

Litigation Management at the Right Cost

Introduction

The Right Cost – a fundamental pillar of the Baylor Law LL.M. in Litigation Management R⁶ FrameworkTM – addresses the way legal services should be priced, purchased and delivered. Given the current emphasis on reducing legal costs and making access to justice more affordable, there should be an intentional focus on delivering “value”¹ to clients based on defining litigation “success” for any litigation project, focusing on litigation planning, reducing litigation process inefficiencies, increasing litigation productivity, providing litigation cost predictability, changing the way litigation is resourced and priced, and delivering the expected litigation results and outcomes. These objectives can be achieved in a variety of billing formats, ranging from traditional hourly fees to flat fees to value-based billing and variations on contingent fees. In short, Right Cost is about achieving expectations of “success” at an acceptable cost to the client and at the Right Price for the law firm.

Backdrop

The litigation service industry has undergone considerable transformation over the last thirty years. That transformation, perhaps even more aggressive than at any prior time, continues without cessation.² While many date the start of this transformation to the global economic recession of 2008, it probably started much earlier, as the cost of legal services continued an upward escalation. Many began to question the “value” provided by rising costs and were intent on assessing the return on the cost investment (ROI). The emphasis on delivering value, labeled the “Value Proposition,”³ probably started in the early 1990s when

¹ Value can be seen as an equation: Value = Benefit – Cost. Value can be increased by adding pure benefit, reducing cost for the same benefit, adding benefit for the same cost, or increasing benefit that exceeds the cost. “Value is not independent of cost.” Steven B. Levy, *Legal Project Management* (Second Edition) (Am. Bar, Assn. 2014) (hereinafter “Levy”) @ 14.

² See Mark A. Cohen, *Big Money is Betting on Legal Industry Transformation*, FORBES (Oct. 7, 2019, 6:36 a.m.), <https://www.forbes.com/sites/markcohen1/2019/10/07/big-money-is-betting-on-legal-industry-transformation/#77c89aa15ce2>.

³ See Thomas S. Clay & Daniel DiLucchio, Jr., *Clients and the Value Proposition*, (Dec. 2012), http://www.altmanweil.com/dir_docs/resource/cc05cde9-5f0d-4d9b-8a4a-49716ecec0df_document.pdf.

some corporate clients began the use of alternative (non-hourly) fees⁴ to slow, completely halt and even reverse the upward trend largely caused by increasing the dollar value of law firm compensation packages and the standard law firm pyramid-model that is based on increasing hours, ever-increasing hourly rates or both.⁵

The legal cost concern reached a peak during the recession that began in earnest in 2008. When the global economic crisis forced companies to hold and even reduce prices on goods and services, law firms continued to increase lawyer compensation, hourly billing rates and bill more hours.⁶ From 2000 to 2010, overall company costs rose 20%, whereas legal costs rose 75%.⁷ Rising legal costs did not sit well with corporate counsel who questioned the efficiency of hourly billing and stated that their “single largest unmet need” was “better value from law firms.”⁸ Corporate CEOs/CFOs demanded reduced outside counsel costs.⁹ Non-hourly fee structures were seen, at that time, as an effective way to manage costs and a better use of management techniques to advance company business interests.¹⁰

Despite corporate in-counsel pleas and company urgings, the use of value based alternative fees has not progressed as desired because many outside law firms have remained tied to the hourly rate formulas of old – focused on increasing hours, hourly rates or both as the only means to enhance firm revenue year-to-year. Personal injury plaintiff lawyers abandoned hourly billing long ago in favor of the shared risk contingency fee which gives many access to justice. Nevertheless, there are many individuals and small companies that have legitimate disputes that are being denied access to justice because it is not affordable. It is not affordable because of hourly billing inefficiencies.

⁴ See Michael Roster, *Time to Blow Up the Billable Hour Formula*, ABA JOURNAL (Nov. 28, 2012, 3:10 p.m.) http://www.abajournal.com/legalrebels/article/time_to_blow_up_the_formula. (“Blow-up”)

⁵ Reynolds Holding, *Breakingview – Holding: \$1,745-an-hour lawyers due for disruption*, REUTERS (May 25, 2018, 11:23 a.m.) <https://www.reuters.com/article/us-usa-lawyers-breakingviews/breakingviews-holding-1745-an-hour-lawyers-due-for-disruption-idUSKCN1IQ2GN>.

⁶ ACC Value Based Fee Primer, 2010 @ 3

⁷ ACC Value Based Fee Primer, 2010 @ 3

⁸ ACC Value Based Fee Primer, 2010 @ 3

⁹ ACC Value Based Fee Primer, 2010 @ 3

¹⁰ ACC Value Based Fee Primer, 2010 @ 3

Today, newer and perhaps more significant driving factors, including the global COVID-19 pandemic, should exponentially enhance or “turbo charge”¹¹ the transformation and move law firms to deliver “value” by setting the Right Price to deliver litigation services to a client at the Right Cost. These driving factors include:

1. A changing litigation market place;
2. Increased pressure on litigation service purchasers;
3. Competition;
4. Changing law-firm economics; and
5. Advancements in technology.¹²

Driving Factors

1. Changing Legal Market

The changing legal marketplace refers to a significant paradigm shift in the definition of litigation “success.” For the client, success is not a courtroom “win” or favorable settlement resolution. Instead, success means achieving client expectations at a “predictable,” “reasonable,” “fair,” and “acceptable” cost.¹³ For the law firm, success is not a trial “win” but rather achieving client objectives at a “predictable,” “reasonable,” “fair” and “acceptable” law firm cost that is profitable for the law firm.¹⁴ A desirable outcome at a cost that exceeds client

¹¹ See Mark A. Cohen, COVID-19 Will Turbo Charge Legal Industry Transformation, (March 24, 2020 10:00 am EDT) <https://www.forbes.com/sites/markcohen1/2020/03/24/covid-19-will-turbocharge-legal-industry-transformation/#36da45961195> (hereinafter “Cohen COVID”

