

# IN-HOUSE AND LAW FIRM MANAGEMENT

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## IN THIS ISSUE

*The appeal of a flat fee arrangement for both the client and the law firm is quite simple: the client pays a flat fee to the law firm to provide all necessary legal services for a discrete assignment thereby providing predictable legal spend for the client and revenue for the law firm, with no required bill preparation, review or adjustment, thus saving administrative time and costs for both parties. This approach has worked well in rather simple, predictable, straight-forward, individual pieces of litigation. As the complexity of the litigation increases, adopting this flat fee model for individual lawsuits becomes, in a word, complicated. Designing a flat fee system for an entire book of complex litigation placed with one law firm becomes exponentially more difficult. This article explores one possibly design of such a program, but invites others to weigh in on what has worked for them in similar circumstances. Alternative Fee Arrangements (AFA), of which the flat fee is one type, will become more accepted and expected by clients and it is vitally important for law firms to get ahead of the curve and embrace AFAs in the increasingly competitive legal market.*

## Flat Fee Agreements in Complex Litigation: A Workable Approach

### ABOUT THE AUTHOR



**Ray Sheldon** is an Associate General Counsel in the State Farm Mutual Automobile Insurance Company's Law Department in Bloomington, Illinois. Ray leads the Affirmative Litigation Team that manages litigation initiated by State Farm involving fraudulent claims practices. Prior to joining State Farm in 2000, Ray practiced law in New Jersey for 20 years, largely focused on litigated matters representing both plaintiffs and defendants. He can be reached at [ray.sheldon.loum@statefarm.com](mailto:ray.sheldon.loum@statefarm.com).

### ABOUT THE COMMITTEE

The In-House and Law Firm Management Committee educates IADC members on the latest trends and developments pertaining to the "business of law," so as to allow in-house legal departments and law firms to establish best practices for providing excellent legal service in a cost-efficient, effective, and responsive manner. They serve as a resource for IADC members, leadership, and staff on strategies for managing law firms and in-house legal departments in a manner that enhances client service and business relations; as well as improving economic value and profitability; marketing and business development; leadership succession and planning; and culture, diversity, and ethics. Learn more about the Committee at [www.iadclaw.org](http://www.iadclaw.org). To contribute a newsletter article, contact:



**Amy K. Fisher**  
Vice Chair of Publications  
Ice Miller, LLP  
[amy.fisher@icemiller.com](mailto:amy.fisher@icemiller.com)

*The International Association of Defense Counsel serves a distinguished, invitation-only membership of corporate and insurance defense lawyers. The IADC dedicates itself to enhancing the development of skills, professionalism and camaraderie in the practice of law in order to serve and benefit the civil justice system, the legal profession, society and our members.*

Historically, hiring a law firm to defend or prosecute complex litigation involves paying an agreed upon hourly rate for work performed *after* the work has already been completed. This post-mortem bill review, if done properly, involves the expenditure of many hours by the client to review and adjust each submitted bill, potentially followed up with an uncomfortable conversation with the law firm, explaining why the hours were reduced for certain tasks. The entire process flies in the face of hiring a law firm because of the trust you place in them to do the work appropriately, yet then questioning the appropriateness of the bills they submit in performing the very services you trusted them to perform.

Requiring detailed matter budgets - including the use of Uniformed Task-Based Management System (UTBMS) coding - at the inception of the attorney-client relationship on a discrete matter, sets the expectations of both parties as to the substance and scope of the work to be performed. The simultaneously developed litigation strategy, coupled with the approved budget, are the criterion against which the submitted bills are measured. However, even with such structure in place *before* the legal services are provided, a detailed review of the submitted bills is inevitably required to confirm compliance with client expectations set by the budget and litigation strategy. Once again, the expenditure of time by the client reviewing the bills and the potential questioning of the appropriateness of the billing by the law firm is prominently in focus.

Flat fee agreements are not new to the legal profession. Paying a set fee for a specified quantity of work on a discrete matter is a deceptively simple process for each party: the law firm doesn't need to track internal resource expenditure for billing purposes (although they likely do for internal purposes) because no bill is generated, and the client doesn't have to review bills. The agreed upon amount for the work performed is paid to the law firm in whatever intervals the agreement calls for. From the client's perspective, there is predictability in legal expenditure. From the law firm's perspective, there is predictability in revenue without specifically being tied to actual work performed on a matter in a given month. Such an arrangement, across multiple files assigned to a particular law firm, simplifies the accounting for both parties, avoids laborious and time-consuming bill review, requires the firms to increase their efficiency by moving the work to the appropriate timekeeper level, and avoids the potential uncomfortable discussion between law firm and client that detailed bill review and adjustment can engender.

