a budget on a frequent schedule benefits both parties.

Summary

Corporate clients are demanding higher-value legal service because they have seen their legal fees continue to escalate without a demonstration of increased, proportionate business value. To address that demand in a systematic fashion, law firms need an approach that is simple, practical, and consistent. Moreover, whichever approach law firms use must also enable them to address clients’ interest in alternative fee arrangements in a similar way.

Alternative fee arrangements based on the VRQ framework will provide law firms the tools to design metrics and management systems that take into account a variety of fee arrangements because the measurement will be client satisfaction regardless of the specifics of the fee arrangement and without direct relationship to the dollars and cents of those fee arrangements, however those fees are calculated. The benefits of incorporating VRQs into a law firm’s service delivery can extend, however, beyond better fee arrangements; VRQs can lead to improved client relationships, enhanced client satisfaction, and more efficient and effective representation. In other words, they can enable a law firm to set itself up to succeed in the increasingly competitive environment for corporate representation.
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