¹² Susan Raridon Lambreth and David Rueff, Jr. *The Power of Legal Project Management: A Practical Handbook* (Am. Bar Assn. 2014) (hereinafter “Lambreth”) @ 3-14; *See also* Thomas S. Clay & Daniel DiLucchio, Jr., *Clients and the Value Proposition*, (Dec. 2012), http://www.altmanweil.com/dir_docs/resource/cc05cde9-5f0d-4d9b-8a4a-49716ecec0df_document.pdf; Daniel DiLucchio & James Wilber, *Between a Rock and a Hard Place*, REP. TO LEGAL MGMT., July-Aug. 2008, at 3-5, 12, *available at* http://www.altmanweil.com/dir_docs/resource/0ec352cf-4c44-40d6-b5ea-1cb87639981e_document.pdf.

¹³ Lambreth @ 3. *See also* Mark A. Cohen, *What are the Right Metrics for Law Firm Success?*, BLOOMBERG LAW (Aug. 19, 2015), <https://news.bloomberglaw.com/business-and-practice/what-are-the-right-metrics-for-law-firm-success>.

¹⁴ *Id.* This is not intended to diminish the impact of a trial victory or favorable settlement resolution. Instead, the success definition recognizes there is increasing pressure placed on the purchasers of legal services (legal departments) which is in turn placed on the deliverer of those services (lawyers and law firms). That pressure means there should be some direct definable correlation between the “value” delivered by the law firm and the way the services are priced and the manner in which they are delivered.

expectations is not success for the client. Similarly, a desirable outcome that is not profitable is not success for the law firm.

2. Pressure on Litigation Service Purchasers

Litigation service purchasers look at the cost of those services as an investment and, like any purchaser, there should be an acceptable return on the investment. Corporate finance officers view litigation as pure cost and are legitimately, as with any other cost item, concerned about any inefficiencies leading to escalating costs that inevitably impact the company bottom line. Simply avoiding a loss, even catastrophic, is not necessarily viewed as an acceptable return on investment.¹⁵

3. Competition

There is, today, an over-abundant supply of litigation service providers. Like in any industry, abundant supply results in a buyer's market. A buyer's market is accompanied by lower pricing for the service which, in effect, reduces purchaser cost. In other words, competition drives the price down and, therefore, the cost lower for the purchaser. Lowering the price and still maintaining a profit means, among other things, greater efficiency, better processes, and significantly better resource management.¹⁶

Newer, non-traditional, litigation service providers present additional competitive pressures. There are now many new competitors that offer the ability to do a wide variety of litigation tasks, handled traditionally by young lawyers at law firms, more efficiently and at lower client cost.¹⁷ The presence of these new competitors means a decreased demand for traditional litigation law firms. Increased competition has two consequences: over-supply and decreasing demand. Both drive law firm pricing and client cost downward.

¹⁵ *Id.* @ 5-12.

¹⁶ *Id.* @ 12-14. See also Debra Cassens Weiss, *Law Firm Leaders Report Lawyer Oversupply and 'Chronically Underperforming Lawyers'*, ABA JOURNAL (May 24, 2017, 4:26 p.m.).

¹⁷ *Id.* @ 12-13. See also Nita Sanger, *An Industry in Transition: Legal Services "Market of the Future"*, LEGAL BUSINESS WORLD (June 21, 2019), [https://www.legalbusinessworld.com/single-post/2019/06/21/An-Industry-in-Transition-Legal-Services-\"Market-of-the-Future\"](https://www.legalbusinessworld.com/single-post/2019/06/21/An-Industry-in-Transition-Legal-Services-\).

4. Changing Law Firm Economics

Some law firms are finally changing the way they obtain revenue and how they assess law firm profit.¹⁸ Under the traditional law firm pyramid structure, with multiple levels of legal assistants, associates and partners all billing by the hour, partner compensation and profit was centered around hourly rates and hours both billed and collected. Under the hourly billing model, there is a focused attention on revenue production in three ways: Increased hours worked, increased hourly billing rates, and a combination of increased hours worked and hourly billing rates. Law firms have focused on revenue increase. Little attention, if any, has been paid to internal law firm costs, other than to increase salaries and office space size, both of which necessitate higher hourly rates and more hours billed. Traditional law firms end every year with bonus eligibility based on some arbitrarily high hours worked figure, and firm management demanding greater billable hour requirements and increased rates.¹⁹

Some firms, on their own or pressured by clients, have changed their economic approach. These firms have recognized that the traditional structure with its reliance on the billable hour for revenue production is inherently inefficient²⁰ and contrary to their own self-interest. If inefficient and largely ineffective, then any traditional methods for assessing law firm, lawyer, or law firm practice group profitability do not work and must be changed to account for more efficient revenue production.²¹ In other words, efficiency is a marker for assessing profitability and productivity and can be measured objectively. These firms have changed their compensation and profit analysis metrics to focus on

¹⁸ *Id.* @ 14-16. See also Michael Roster, *Aligning Your Firm's Compensation System with Client Priorities*, www.arkgroup.com/sites/defaykt/files/product-key (2012) (hereinafter "Aligning").

¹⁹ *Id.* @ 16-17.

²⁰ As early as 2002 the American Bar Association ("ABA") concluded that the billable hour approach has significant deficiencies that no longer work. The ABA stated the billable hour: The structure does not work any longer:

1. Lacks sufficient planning and rewards inefficiency and lack of productivity.
2. Results in re-working, duplication, and poor staffing.
3. Is inconsistent with a demand for value; and
4. Rate differences did not account for actual experiences and true productivity. (Need cite.)

See generally ABA Commission on Billable Hours Report 5-7 (2001-2002).