The more complicated the discrete litigation however, the more complicated the flat fee arrangement will become. Solutions range from "staging" the work to be performed with a separate flat fee for each segment, to setting "collars" and "caps" for unexpected work required to be performed. But what if one sets out to design a flat fee arrangement, not covering a single complex law suit, but an entire book of business

consisting of multiple, complex, discrete law suits? Class action defense or affirmative litigation, for instance? What would a flat fee arrangement with all the advantages, and none of the disadvantages look like?

After exploring this question for several years, reading much literature on the subject, and consulting with procurement, financial and legal experts in the field, I have reached the regrettable conclusion that you cannot completely remove hourly rates nor bill review from the process, and thus have sadly accepted the bursting of my flat fee as panacea balloon. However, despite my hopes being dashed, I believe there is a way to work within existing variables common in the billing dynamic to fashion a hybrid process where the predictability of legal spend and revenue is achieved through payment of a flat fee, but with a reduced degree of painful “digging in the weeds” of extensive bills that sap time and money to process. Developing such a process is beyond the expertise of attorneys and that’s where the procurement, financial and legal fee experts come in. What follows is an oversimplified explanation of the design of such a system (as the late, great Rod Serling might say), “for your consideration.”

At the heart of this design is an agreed upon blended hourly rate negotiated between the parties, ideally for an extended term (3-5 years), which may adjust for an agreed amount (annually, for example) during the life of the agreement. Historic billing data for the firm is examined to arrive at an appropriate blended rate. The blended rate

should include paralegals as well as attorneys, to encourage work being performed at the appropriate level. The agreement might even specify the expected percentage of work to be performed by category of timekeeper (partner, associate, paralegal) although this complicates the management of the relationship with the law firm. Once the blended rate is agreed upon, the historical usage of the law firm by the client (average annual hours billed) is examined in order to determine the cost of using the firm moving forward, and if desired, to adjust the annual allocation of hours assigned to that firm to arrive at the annual spend for each year of the agreement. A simple multiplying of the annual allocation of hours times the agreed upon blended rate, divided by twelve gives you the monthly flat fee that will be paid to the law firm in each year of the agreement. Of course, other intervals of payment may be agreed upon instead, with adjustment of the flat fee payments accordingly.

Unfortunately for the law firm, it is still required to submit monthly bills, but frankly, most will keep track of their time in any event as their means of monitoring their realization rates on the flat fee payments. Monthly bills are submitted to the client as usual, and either the client’s business office or legal operations office will track the hours expended and compare it to the annual allocation of hours for the firm. Budgets are submitted on each discrete matter within the book of business, which will track not only tasks but anticipated hours expended on each task as well. Quarterly true-ups

between the client and the law firm will discuss budget variances on each matter, if any, as well as overall progress on the annual allocation of hours across the entire book of business. Adjustments on assignments will be made as appropriate during the year to maintain the desired annual allocation. Finally, an agreed upon annual allocation collar (percentage) will assure the client that they are not overpaying for the actual legal services obtained, and a cap will ensure the law firm that they are not being underpaid for the services they provide.

To avoid the painful, laborious bill review on each month by the client, the historical percentage reduction in the law firm's billing can be factored into the annual comparison of the actual time billed to the annual allocation. Alternatively, the parties can agree to an audit (detailed bill review) of a small percentage of bills submitted, with any adjustment percentage applied to the balance of the bills (not audited) to arrive at the adjusted allocation. The entire reconciliation process, as well as the wide expanse of the blended rate to cover paralegals, should drive staffing efficiencies within the law firm, potentially impact their hiring decisions and ultimately compel them to work smarter and more efficiently without sacrificing the quality of their work product. In return, the law firm can maintain and likely improve their revenue margins while having predictable, regular income, and the client gains predictability in legal spend.

The described system does not eliminate all of the "painful" processes endemic in the budgeting, preparation and billing review, but it does reduce the administration of the financial relationship significantly, while evening out annual spend/revenue. If multiple firms are retained under such agreements, it allows the client to differentiate between various firm's price points and permits a more efficient and data-driven management of their day to day business and legal resources. In this era of big-data, this proposed flat fee arrangement for a book of complex litigation business is just scratching the surface of what can be utilized to retain cost-effective, quality legal services in the rapidly changing legal environment in which we all operate.

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R. Matthew Cairns