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COVER STORY

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Getting Your Fix

Two veteran lawyers say that now is the time for fixed fees.

In these troubled economic times, fixed fees for particular legal matters have appeal both for law firms and their corporate clients. We—a former general counsel of a major company and a current co-managing partner of a major firm—strongly believe that this is an idea whose time has come. For in-house counsel facing tremendous budgetary pressures, the fixed fee addresses the problems caused by the hourly rate, such as unpredictability, high costs divorced from actual value and, most importantly, the maddening law firm definition of “productivity”—defined as more lawyers and more hours per matter.

For law firms facing reduced demand and cash flow problems (if not crises), the fixed fee addresses the issues of increasing overhead devoted to the billing process, clients flyspecking bills and demanding after-the-fact discounts, and delays in payments and falling realization rates.

Seen in its best light, fixed fees thus have significant benefits for both in-house and outside counsel: reduced billing hassles, more predictable cost to the client, more predictable and timely payments to the firm, and, ultimately, better alignment between the cost and the value of the legal service. The credit meltdown and the deep global recession may provide the impetus for real change in this corner of the economy, as in so many others.

Seen in the sweep of recent history, the fixed fee can also address a critical conflict at the center of the evolving inside counsel-out-

side counsel relationship. The 20-year rise in the talent, experience, and expertise of in-house lawyers has led to co-equal partnering on matters. But significant changes in both law firms and law departments have often led to ill will and conflict over money. As Am Law 200 firms have grown as businesses, they've faced relentless pressure for revenues, and the new breed of in-house lawyers (often alums of firms) face incessant business pressures for cost control.

During this period, there have been many attempts to find détente on hotly contested money issues: task-based budgeting and billing; RFPs; preferred providers; auctions; discounted, blended, or bulk hourly rates; or some combination of the above. But all have stumbled on the ultimate questions: how to set price with quality and achieve cost and value alignment.

SETTING A FIXED FEE

Historical data should provide the starting point for setting the fixed fee. Both firms and corporations have detailed information on the past cost of different kinds of matters. They can use data-mining techniques to determine reasonable ranges of cost for a wide variety of legal services. These services range, obviously, from the simple to the complex:

- A single project involving expertise and judgment, but not much risk, such as writing a handbook, creating form contracts, developing a compliance training program, and

monitoring developments in evolving areas of law.

- A repeating, routine book of business, which involves expertise and judgment, but not much risk, such as filing a certain type of patent or trademark application, monitoring compliance with environmental permits, and handling routine labor matters in arbitration (as opposed to court).

- A repeating, but more complex book of business that involves judgment, expertise, and risk, such as annual securities reporting, a line of product liability cases, a series of venture capital financings, or more complex multi-party contracts for capital equipment sales.

- A one-off, highly complex, high-risk matter. Some may have historical antecedents: the bet-the-company litigation for the pharma company; the companywide bribery scandal being pursued by enforcers in multiple jurisdictions; the transaction to double the company's size with a target in similar lines of business. Other high-risk matters may arise on new frontiers: a patent-defense action in China; a novel product litigation; the huge acquisition of a company in a different line of business.

In complex, risky matters, the fixed fee can be split into segments. For example, one flat fee for a litigation evaluation period, and then a second fixed fee for completion—depending on joint expectations of the likely process (early settlement; reasonable discovery/settlement; full, contested discovery and trial). But

whatever the type of matter, arriving at the fixed fee will depend on the motivation of both in-house and outside counsel to work toward a future result that is fair to both parties.

As in all business, a total price for a matter or a book of business is built up from costs (and, at times, also derived from the significance of the matter). One of the most important issues in setting fixed fees is distinguishing between a law firm's actual costs (which firms see), and the actual costs, plus profit margins for the partners (which is what clients see in a firm's bills). A second, related problem is that the history of costs to the company may be an imperfect guide. Past bills are an aggregation of hourly rates (plus out-of-pocket costs), which may reflect inefficiencies.

