
Executive summary

In today's economy, companies are scrambling to cut costs. Clients are pressuring law firms to offer alternatives to the billable hour, including negotiated discounts, fixed fees, and hybrids such as hourly rates plus a contingency, blended contingency fee agreements, and hourly fee caps.

The basic concepts of alternative billing have been around for several decades, and the American Bar Association published its first book on this topic in 1989. But client pressures to use the approach increased in 2008 when the Association of Corporate Counsel announced its Value Challenge "to reconnect value and costs for legal services."

According to a BTI Consulting survey, alternative fees are most commonly used in litigation, followed by mergers and acquisitions work, corporate finance, and labor and employment. But experts disagree about exactly how often alternative fees are used at the present, and one goal of the Value Challenge is to establish benchmark data to monitor trends.

A number of boutique firms have been especially active in promoting alternative fees, including Valorem Law Group; Summit Law Group; Shepherd Law Group; Bartlit & Beck; Exemplar Law Partners; Chinn and Associates; Waite, Schneider, Bayless & Chesley; and Raymond & Bennett. Some large firms have also begun to publicize their work in this area, including Seyfarth Shaw; Cravath; Howrey; Morgan Lewis; and Fenwick & West.

This guide describes eight steps to succeed with fixed fees. The most important is to set the right price. There are two basic approaches to setting fixed fees: cost-plus pricing and value pricing. While there are arguments to be made in favor of each, we recommend a hybrid approach, which starts from cost-plus estimates, and uses value pricing to determine the size of the safety factor. Ultimately, pricing is an art which requires a great deal of trial and error, and improves with practice.

Hourly rates can be combined with fixed fees in a large number of ways to form hybrids. The third edition of the ABA book *Winning Alternatives to the Billable Hour* lists fifteen of the most common types, and a quick web search will turn up many more. One of the most interesting is value-adjusted hourly billing in which legal matters are billed in the traditional hourly way, but at the end of the matter the client is invited to subtract or to add any amount, in order to reflect the value received.

For many years, law firm work practices, recruiting, and compensation models have all been built around billing more hours. If law firms decide to change to a business model that stresses fixed fees and rewards efficiency, many of these

practices will have to change. How quickly this will occur depends on many factors, including the conservatism of inside counsel who are accustomed to hourly billing.

It appears that the profession is entering a period of growing experimentation, in which more lawyers will try alternative fees. This will continue for at least as long as clients remain under financial pressure. If the use of alternative fees hits a tipping point, it has the potential to totally transform the legal profession, from the way legal matters are handled to the way lawyers are compensated.

Challenges to the billable hour

In discussing the economic outlook for 2009, *Business Week* (January 5, 2009, p. 39) noted that most companies are “scrambling to protect their bottom lines” and “costs cannot be cut fast enough.” For law firms, that means more pressure from clients for alternative fees.

But there is no clear consensus on how lawyers should use alternative fees, or even on exactly what the term means.¹ Is a blended rate an alternative fee? Some experts would say yes, some no. And there is even less agreement about the risks and benefits of all the variations, including flat fees, contingency fees, retainers, capped fees, safety valves, and other alternative approaches.

This guide was written to help lawyers put alternative fees into perspective, and consider when and how to use them.

Any big picture overview of alternative fees must start with the system that it is an alternative to: billing by the hour. A few years ago, the American Bar Association established a “Commission on Billable Hours” to study the pros and cons. Their final report in 2002² highlighted many disadvantages of hourly billing, including (p. 5):

- “Simply put, the overreliance on billable hours by the legal profession:
- results in a decline of the collegiality of law firm culture and an increase in associate departures
 - discourages taking on pro bono work
 - does not encourage project or case planning
 - provides no predictability of cost for client
 - may not reflect value to the client
 - penalizes the efficient and productive lawyer

¹ It starts from a broad definition of the term “alternative fees,” which includes both discounting tactics which are widely used, and fixed fee structures which are less familiar.

² <http://www.abanet.org/careercounsel/billable/toolkit/bhcomplete.pdf>

- discourages communication between lawyer and client
- encourages skipping steps
- fails to discourage excessive layering and duplication of effort
- fails to promote a risk/benefit analysis
- does not reward the lawyer for productive use of technology
- puts client's interests in conflict with lawyer's interests
- client runs the risk of paying for:
 - the lawyer's incompetency or inefficiency
 - associate training
 - associate turnover
 - padding of timesheets
- results in itemized bills that tend to report mechanical functions, not value of progress
- results in lawyers competing based on hourly rates"

Later in the final report (p.8), the Commission focused on the most critical problem:

“Hourly billing allows, indeed may encourage, profligate work habits. A cost-plus contract can degenerate into disregard for basic market discipline. So too can the obvious benefit of being paid for working more hours lead, directly or indirectly, to inflating the number of hours worked. Cost-plus can also override scruples about quarter-hour billing increments, which are never marked down, only up.”

If the billable hour has all these inherent problems, why does it continue to dominate the legal profession? In part, because it is simple and straightforward, and everyone is used to it. But most of all, in the words of the ABA commission (p. 8), because it “Lets law firms make more money.”