²¹ *Aligning* @ 3

revenue versus the true cost to produce that revenue. Revenue is important, but revenue production based upon the billable hour formula is not. Indeed, any law firm compensation or profitability metric that continues to use “the billable hour” as its basis may not remain competitive.²²

5. Advanced Technology

Rapid advances in sophisticated technology, including Data Analytics, Artificial Intelligence, Machine Learning and Robotics is fueling an even more rapid transformation.²³ Clients demand that technology be used to reduce overall legal spend. Indeed, firms should now invest in a wide array of advanced technologies for greater efficiency, and law firm costs associated with the purchase, training and use of these technologies will likely be borne by the law firm without client charge back.²⁴ Work previously sourced to a team of outside lawyers can now be done by advanced technologies that have the ability to learn and keep learning.²⁵ The work can be done quickly, correctly, efficiently and effectively at an acceptable, predictable cost.²⁶

This may not necessarily be welcome news for young lawyers. The number of lawyers needed for any particular case or case docket may diminish because lawyer salaries, benefits and space are significant law firm cost items²⁷ that affect the law firm price.²⁸ Nevertheless, legal technology specializations may prove to be the next fertile ground for young entrepreneurial lawyers to make their mark.²⁹

There is little doubt that the rising cost of litigation supports the need for excellence, effectiveness and efficiency in litigation management. Increasing client litigation cost was an issue even before the 2008 recession. The recession

²² *Id.*

²³ *See generally*, Kevin Ashley, *Artificial Intelligence and Legal Analytics: New Tools for Law Practice in the Digital Age* (Cambridge University Press) (2017) hereinafter “Ashley.” *See also*, Nita Sanger, *An Industry in Transition: Legal Services “Market of the Future”*, LEGAL BUSINESS WORLD (June 21, 2019), <https://www.legalbusinessworld.com/single-post/2019/06/21/An-Industry-in-Transition-Legal-Services-“Market-of-the-Future”>.

²⁴ Ashley @ 8-14.

²⁵ *Id.*

²⁶ Lambreth @ 126-128.

²⁷ *Id.*; *see also* Aligning @ 14-16.

²⁸ *Id.*

²⁹ Marc A. Cohen, *After-Corona Legal Careers: More Choice and Less Practice*, <https://www.forbes.com/sites/markcohen1/2020/05/14/after-corona-legal-careers-more-choice-and-less-practice/#fb86b3a36208>

accelerated the demand for a solution to the litigation cost issue and the global COVID-19 2020 pandemic³⁰ has exponentially accelerated the necessity of a solution now. The rapidly changing, highly competitive market, increasing client pressures, changing law firm profit equations and advanced technologies should now enable the “Right Cost” for the client to be achieved.

Right Cost/Right Price

For a client the Right Cost means delivering “value.” Delivering value means meeting and exceeding objectives and expectations (Benefit) at a satisfactory and acceptable cost. For a law firm, the Right Price is delivering value at a price point where the revenue exceeds the law firm’s cost to produce that revenue. The Right Cost and Right Price are the components of the “value proposition” in a nutshell. If the Right Cost and Right Price are the same, corporations, legal departments individuals, small companies, and law firms can “dramatically improve their alignment.”³¹ To reach the “Right Cost” probably starts with a law firm’s ability to arrive at the Right Price for the firm that is hopefully commensurate with the client’s expectations about the Right Cost. Perhaps, it is the best way to address the often unspoken, but nevertheless, ever present tension between a client demand for lower litigation costs and the law firm desire to increase revenue.³² Before addressing the Right Cost/Right Price proposition, some consideration should be given to what has transpired in the past in the area of litigation cost reduction and the value proposition.

Historically, a directive given by a corporate or company client to deliver value has been simultaneously accompanied by the command to reduce legal spend, typically, through a reduced legal budget.³³ In response to the reduced budget, in-house counsel’s efforts have been directed at their outside counsel law firms. The efforts have included not accepting rate increases, lowering billing rates through competitive bidding, percentage reductions off invoices, discount rates, reducing the number of approved time keepers, limiting travel, and refusing to pay for typical overhead expenses (copying, phone service, etc.).³⁴ Efforts

³⁰ See Cohen COVID.

³¹ Aligning @ 1.

³² *Id.*

³³ Sterling Miller, Ten Things: Effectively Managing Outside Counsel Spend, Sterling Miller 2014. Wordpress. com/2015/01/22/ten-things-effectively-managing-outside-counsel-spend/

³⁴ *Id.*

directed toward outside counsel law firms have continued with advent of new technology that allow companies to analyze invoices from competing firms for comparison.³⁵ There have also been some efforts to lower costs through use of non-hourly alternative fees, but those efforts have been stymied by both client and law firms continuing to use the billable hour formula as a comparison to what would have been paid had the matter been billed by the hour. Complaints of over or under payment depending on perspective persist when so called “shadow bills” are provided,³⁶ leading to internal law firm distrust and difficult law firm and client partnerships.

In-house counsel have not been exempt from cost reduction mandates. Recent efforts at internal cost reduction tend to address changes in the way legal staffs are organized, staffed and functionally operate.³⁷ One functional change that has had a positive impact on litigation spend has been the increased emphasis on “preventative law.” Before Sarbanes-Oxley³⁸, and other regulatory changes, little, if any, time was spent on preventing future litigation. There is now clear personal risk to company management, legal departments, and to the overall company reputation for failing to recognize litigation trends and act when those trends are encountered.³⁹ Today more time and attention is given to addressing issues before they give rise to litigation or unwelcomed regulatory action. The idea is to identify and correct issues before a litigation problem arises. If issues are corrected early, then litigation and its cost are less likely to occur.