REDUCING COSTS AND REWARDING RESULTS

These two issues lead to a third in setting a fixed fee: How much can actual costs be reduced? To deal with this question, the law firm can decide that the fixed fee is just that: It will get the benefit of the savings if it is productive and does the work for less than the flat fee, and it will take the pain if the costs

critical strategy calls. Who "leads" the matter and how much in-house counsel contribute to the actual lawyering (e.g., fact-gathering and legal analysis) will depend on the size and specialization of the corporate law department.

Even with good processes, law firms under fixed-fee regimes will, of course, also be judged by the quality of their results. The fixed fee can make incentives or demerits easier to design and implement. For example, the monthly payment in a litigation could be 80 percent of the fixed fee. If a satisfactory settlement (defined at the outset) is reached, then the firm receives the withheld 20 percent. If the matter goes to trial with a positive result, the firm receives 125 percent of the fixed fee. If neither a good settlement nor a good trial outcome occurs, then the firm receives the original 80 percent of the fixed fee.

Similarly, some part of the fixed fee can be held back until after a deal is completed and acquisition integration occurs. Then the client can see if the due diligence done by the outside firm properly identified problems. A bonus could be possible if corporate performance is better than the pro forma projections. Moreover, if a law firm is managing a book of business, like labor arbitrations, as

both in-house and outside lawyers, connective technology (e.g., general and specific deal documents, databases, or general and specific litigation documents) and selective outsourcing to third parties can help drive real productivity.

CALCULATING BUDGETS AND COMPENSATION

In a fixed-fee world, law firms will build their budgets on whether fixed fees for matters (not just hours billed and received per lawyer) cover their projected costs. Under this approach, partners' compensation will turn not just on generating business but also on delivering matters on or below budget and with good results. Similarly, this could lead to more productive—and morale-boosting—use of associates who will be paid for doing quality work within the fixed-fee budgets on more matters in smaller teams, rather than billing endless busywork hours on overstuffed megamatters. But fixed fees may not eliminate the tyranny of total billed hours or vexing issues such as professional development for associates ["Lost Generation," March 2008].

The fixed fee is not an easy answer to the economic conflicts between firms and corporate clients. But the current economic crisis makes it imperative to have greater predictability and regularity on billing and payment for both law firms and corporate clients. Beyond economic necessity, the fixed fee provides the opportunity for better cooperation on money, just as the enhancement of in-house lawyers has made for much better cooperation on matters. This closer alignment between matters and money, between in-house and outside lawyers, can serve a broader societal goal in this time when trust in boards of directors and CEOs has been shredded, and when wise counseling is so critical to help corporations better balance risk-taking with risk-management, and better fuse high performance with high integrity.

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are higher than predicted. Alternatively, firms and companies can share the upside (the productivity gains) by splitting the difference between the flat fee and the lower actual cost. They can also share the downside (cost overruns above the flat fee). Such cost-sharing may be especially appropriate in novel, complex, and risky matters.

Sharing the cost-overrun risk drives both parties back into a review of hours and costs (what was the cause and how much was justified). However, such a review will likely occur at the end of the matter, not on a monthly or quarterly basis. The law firms, in any event, will be tracking costs continuously.

Most in-house counsel are concerned about the proper mix between cost and quality—not on getting the cheapest legal service available. From one perspective, quality is about process—close cooperation, coordination, and partnership between in-house and outside counsel. This entails a careful, continuing joint review of facts, law, policy, and politics—and

well as preventative measures inside the company, a bonus payment can be designed if the number of labor disputes declines year over year.

PROJECT MANAGEMENT

Communications between the law firms and the client on a continuing basis will be the key to fixed-fee success. Law firms must develop project management capacity that combines sensitivity to quality with sensitivity to productivity. The time invested in a project will be managed as the project proceeds, rather than discussed after the fact. It will require that firms, like corporations in fiercely competitive environments, learn to do more with less: the real definition of productivity. By the same token, in-house law departments must also develop project management capacity (and productivity measures for in-house lawyers) that mirrors the firms' efforts: focusing on working seamlessly with the outside firms to ensure efficiency on the merits. For