The seductive appeal of hourly billing is a problem not just in legal circles, but in every profession. In my experience as the owner of a training and consulting company, hourly contracts are an addictive habit. Before we started working with lawyers, one of our biggest clients was the US Government and we earned over \$15 million on contracts developing and delivering training programs on an hourly basis.

From the government's point of view, the job we did was good enough to win an award from the US Small Business Administration as the best small business government contractor in New England. But from our point of view, the business model of billing by the hour created a disturbing conflict of interest.

The only way to make more money was to hire more people. The more efficient we became, the less money we made. Our needs were fundamentally opposed to our clients' needs. It was bad for business relationships, bad for work habits, and bad for employee morale.

Nevertheless, we became addicted to hourly billing. Every time we had some success, we hired more people. That increased the number of hours we needed to bill the next month to break even.

When signing new business, sometimes we had a choice between a fixed price contract and an hourly approach. In those days, I always chose hourly. Because I hate risk, and the hourly approach minimized my risk.

A few years after our government contracts peaked, we switched our focus to helping lawyers develop new business, and renamed the company LegalBizDev. Since then, all of our work has been fixed price. The reason is ironic. Lawyers love to bill by the hour, but they hate to pay that way. When we consult with lawyers about how to bring in new business, we want to maximize our chances of success by being able to help and support lawyers whenever a new opportunity for more legal work comes up. But if we billed by the hour, lawyers would be reluctant to call us, because they would know that the meter is always running.

These same fundamental business realities apply to every law firm. As David Sump, now at Troutman & Sanders, wrote in the Newsletter of the Virginia Bar Association³ a few years ago:

“The billable hour dies hard, like a cockroach that refuses to check into its own special motel or a rodent that scoffs at the spring-loaded cheese morsel... I must confess that as much as I detest the billable hour, I know that if we bill enough of them each month, there will be money left over at the end of the month to pay my partners.”

This explains why the transition from hourly billing to alternative fees has been so slow. Most lawyers will seriously consider alternative billing only when they are pressured to do so by clients and competitors. As a result of the economy in 2009, that pressure is rising.

³ http://www.amazon.com/Winning-Alternatives-Billable-Hour-2nd/dp/1590311175/ref=sr_1_4?ie=UTF8&s=books&qid=1230316424&sr=1-4

An idea whose time has come?

The basic concepts of alternative billing have been around for several decades. The American Bar Association's first book on the topic—*Beyond the Billable Hour: An Anthology of Alternative Billing Methods*—was published in 1989. That book is no longer in print, but it has been replaced by several other ABA books. The most recent was published last year: the third edition of *Winning Alternatives to the Billable Hour: Strategies that Work*, by Mark A. Robertson and James A. Calloway.

The blogosphere and the media began buzzing about alternative fees last fall, when the 25,000 member Association of Corporate Counsel announced its *Value Challenge*⁴ “to reconnect value and costs for legal services.”

As an October 19 *Washington Post* article⁵ put it:

“New efforts to jettison hourly billing are being driven by in-house corporate lawyers, who say they have grown frustrated seeing fees to outside firms soar even as they slash their own costs. They said they want more certainty in their legal budgets and worry that outside firms are spending unnecessary amounts of time on their matters.”

When *The American Lawyer* published its latest survey of 112 law firm leaders in December 2008⁶, sixty-nine percent agreed with the statement, “Due to the advent of new technology and increased commoditization of legal services, many, if not most, Am Law 200 firms will have to change their business and billing practices.”

The ideas got another publicity boost in January, when Cravath Chairman Evan Chesler published an article in *Forbes* with the provocative title “Kill the Billable Hour,”⁷ arguing that:

“For reasonable periods of time during the life of a lawsuit, say three months at a time, [lawyers should] identify the client's objectives, measure, calculate, build in a contingency and come back with a price. Once the price has been agreed upon, the billable hour should be irrelevant.”

⁴ <http://www.acc.com/advocacy/valuechallenge/>

⁵ <http://www.washingtonpost.com/wp-dyn/content/article/2008/10/19/AR2008101901397.html>

⁶ <http://www.law.com/jsp/article.jsp?id=1202426433148>

⁷ <http://www.forbes.com/forbes/2009/0112/026.html>

This central idea is familiar to advocates of alternative fees. But when the chairman of one of the most prestigious law firms in the world says it, that is news.

While many people agree that alternative fees are a hot issue, there is less agreement about exactly which types of billing are alternative and which are not. As ACC General Counsel Susan Hackett put it in an interview with *Corporate Counsel*⁸:

“I don’t know what alternative billing will look like. Perhaps you’ll see more contract people, more people providing legal products and services that are currently being done by lawyers but probably don’t need to be. I think you’ll see a lot more focus on technology and how it can move those processes forward. And I hope you’ll see a much more vibrant law firm market, one that will have corporate practice spread across a much broader swath of firms than you currently see.”