Today most companies have a Legal Operations Department (Legal Ops). Legal Ops are typically tasked with a broader mission to dive deeper into newer, collaborative, creative and innovative means to handle litigation more effectively

³⁵ See for example, Robert Ambrogi, *Launching Today: Legal Billing Rates Database Enables Benchmarking by Firms and Clients*, <https://www.lawsitesblog.com/2020/05/launching-today-legal-billing-rates-database-enables-benchmarking-by-firms-and-clients.html>. Comparisons can be made between the people involved, hours spent and billing rate of one firm versus another for the same or similar output dollar (i.e. Summary Judgment Motion). If the output is essentially the same, the law firm submitting the higher dollar invoice is asked to reduce the invoice amount and is at significant risk of losing business to the lower cost law firm.

³⁶ See www.abovethelaw.com/2016/05/2-problems-on-the-shadow-bills/

³⁷ See *generally*, Susan Tahernia, J.D., *Leading Practices in Law Department Metrics: Company Best Practices* (October 2013)

³⁸ The Sarbanes-Oxley Act of 2002 is a law the U.S. Congress passed to help protect investors from fraudulent financial reporting by corporations. Will Kenton, *Sarbanes-Oxley (SOX) Act of 2002*, INVESTOPEDIA, <https://www.investopedia.com/terms/s/sarbanesoxleyact.asp> (last updated Feb. 4, 2020).

³⁹ See for example, Z. Jill Barcliff, *Preventative Law: A Strategy for Internal Corporate Lawyers to Advise Managers of their Ethical Obligations*, (2008) Mitchell Hamline School of Law.

and efficiently.⁴⁰ In other words, to achieve the Right Cost, Process Improvement tools (Analyzing, Solving, Implementing, Reviewing) every litigation process for opportunities to do things better, and more basic Project Management or Litigation Project Management (Defining, Scoping, Assessing, Implementing, Monitoring and Evaluating) tools are significant in this effort.⁴¹ Perhaps the most important task of Legal Ops professionals is collaborating with their outside law firm’s counsel and settling on a structure to address the competing interests of outside counsel (increasing revenue and profit) and in-house counsel (determined to reduce litigation spend). As earlier indicated, solving the competing interests issue should probably start with outside law firms. To be a collaborative partner, law firms should completely understand the interests of the client and align their own revenue and cost structure with the client’s interests to arrive at both the Right Cost for the client and Right Price for the law firm.

Right Price: Law Firm Revenue and Cost

Given the importance of achieving the “Right Cost” for clients, it is particularly important now, years after the 2008 recession and presently in the face of a worldwide COVID-19 pandemic, for law firms to dramatically change the way their litigation services are priced and profit determined to reach the correct “Right Price” for the law firm that is also the Right Cost for the client.

The price of any product or service has two components: a price level and a price structure.⁴² The price level is how much the law firm charges.⁴³ The price structure is the means by which the firm charges the price – hourly rates, flat rate, fixed fee or some other alternative fee.⁴⁴

There are different approaches to setting the price of any product or service. Cost-plus pricing uses the cost to produce a product or service and adds to the production cost some profit margin to set the price.⁴⁵ Another pricing approach is one based on the prevailing market, which looks less at the production cost and more at a price that it will take to get the business.⁴⁶ This

⁴⁰ See Corporate Legal Operations Consortium. www.cloc.org.

⁴¹ See R6™ Right Tools: Litigation Project Management and R6™ Right Tools: Process Improvement.

⁴² Susan Raridon Lambreth and David Rueff, Jr., *The Power of Legal Project Management: A Practical Handbook* (Am. Bar Ass. 2014) @ 126 (hereinafter “Lambreth”) @ 126-127.

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ *Id.*

approach identifies competitors, assesses what competitors charge, analyzes the competitors market position and determines a price after investigation. Pricing in this fashion is often subjective and generally misses the significance of production cost to the bottom line.⁴⁷ Value based pricing generally attempts to understand how much the product or service is worth to the potential purchaser and sets the price based on this assessment.⁴⁸ The price here is based, in part, on a subjective assessment of the purchaser's perception of value.⁴⁹

Law firm pricing designed to achieve the Right Cost for the client should give consideration to all three pricing approaches, but the bottom line is that the Right Price for the law firm is whether the price, if paid, is sufficient to cover all costs plus a reasonable profit. Increases for the law firm revenue comes not through increasing hours, rates or both, but instead from additional business sent to the law firm because of its ability to regularly achieve the Right Cost with adequate profit for the firm. In setting the Price, the law firm has some measure of control over the costs to do the work by aligning its resources (people, space, technology, etc.) with the client cost objectives and expectations.

A law firm Revenue versus Cost (Profit) analysis, if done correctly, can enable the law firm to make a rational decision about whether any particular work requested or sought can be done profitably for the amount requested by the client or proposed by the firm (budget or alternative fee). Moreover, if done correctly, the law firm and client can creatively, collaboratively and innovatively decide how best to handle any matter, including the ability of the client and law firm to share some risk. A correct analysis can also be effectively used with hourly rate billing or any type alternative fee.

To fully appreciate the Revenue versus Cost (Profit) approach in setting a price, consistent definitions may be helpful. Revenue is the total, in fees, collected from a client, however these fees are paid.⁵⁰ Revenue does not include expenses paid by the client. Direct costs are costs (compensation and benefits) associated with all who actually perform litigation work that are not equity partners (associates, legal assistants, of counsel, non-equity partners and full-time contract

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ Blow-Up @ 1

lawyers).⁵¹ Equity Partner Costs include partner compensation and benefits.⁵² Allocated Overhead Costs includes all other costs that are not direct costs. Allocated overhead costs can come from standardized outside sources or by drilling down to determine the specific costs for each equity partner. Drilling down means looking at specific office space size, assistant compensation, lawyer conference attendance paid by the firm, and a host of other like items.⁵³ Total Cost means all direct costs, allocated overhead costs, and equity partner costs.⁵⁴

