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Should Corporate Counsel Mandate Risk-Sharing Fee Arrangements?

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Declining revenues and dramatic cutbacks confront general counsel across corporate America. Law firms are cutting associate and non-equity partner ranks while trying to retain key rainmakers and avoid risk of possible dissolution.

The rocky start to the 21st century portends an acceleration of underlying trends in the corporate counsel-outside law firm relationship. Clients who previously felt lacking in power to bargain with the "Big Law" hegemony may seize upon any opening to do so.

Only six months ago at a New York conference sponsored by Eversheds, over 80 percent of senior in-house counsel attendees said they believed law firms should share the risk of budget overruns, yet inexplicably less than 5 percent had put into effect alternative billing arrangements to create risk sharing. Such anomalies will not continue.

Nothing less than mandatory risk-sharing fee arrangements will effectively address the overriding concern with rising legal costs. Despite years of respected industry surveys citing legal costs as a chief concern, the July 2008 Inside Counsel "19th Annual Survey of General Counsel", reported only 11.6 percent of in house counsel believed law firms were actively seeking ways to reduce the cost of legal services.

If corporate counsel want budgets met and costs controlled, they cannot continue to demand one thing from their legal service providers and incentivize something entirely else by pure hourly rate engagements. Two alternatives present themselves.

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1. Require your law firm to set a matter budget and track their time at their regular hourly rates. If the law firm does not deliver 'defined success' in terms of budgets and results, adjust the fee downward at the matter conclusion based upon predetermined criteria. Upside rewards would be discretionary.

2. Require your law firm to significantly discount their hourly rate during a matter's progress. If at the conclusion, agreed upon budgets have been met and satisfactory results obtained restore the discounted portion. To reward truly outstanding efforts implement a bonus arrangement.

The decision to pursue the above alternatives should be an easy one given law firm failure over the last decade to control costs. In fact, the current economic and cultural forces at work in the legal industry make such a change an imperative. Moreover, fostering that change may facilitate a movement to a law firm culture that would better serve the long-term interests of corporate counsel.

The often heard practice of "We hire lawyers, not law firms" has had to a significant degree unintended negative affects on client service. The constant threat of a potential exodus of key "rainmakers" and their books of business forces firm management to be singularly focused on profit per partner numbers.

Increasing profits-per-partner requires leverage. Leverage demands growing ranks of associates and non-equity salaried 'service partners'. Large hierarchical segmented litigation teams are a perfect fit for that model. For a client seeking cost-effective solutions, however, a pyramid-style chain of command not only undermines securing an optimum result but also creates inefficiencies and duplication of effort. The smaller the team, the better for meeting budgets and delivering results.

Clearly the more rigorous an initial case assessment and the more carefully thought out a case "blueprint," the greater the likelihood of achieving efficiencies in the handling of a matter and ultimately securing a successful resolution. The more pressing question is what should be the central focus of that blueprint.

It is often said that the best way to avoid a trial, is to prepare the case from the outset as if it will be tried. True leverage for successful resolution stems from a perceived capability to secure a jury verdict. The best plans are built around what issues will control the verdict outcome.

Current law firm economics, however, demands billable hours and is best served by a far broader focus. The hierarchical team approach is best suited to the identification of as many issues as are possibly germane to the matter at hand in the style of a white paper. Compare for example, the volume of discovery generated in a large firm litigation to the tiny percentage of material actually used at trial.

Other cultural issues are in play that should lead corporate counsel to reconsider reinforcing the "rainmaker culture" with a continued stream of pure hourly rate engagements. First, lawyers with 3 million to 5 million dollar "books" are not personally taking too many verdicts. In fact, few large firm "litigators" responsible for complex matters have even tried as few as 10 cases in their careers. Additionally, firms preoccupied with maintaining economic leverage are not fully invested in developing trial skills of team members who in all probability will depart the firm having failed to achieve equity status.

"Trial-focused" strategies simply don't take shape amidst a dearth of trial experience. Even assuming the team leader has significant trial experience, when the captain is simply managing and not "living the case"; it is not being brought to bear on the matter in a meaningful way. Cost effective efficiencies manifest themselves in the daily decisions to pursue and reinforce one piece of evidence and to de-emphasize or abandon pursuit of another. When a distanced and insulated "manager" delegates to team members, who may have zero trial experience, the daily calls on what is of greater or lesser importance and how to develop evidence in a persuasive and admissible way, efficiencies never materialize.

If history is a guide, law firm leaders will not embrace the idea of risk-sharing unless it is made mandatory. Risk-taking represents a greater threat to profits per partner than an opportunity for the firm to make a statement about its confidence in its abilities.

Mandating risk-sharing fee agreements would encourage a culture more beneficial in the long run to corporate consumers of legal services. Smaller teams, a more collegial environment, a true sharing of firm clients by trial partners who litigate and try a limited number of cases for limited clients as opposed to rainmaking to the multitude, and investment in developing the trial skills of younger firm members can all be expected byproducts of a changed set of financial incentives.

In short, senior corporate counsel cannot expect to receive the opposite of what they currently incentivize. Pure hourly rate engagements and a rainmaker culture have stagnated cost control efforts and law firm innovation.

If inside counsel truly want to meet the challenges presented by the current business climate then cost control has to mean risk-sharing.

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