SPECIAL FEATURE

Prevent runaway fees with structured agreements

By Russell Beck

Your company has a need for ongoing legal services. Maybe you have litigation, corporate, employment, real estate or some other type of matters that, year in and year out, require outside legal services. You know you will incur legal fees, but you have no way to reliably predict and budget what they will be — especially in the case of litigation.

But what if you could?

As discussed in "Prevent runaway legal fees with proper planning" in the last issue of New England In-House, alternative fee arrangements, or AFAs, based on the billable hour don't really address the problem. Instead, while they may more closely align the incentives of clients and their lawyers, they never really manage the costs and certainly do not provide a fixed amount that you can reliably budget around.

One approach does: "complete solution billing."

I had been handling multiple cases every year, year after year, for a particular client. It was complex business litigation. Accordingly, as would be expected, in some years the fees were substantial, and in other years they were comparatively little.

I asked the client whether, for predictability purposes, it would prefer an option in which we agree on an annual fee (to be paid monthly on a pro rata basis) for all of its litigation in Massachusetts (and certain other states). Such arrangements have colloquially been referred to as having a firm "on retainer," though more recently the term "portfolio billing" has been used.

The client's reaction was a bit surprising. While it liked the idea of predictable fees, it had a concern — but not the one I expected. Its concern was that the law firm where I practiced at the time would be inundated with all types of small claims litigation that had, to that point, been handled in-house.

From the firm's perspective, the risk was significant. Indeed, the firm had been burned on a similar arrangement with a different client. In that case, shortly after the arrangements were in place, the client was sued in a class action with all of the attendant astronomical costs, which the firm was obligated to handle, though compensated on an arrangement that anticipated only "routine" litigation.

But, whether it's the fear of being inundated with small matters or large, the solution is not to throw the baby out with the bathwater. Rather, the solution is to define with reasonable precision the scope of the work that will be covered.

An easy place to start is to identify the types of cases that the company has had in the past three to five years, and then limit the agreement to those, or separately address other possible cases.

With the scope of the agreement defined, the next step is to establish the cost. Again, a review of your historical costs is the best starting point. But that is just the beginning.

Litigation takes not only many forms, it takes many turns, which is what makes it so hard to budget for. Moreover, when the cost of legal fees is taken out of the equation, the incentives can change. A party may, for example, be more inclined to push the case further than it otherwise would. Those realities should be considered in establishing the fee.

If historical data is available, it must be "sliced and diced" to get at what the actual costs have been. For example, if you've had 10 cases a year for the last five years, and only one a year has gone to trial, that is important to know.

It's also important to know how many depositions the cases had. How many went as far as summary judgment? How many were mediated? How many were arbitrations as opposed to in court? With the data fully vetted, the parties' expectations for what will be included in the fee can be established.

Once the expectations are set, leaving aberrations for a later time can prevent problems. Specifically, what if you can't agree on how to handle it? What then happens to the overall structure?

A simple way to avoid such problems is to address the potential aberrations in advance using something akin to "risk collars" (which are used in the context of billing by the hour).