Law Firms have historically used a wide variety of systems for setting equity partner compensation and assessing law firm profit. Many are inconsistent with the law firm's ability to set the Right Price. Some use an equation of Revenue less Direct Costs to provide some guidance about equity partner compensation. Others use Revenue less Direct Costs less Allocated Overhead Costs as a means to assess equity partner compensation.⁵⁵ These methods continue to focus on expertise, experience and billable hours. Typically a "look back" method is used. In other words, looking back to the preceding fiscal year as a foundation for equity partner compensation in the next succeeding fiscal year without an in-depth analysis of whether the revenue and cost trend will change during the next fiscal year. These systems also do not address good law firm institutional behavior – returning money to the firm for the benefit of the firm.⁵⁶

A system that compensates all practice groups or partners within a practice group the same based upon years of experience or even expertise is probably not aligned with the client's interests.⁵⁷ Most clients recognize that different products or services have different production costs with different pricing that results in differing compensation.⁵⁸ They recognize that a lower priced product or service may be far more profitable than a higher priced product or service.⁵⁹ Many law firm compensation systems do not include equity partner compensation (including benefits) and benefits in their profit and/or loss calculations. Therefore,

⁵¹ *Id.*

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ See James Cotterman, *Calculating Profitability* (2014) www.altmanweil.com/CalculatingProfitability.

⁵⁶ There are some that use Revenue – Direct Cost – Allocated Cost – Equity Partner costs to assess whether an equity partner has been profitable.

⁵⁷ *Aligning @ 1*

⁵⁸ *Id.* @ 2.

⁵⁹ *Id.*

an equity partner or the equity partner's group could be operating at a loss.⁶⁰ It is important to include equity partner compensation in any revenue versus cost analysis to arrive at the Right Price.⁶¹

Any compensation system, including equity partner compensation, that looks largely at billable hours continues to reward inefficiency. If a firm continues to measure profitability of alternative fees by comparing Revenue received pursuant to the agreement to what the law firm would have made using hourly billing (i.e. keeping track using Shadow Bills) then price and cost will continue to be tied to the hourly rate system of inefficiency resulting in tension within the law firm and with the client.⁶² A structure is, therefore, needed to meet client objectives of efficiency, effectiveness and cost predictability, to set the Right Price and achieve the Right Cost.

Michael Roster, as part of the Association of Corporate Counsel's value challenge, published a simplified structure that should be considered by law firms moving forward as a foundation for the law firm's ability to set the Right Price to achieve the Right Cost.⁶³ Roster suggests: Profit = Revenue – Total Cost (Direct Costs + Allocated Overhead Costs + Equity Partner Costs + 5% to 15% Institutional Costs). In other words, to be truly profitable for the law firm, the partner or practice group needs to collect revenue greater than the total cost attributable to the partner or practice group by 5% to 15%. Doing so encourages good institutional behavior.⁶⁴ The 5% to 15% can be used year-to-year, in a bonus structure that rewards superior performance benefiting the whole firm, invested for potential lateral hires, office space, mergers, retirements, and advanced technology purchase. If done correctly, it also allows for a bonus system to help address the under compensated partners and practice groups in a given fiscal year. The profit (or loss) of a partner or practice group can also be used to adjust partner regular compensation up (if profitable with a realistic expectation of similar results) or down (if operating at a loss).⁶⁵

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² Blue-Up @ 1. A plaintiff's lawyer's most valuable asset is their time given the risk sharing contingency fee approach. They have historically looked at their revenue versus the cost (cost = percentage of time for people (*direct cost) + allocated overhead. The less time spent (efficiency) the greater the profit. Law firms doing defense work would do well to follow the lead of lawyers on the opposite side of the docket.

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Id.*

This approach allows a law firm to more correctly compare hourly and non-hourly work.⁶⁶ It correctly assesses the true profitability of individual timekeepers and partners, it promotes efficiency and productivity over hours billed, and it encourages the economic use of the right people to do the necessary work.⁶⁷ It also supports the ability to recognize and retain lawyers based upon their real value to the firm.⁶⁸ Finally, using this approach advances access to justice for individual and small company disputes outside of traditional contingent fee categories that have become increasingly unaffordable when using a billable hour formula for revenue production.

Using this approach requires a system to address the total cost attributable to a partner or practice group given that partners work on their own cases and to do the work may require the use of other equity and non-equity partners, associates, full-time contract lawyers and legal assistants. These same people may work for other partners or practice groups. Given these circumstances, to correctly assess the Total Allocated Cost for a partner or practice group requires an assessment of time.

An example should prove helpful. Assume an equity partner produces \$3 million in revenue during a law firm fiscal year. To do so, the equity partner, in addition to his or her own time, uses other equity and non-equity partners, and some associates, each of whom work on their own matters and also for other firm equity partners.

Time, not hourly rates, billings or collections, is the critical component for a correct Total Allocated Cost. Cost allocation means applying the percentage of total time in a given year that each time keeper spent on the work to produce the \$3 million in revenue. That is, the percentage of time devoted to doing work for that equity partner versus what the timekeeper did for themselves or others to a total of 100%.

Once the percentage time has been calculated, it can be multiplied by compensation and benefits (direct costs), allocated overhead costs, and equity partner costs to arrive at the Total Allocated Cost associated with producing the \$3 million revenue. Once done for every time keeper, the Total Allocated Cost to

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Id.*

produce that Revenue is reached. There is, however, no true “profit” unless the revenue exceeds the Total Allocated Costs plus the additional 5% to 15%. See Figure 1.