Whatever the change looks like, few seem to think that it will come quickly. When Cravath’s Evan Chesler was interviewed in the *Wall Street Journal* blog⁹ they asked him to identify “the highest hurdle to achieving a billable-hour-free world.” Chesler replied:

“One is inertia. People tend to continue doing what they’ve always been doing. Change requires the application of force. Another is the difficulty of defining what constitutes success. Because in large, complex cases, that’s not a question with a simple answer. It’s easy to think of it in terms of a jury foreman standing up and announcing who won. But the world is more complicated than that.”

When Aric Press interviewed Chesler for *AmLaw Daily*¹⁰, he asked how much progress Cravath has actually made in getting away from the billable hour, and reported that “Chesler says that he’s been raising this issue with clients and in private talks for the last few years. Thus far, he says that he has ‘just a few situations, in the single digits’ with clients who have abandoned the billable hour.”

Ron Baker, founder of the VeraSage Institute, has devoted the last several years of his life to “burying the billable hour and timesheets across all Professional Knowledge Firms.” But Baker believes that widespread acceptance of value based pricing:

⁸ <http://www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202426214778>

⁹ <http://blogs.wsj.com/law/2009/01/07/im-a-trial-lawyer-i-bill-by-the-hour-this-needs-to-be-fixed/>

¹⁰ <http://amlawdaily.typepad.com/amlawdaily/2009/01/cravaths-chesler-time-to-kill-the-billable-hour.html>

“...could take decades if not centuries, since it involves the diffusion of a theory. I was naive enough to think the ABA Report in 2002 would have an impact, but alas, it fell flat. I’m starting to think physicist Max Planck was right: progress happens funeral by funeral.”¹¹

Examples from boutique firms

Despite all the barriers, a growing number of visionary boutiques are leading the charge to alternative fees.

Last year, Patrick Lamb, author of the widely read blog, *In Search of Perfect Client Service*, founded a Chicago litigation firm which takes its name from the Latin word for value: Valorem Law Group.

The animation that greets users to their web page begins by announcing, “The billable hour is dead.” Then it asks a question “How many lawyers does it take to screw a client?” After a short pause, the answer: “On a billable hour basis, only one.”¹²

One of Valorem’s most interesting innovations is their “value line adjustment”:

“On each bill, you have the right to make any adjustment to our proposed fee that you feel is needed. We provide value or you adjust the bill, it’s that simple.

We do this to give you the ultimate check on our unwavering commitment to client service, and to eliminate the concern that our level of service will wane once the work we’ve performed exceeds a given flat rate or capped fee allotment.

Some have said that the Value Adjustment Line is extremely risky. We agree. If we aren’t willing to risk our own fees on our service, do you really want us advocating for you?”

While Valorem is one of the best known firms to move away from the billable hour, it is certainly not the only one, or even the first. When Pat Lamb announced its formation in January 2008, he noted that many of its features, including the value line adjustment were “shamelessly copied” from his friend Ralph Palumbo of Summit Law Group. Palumbo’s vision of “Creating the

¹¹ http://www.verasage.com/index.php/community/what_a_great_idea/

¹² <http://www.patrickjlamb.com/archives/commentary-valorem-launches.html>

Law Firm of the Future”¹³ describes his approach to “getting away from the billable hour” and much, much more.

Another firm that takes a position on its web page is Shepherd Law Group, founded by Jay Shepherd in Boston to specialize in employment law:

“Hourly billing pits the interests of the client against the interests of the law firm. If a project takes longer to complete — which is bad for the client — the law firm makes more money — which is good for the law firm. And most firms have annual billing requirements for their lawyers, who don’t receive bonuses if they fail to bill a certain number of hours. With that kind of pressure, how hard are your lawyers going to try to keep your billable hours down?”

The Shepherd Law Group does all its work based on “Up-Front Pricing”:

“Up-Front Pricing is our approach to helping clients control their legal expenses. You will always know how much our work is going to cost before we do it. It’s our solution to the problems of hourly billing.”

A number of other lawyers and firm have announced their commitment to this approach, including:

- Fred H. Bartlit, Jr., the founder of Bartlit & Beck, a 70 lawyer firm with offices in Chicago and Denver which was named Litigation Boutique of the Year in 2009 by *The American Lawyer*. The firm does not charge by the hour “in the vast majority of our cases.”
- Chris Marston, founder of Exemplar Law Partners in Boston “the first corporate law firm in the nation to exclusively adopt a fixed price model.”
- Mark Chinn, founder of Chinn and Associates, a family law firm near Jackson Mississippi that promises a “method of pricing that is relatively unique to divorce practice and is designed to foster extreme customer satisfaction.”
- Michael Grodhaus, a litigator at the Columbus Ohio office of Waite, Schneider, Bayless & Chesley and author of the blog, *The Alternative Fee Lawyer*.
- Bruce Raymond founder of Raymond & Bennett, a Connecticut firm that specializes in business and personal injury litigation.

In December 2008, Bruce Raymond founded the Alternative Fee Lawyers group on LinkedIn.

¹³ <http://www.summitlaw.com/PalumboArticle.pdf>