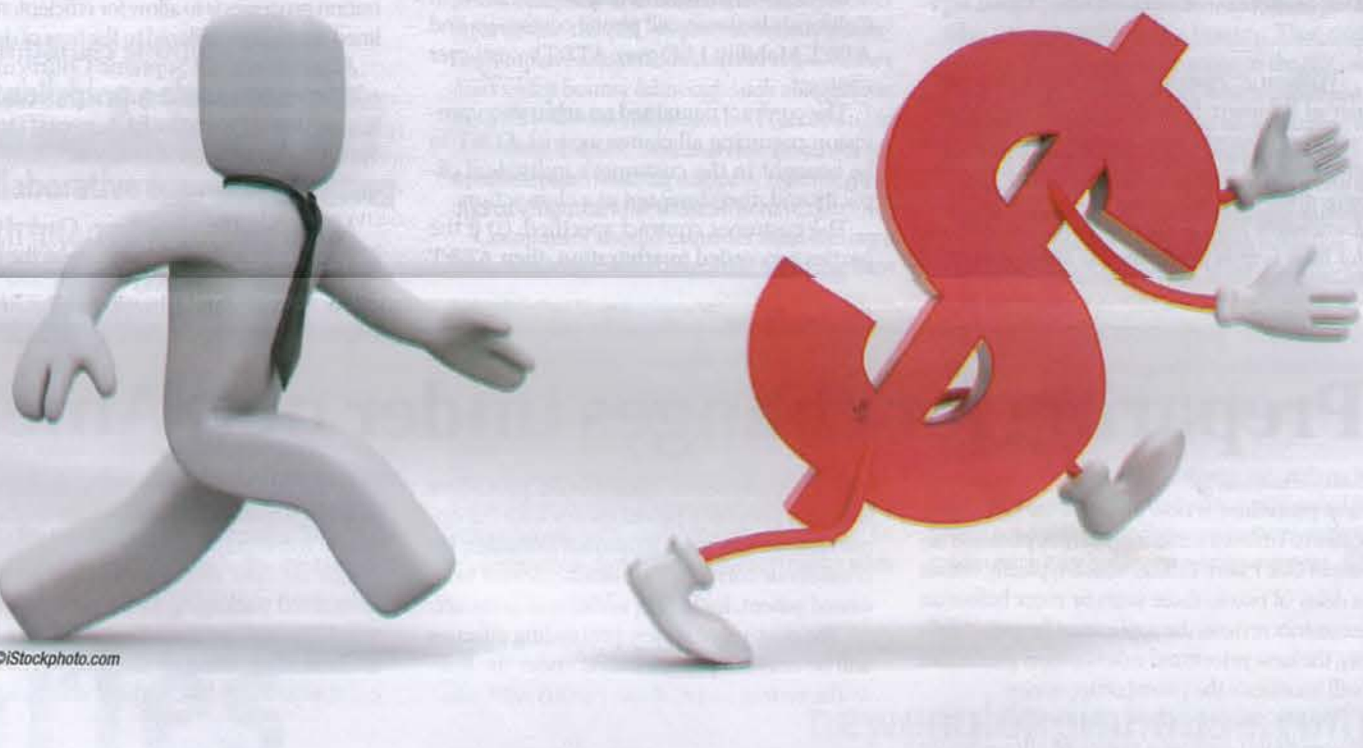
For example, if there is a 20 percent increase in cases, one solution is for the client and law firm to share in the increased cost: split it equally; increase the fee by 10 percent. Similarly, if the cases tend to go further than historically, share in the increased cost, and increase the fee by a proportionate amount.

This should not be a one-way street. If, in a given year, the number of cases is 20 percent fewer or the cases resolve 20 percent faster, the client and law firm should share in the savings; reducing the fee by 10 percent.

One way to manage that administratively is to make an adjustment to the next year's fee. Or, the increase or decrease can be applied prospectively starting in the month after the aberration becomes apparent.

But an aberration should only be something that is well outside the norm. It must be something substantial; otherwise, the complete billing solution is essentially just a billable hour model in disguise.

While complete solution billing may have the most bang for the buck in the context of litigation, it can be used for any practice area in which a company has an ongoing need.



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For example, one additional case may not be something warranting an adjustment. Generally, something along the lines of a 20 percent fluctuation is significant enough to use as the break point. And, if the risk is truly great, you can even use a second band at, perhaps, 40 or 50 percent. These risk-adjustment issues should be hammered out in the context of establishing the scope of the work covered by the agreement.

With the scope set, the appropriate fee can be established relatively easily. Part of the reason is that risk is limited, given that it will be automatically increased or decreased if there are significant changes to the underlying assumptions.

The other key term to consider is what happens at the end.

Like most arrangements, it is generally easier to negotiate the details at the beginning of a relationship than at the end. Accordingly, like all proper agreements, consideration should be given to what will happen if one of the parties wishes to end the agreement. The easiest wind-down scenario a simple reduction in the fee on a pro rata basis as the cases end.

But the client or law firm may wish to cut the cord entirely. The agreement should address how that is handled. It may be as simple as calling for the cases to be transferred to successor counsel, with all payments stopping. Or, it may call for an adjustment based on the progress made in each outstanding case, the costs to replace counsel or other factors. And it may depend on who calls for the termination.

In the end, arrangements like these can eliminate erratic litigation spends, budget overruns and surprise bills. When done right, they provide predictability, manageability and value.

While complete solution billing may have the most bang for the buck in the context of litigation (because litigation has the greatest fee volatility), it can be used for any practice area in which a company has an ongoing need. NEIH

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