	% Time	Compensation & Benefits	Figure 1 Allocated Costs	<u>Total Cost</u>	<u>% of Total Cost</u>
Partner	95%	750,000	150,000	900,000	855,000
Non-Equity Partner	90%	350,000	125,000	475,000	427,000
Associate 1	70%	215,000	100,000	315,000	220,000
Associate 2	70%	200,000	100,000	300,000	210,000
Associate 3	60%	175,000	100,000	275,000	165,000
Of Counsel	100%	250,000	125,000	375,000	375,000
Legal Assistant	100%	60,000	60,000	120,000	<u>120,000</u>
Total Allocated Cost					2,375,000

$$\begin{aligned} &\text{Total Allocated Cost} \times .15\% \\ &\$2,375,000 \times .15\% = \$356,250 \end{aligned}$$

$$\begin{aligned} &\text{Total Allocated Cost} + .15\% \\ &2,375,000 + 356,250 = \$2,731,250 \end{aligned}$$

$$\begin{aligned} &\text{Revenue} - \text{Total Allocated Cost} + .15\% = \text{Profit} \\ &3,000,000 - 2,731,250 = \$268,750 \end{aligned}$$

In this hypothetical, the partner’s business produces \$268,750 in revenue over the Total Cost (True Profit). That money can be allocated in bonuses for the partner and the partner team and can serve, along with other analytics, as a foundation for the next fiscal year partner compensation.

In addition to using the approach in a look back method, it should be used to look forward. In this present-day competitive environment, a law firm using this approach can make informed decisions about realistic anticipated Total Allocated Costs to do the work, which, in turn, affects staffing, salaries and other cost items. It gives the law firm the ability to make a rational fact-based decision about how to propose and respond to a client regarding budget and alternative fees.

The approach is also useful for Litigation Project Management where a specific aspect of any plan is setting a price/cost to execute, manage and monitor the plan throughout. After the scope has been confirmed and a playbook created using Litigation Project Management, it is important to correctly identify the appropriate and available resources and their cost to arrive at a total law firm cost (or Total Allocated Cost) for each phase, subphase and task.⁶⁹ There are two methods to do so – top down and bottom up estimating.

The top down approach backs into a total number. By understanding the resources and total cost of these resources, a fixed price can be identified that exceeds the law firm cost. That fixed price is then distributed across the phases, subphases and down to the task or subtask level.⁷⁰

Bottom up estimating starts at the resource assignment level and identifies the expected time utilization and resources to accomplish the tasks at the lowest level of work. All sub-tasks for each task are added, all tasks for a subphase are added, all subphases are added, then all phases for a total project are added to arrive at a total allocated cost.⁷¹ Under either approach, adjustments can be made using the calculations above to reallocate the resources to increase or decrease the total.

The same structure can be used to set hourly rates. Years ago Altman Weil shared a formula for correctly calculating an hourly rate that would presumably return a law firm “profit.”⁷² That formula is:

$$B = \frac{T}{R \times U}$$

B is the minimum calculated hourly rate and is the minimum hourly rate that must be charged to be able to make a profit for any hourly timekeeper. T is the target needed Revenue per lawyer to exceed their Total Cost by some predetermined amount (i.e. 20% above total cost). R is the realization and takes into consideration write offs and non-payment. It is fees actually collected or the

⁶⁹ Lambreth @ 115-116.

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² Ward Bower, Pricing Legal Services (2004), http://www.altmanweil.com/dir_docs/resource/ce653539-fd49-4cfa-a6fe-2c68136304c3_document.pdf

dollar value of time. U is the expected utilization or expected total time for any timekeeper.⁷³

The Altman Weil formula did not include any additional amount or percentage as an institutional cost for the benefit of the partnership. It is fairly simple, however, to calculate an hourly rate that can return the 5% to 15%. For associates, T or Total Cost includes compensation, benefits, allocated overhead, desired profit, plus an additional 5% to 15%. For an equity partner, the same 5% – 15% should be added as cost. See Figure 2.

Associate Hourly Rate Computation

Assume	Associate A
Compensation & Benefits	\$200,000
Overhead	\$100,000
Desired Profit 300,000 x .20%	\$60,000
Additional .15% for the Firm	\$45,000
Total Cost	\$405,000
Historical R	90%
Expected U	1,800
Result	\$250.00

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Equity Partner Hourly Rate Computation

Assume	Partner A	Partner B
Draw/salary	\$300,000	\$500,000
Per Lawyer Overhead	\$140,000	\$140,000
Additional 15% for the Firm	\$66,000	\$96,000
Total Cost	\$506,000	\$736,000
Historical R	90%	90%
Expected U	1,700	1,700
B (minimum hourly rate)	\$331	\$481

⁷³ *Id.*

⁷⁴ It's B equals T, divided by R, which is 90%, times U, which is \$1,800. That turns out to be \$405,000 divided by 1,620 equals \$250 per hour.

This structure outlined by Roster gives law firms a better picture of what the Right Price for the law firm can be and should enable law firms and their clients to more aggressively pursue alternate fee structures. There are a variety of different alternative (or value based) fee approaches.

Alternative Fees

At the outset, there are certain fundamental client traits supporting the use of alternative fees. Clients DO NOT, as purchasers, want to pay for services that are, in any way, based upon time spent.⁷⁵ Alternative Fees are the best way for clients to depart from paying fees based on time spent.⁷⁶ The “business case” for their use focuses on:

- Reduced inefficiencies;
- Increased productivity;
- Predictability; and
- Results and outcomes that add value.⁷⁷

With respect to any “value based” “alternative fee” – whether client or law firm – the first consideration should be what seems to make the most sense in terms of achieving the Right Price for the law firm and the Right Cost for the client. The advantages and disadvantages of varying approaches must be viewed in this light. A few common, Alternative (Value Based) Fee Structures are outlined below.

1. Fixed Fee Per Deliverable

Fixed fee-per-deliverable is an all-in price for distinct pieces of work that encompasses all preparation and effort. It may be suited for situations in which certain pieces of work are well-defined and measurable in terms of resources and time, so that the client and firm can agree upon a workable fee schedule, even if the number of units of work may vary going forward.⁷⁸ It manages uncertainty

⁷⁵ ACC Value Based Fee Primer @ 3. This is particularly true for individuals and smaller companies who want affordable access to justice to resolve disputes. Plaintiff’s personal injury lawyers already operate in an alternative contingency fee world. Even so, offering a contingency fee is based on an assessment of potential liability and recovery. Some personal injury claims have too low recovery to be acceptable. Therefore, some of these AFAs should be considered for smaller claim.

⁷⁶ *Id.* @ 6.

⁷⁷ *Id.*

⁷⁸ *Id.*

and provides flexibility by pricing units of work, which allows for price adjustments based upon needed resources and time as the number of units increase or decrease.⁷⁹

2. Fixed Fee Per Matter

A fixed fee-per-matter sets a fixed price for all legal work relating to a particular matter. These fixed fees are suited for matters in which the litigation evolves in a defined, predictable manner so that it is easier for both the law firm and client to agree on the fee. Usually, there is some historical information that provides some idea about the amount of the fixed fee and typically the initial fixed fee for that type matter is lower than what has usually been paid. In part, this recognizes that past data on similar matters may not have been billed efficiently. It does offer predictability and simplicity.⁸⁰

3. Capped Fee

A capped fee is used to set a ceiling on what the client will pay, on an hourly rate basis, for a particular piece of work. The “not to exceed” or “cap” aspect is a definitive stake in the ground. It is suited for situations where the client is most comfortable with the hourly rate billing model, but favors some measure of predictability. A capped fee helps manage costs better than the “unbridled hourly rate.” It is not easy to pick the right number. If the wrong ceiling is selected, the client may believe it has paid more than it should and if the hourly time and expense exceeds the cap, the law firm believes it should be paid more leading to potentially difficult discussions. It creates limited incentive for efficiency because when hourly billing is used for capped fee comparison, firms tend to at least reach the cap.⁸¹

4. Flat Fee Per Period

A flat fee per period covers categories of service over the course of a certain time period. The period can be monthly, annually, biannually or longer. The period covers services like any advice and counsel on regulatory issues or an all-in per diem fee for trial representation; or even a monthly fee to handle administrative management during certain phases of litigation. It is often broader,

⁷⁹ *Id.*

⁸⁰ *Id.*

⁸¹ *Id.*

such as handling every aspect of a particular type litigation for a specified amount over a definitive time period. Generally, this type fee is suited for situations in which distinct pieces of work need to be performed on a recurring basis and the client wants to create an economic incentive for the law firm to staff and perform the work more efficiently with the same people while reducing its own costs. It allows a fixed fee approach for a large portfolio of work to be assigned to a single firm. Typically, the fee has some basis in available historical case data and often occurs after a competitive bidding process. The flat fee per period offers predictability and certainty over hourly billing. It creates an incentive for the law firm to correctly assess resources and time. If the firm does so correctly, it can earn a greater profit.⁸²

5. Success Based Fees

There are a variety of incentive performance-based, holdback, and/or success-oriented fee agreements. There are different ways to reward firms based upon criteria established by the client.⁸³ They attempt to align the interest of the client and the law firm by tying a portion of the law firm's compensation to meeting desired objectives and outcomes. They can be used in conjunction with any of the other value-based fee options. For example, 20% of hourly fees billed will be set aside and paid to the law firm subject to a multiplier, depending upon achieving success. Success can be both objective and subjective. There is shared "risk" because the client could pay more than the agreed upon amount or the law firm could get less.⁸⁴ They are dependent upon clearly delineated definitions of success that should be both measurable and attainable. There is a definitive strong business case for law firm compensation being tied to outcome, results and delivered value. It aligns incentives and rewards efficiency. It is flexible enough to enable adjustment along the way.⁸⁵

6. Contingency Fee

A pure contingency fee depends entirely upon achieving a definitive outcome. For example, a law firm fee is equivalent to X percent of the client's recovery in a particular matter. A reverse contingency is where a firm gets paid

⁸² *Id.*

⁸³ *Id.* @ 7.

⁸⁴ See Jenny Davis, Jeffrey Carr: Business Unusual (Oct. 2009) https://www.abajournal.com/legalrebels/article/jeffrey_carr_business_unusual/

⁸⁵ ACC Value-Based Fee Primer @ 7.

only if it wins a dismissal or wins a jury verdict. This is suited for situations in which clients seeks recovery and/or is cash strapped and willing to forgo a larger portion of its stake in exchange for protection on the downside. A higher risk and higher reward.⁸⁶

7. Hybrid

A hybrid is a combination of one or more of any of the above. For example, a flat fee for handling litigation, plus a per diem for trial, and a success bonus for outcome. There is a stronger correlation between law firm fees and value generated.⁸⁷

With any value-based alternative fee approach, the notion of a client requiring its law firm to keep track of hours billed times hourly rates as a means of determining whether there has been an overpayment or underpayment makes no legitimate sense. Doing so is just another means of hanging on to the inefficiencies present when fees are paid on that basis. Both law firms and clients are prone to evaluate their financial goals using the very same mechanisms they are trying to eliminate which leads to difficult discussions and animosity, not collaboration and innovation. Keeping track of time is a necessity for the law firm internal profit approach recommended here but largely irrelevant to the client. The deal, whatever it is, is the deal. When the deal is done, law firms can assess their cost structure and make adjustments as needed and so too can the client.

Expense Cost

Litigation expense costs do not typically rise to the cost level of attorney's fees. Even so, to meet client demands, management of expenses is essential. There are several options to better manage these costs – including a fixed fee with experts and court reporters, leveraging volume for lower deposition cost and most significantly better overall project management. Better project management starts with a plan that better recognizes what is truly important to the claim or defense and pursue only what is important and only when it needs to be done. In some alternative fee approaches, expenses are the responsibility of the client where they have the ability to use their influence with outside vendors to lower costs. Others place the expenses as the responsibility of the law firm. In these

⁸⁶ *Id.*

⁸⁷ *Id.*

situations, law firms become much better judges of what must be done and when.

Right Cost Moving Forward

In her book *Legal Upheaval: A Guide to Collaboration, Creativity, and Innovation in the Law*⁸⁸, Michele DeStefano conducted a series of interviews with in-house counsel and outside counsel around the world and rightly concluded, even before the COVID-19 pandemic, that the “delivery, pricing, packaging and sourcing of legal services is rapidly changing” and the “focus is changing from what does a lawyer do to how do lawyers do it?”⁸⁹ Why is it changing? She sets forth a variety of reasons including: (1) technology; (2) socioeconomic and demographic change; and (3) globality and glocality.⁹⁰

Technology includes a host of different things that were unheard of and even unthinkable just a few short years ago.⁹¹ There are billions of pieces of data transmitted by way of smart phones across the world every second. The mobile internet and iCloud technology allows for the efficient, rapid delivery of all legal services. Everything is or will be done digitally. The use of remote communication capabilities has changed how people work, communicate, and interact. Rapid growth in artificial intelligence (AI) and machine learning have been changing how people work.⁹² Google and Alexa are in homes and delivering accurate responses to inquiries. Siri responds accurately. IBM Watson has the ability, if adjusted correctly, to answer fundamental legal questions that previously would have involved resource (people) time and therefore cost. Technological singularity – the point at which artificial intelligence is capable of continually rebuilding and improving to make it more powerful and smarter without the need of any human interaction – is approaching fast.⁹³ Machines can learn and have the ability to change rapidly based upon what has been learned.⁹⁴ The law of accelerating returns refers to the fact that innovation begets innovation. Existing technology is used to improve current technology and create new technology. Technology has the ability to mine data and give people what they want in the way that they want

⁸⁸ MICHELE DESTEFANO, *LEGAL UPHEAVAL: A GUIDE TO COLLABORATION, CREATIVITY, AND INNOVATION IN THE LAW* (2018).

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² *Id.* at 2.

⁹³ *Id.*

⁹⁴ *Id.*

it and when they want it.⁹⁵ Accordingly, advancing technology will change the cost of litigation because it will likely replace many resources and do the work effectively, efficiently, on time and cheaper.

Even before the COVID-19 ban on office work led to more remote work, there was already a move to remote work. Technology provides great flexibility in where, how and with whom people work.⁹⁶ Remote, virtual work was increasing and is now nearly universal. Systems like Skype and Web-Ex were in use pre-pandemic but now these systems and Zoom, Blue Jeans and Microsoft Teams are used daily for almost every aspect of litigation-related work, including depositions, conferences and even remote trials. Client bottom line Right Cost expectations and outside counsel bottom line pricing structures must account for this remote work. There is no longer the same relative need for extensive travel or even expensive office space. Clients experienced now with remote work will likely sacrifice the limited advantages of in-person mentoring and will be increasingly reluctant to pay for pricing that includes, as a component, significant office overhead. Clients hire lawyers, not their space.

Mark Cohen has identified a number of ways that the pandemic has “turbo charged”⁹⁷ rapid transformation, noting the coronavirus will “propel law into the digital age and reshape its landscape. The entire legal ecosystem will be effected – consumers, providers, the Academy and the judicial system.”⁹⁸ He notes the lightning speed movement to a virtual work force out of necessity that he believes has already produced greater job satisfaction, enhanced productivity and cost savings in the legal community.⁹⁹ The economic downturn directly related to the pandemic will mean clients must look to outside law firms for clear business solutions to business-related challenges.¹⁰⁰ Cohen believes traditional law firm models, already diminishing in numbers will likely break up and become virtual. They must demonstrate an affirmative willingness to innovate and collaborate across firms, corporate legal departments and newer non-traditional legal service

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ See Mark A. Cohen, COVID-19 Will Turbo Charge Legal Industry Transformation, (March 24, 2020 10:00 am EDT) <https://www.forbes.com/sites/markcohen1/2020/03/24/covid-19-will-turbocharge-legal-industry-transformation/#36da45961195>

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ *Id.*

providers.¹⁰¹ Corporate legal departments under increased pressure to obtain the “Right Cost” will look for innovative, creative, collaborative and results-oriented solutions. Innovative and creative solutions will be driven by access to “data driven information to make quicker, better informed decisions.”¹⁰² Risk tolerance and expectations will also be data driven. Outside counsel with expertise in legal process improvement, project management, supply chain, data analytics, data-based risk assessment and up-to-date legal technologies will, he believes, do well.¹⁰³

Armed now with a clearer understanding that the legal business must operate differently into the future, outside counsel must adopt a business mentality to their services by adopting the revenue versus total cost model mentioned above just like any other sustainable business. Once adopted there are fundamental areas to address related to law firm cost structure in light of the continued legal upheaval and to reach the client Right Cost. They include:

- Compensation – Because resources and time are the important ingredients in setting the Right Price for the law firm and Right Cost for the client, law firm compensation should be based on “value” and not “years of experience.” Starting salaries must be lower, increases and decreases based on a sound profit analysis and firms must look for opportunities to use alternative lower cost providers.
- Space – In a virtual legal world, office space should be significantly reduced. Any thought that lawyers must be in the office all the time even on weekends will not work in the future. This is particularly true when the emphasis shifts away from billing hours. Mentoring is important, but firms must look for creative means to mentor.
- Technology – Firms and clients must invest correctly in technology that improves efficiency and enables data-driven, rapid decision making and the on-time delivery of legal services.

¹⁰¹ *Id.*

¹⁰² *Id.*

¹⁰³ *Id.*

- Collaboration – With other firms and new legal service providers that can help bring a total package to the client for acceptance as the Right Cost. Clients will no longer pay for any “learning curve.”
- Litigation Project Management – Treat every phase of litigation in a manner that delivers excellence with efficiency and effectiveness. Put together a playbook, analyze the resources and time to arrive at the Right Price and Right Cost.
- Process Improvement – Continually examine every aspect of work using proven tools to assess and improve.

There are likely hundreds of ideas but there must be a willingness to change. Simply put, the “Right Cost” must be achieved for the benefit of the jury system. Other alternatives do not suffice, and lawyers do not want to proceed down an alternative path.