

# CORPORATE counsel

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Talkin' Revolution

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Jeffrey Carr is sick of talking about alternative fee arrangements. The general counsel for Houston-based FMC Technologies, Inc., has been using alternative fee structures—arrangements with outside counsel that are not based on billable hours—for "well over a decade." But Carr says his efforts over the years to promote these billing models among his counterparts at other companies fell largely on deaf ears.

That all changed when the downturn hit and corporate management started pressuring general counsel to reduce costs. Suddenly, Carr found himself being asked to join panels, conferences, and workshops on alternative billing structures. He turned down all the requests but one. "I've got a day job," he says.

Carr is one of a handful of well-known, visionary corporate counsel, including Cisco, Inc.'s Mark Chandler, Sun Microsystems, Inc.'s Michael Dillon, and Clorox Company's Laura Stein, who long ago embraced alternative fee structures as a way of realigning their relationship with outside counsel. They were lonely then and they are lonely now.

But despite the sudden interest in alternative fee structures, the billable hour still dominates by far. A survey of 200 law firms conducted this spring by legal consulting firm Altman Weil found that the billable hour still reigns supreme, especially among the biggest firms. Survey participants with 1,000 or more lawyers predicted that just 1-to-10 percent of revenue in 2009 will come from matters billed on a nonhourly basis. Other industry observers think even that estimate is too optimistic. Currently, less than 2 percent of matters are done on an alternative fee basis worldwide, says Nicky Mukerji, director of business intelligence at Legalbill Co Llc, a Nashville company that audits corporate legal departments and analyzes their legal spend. Although alternative billing has been around "for years and years," until the last year or so the pace of change had been glacial, he says. Admittedly, the recession has boosted momentum, but Mukerji predicts that ten years from now, the billable hour will still account for 80 percent or more of billings.

"Alternative fee arrangements are like teenage sex. There's a lot more people talking about it than doing it—and those that are doing it don't really know what they're doing," says one industry observer.

But many observers—and advocates—say widespread change is on the horizon. "We're at a tipping point," Carr says, "As alternative fee arrangements become more mainstream, it will set the industry on a path that is, thankfully, irreversible."

And that's the big story in this year's survey of Who Represents America's Biggest Companies. Though the firms at the top often swap places with one another, most of the same marquee names predominate. What is changing, however, is the "how," rather than the "who." The recession, and the attendant pressure from corporate leaders to reduce all expenses, including legal costs, is leading many more in-house leaders to lean on their outside counsel to agree to alternative billing methods. And many report that firms are showing a newfound willingness to do so. The question is whether it's a true realignment, or a temporary reaction to the downturn.

With a team of just eight in-house attorneys, Carr has always had to outsource much of his legal work to a roster

ranging from Am Law 100 firm Howrey to Valorem Law Group, a seven-lawyer litigation boutique based in Chicago.

But Carr has no interest in outsourcing all of his company's profits along with the work. That's why more than a decade ago, the FMC general counsel started converting almost all of his legal engagements to performance-based pay. Typically, 20 percent of every invoice is "at risk," meaning that a firm gets paid between zero and 200 percent of the at risk amount, depending on its performance. Carr also uses a more complex system in which standard multipliers are adjusted for performance against budget. Either way, the number of hours billed are not a factor. "I don't want to buy hours, I want to buy results," Carr says.

Carr's efforts have paid off. From 2001, when the Houston-based energy technology company was spun off from FMC Corporation, to the present, total company revenue has more than doubled, from \$2.2 billion to \$4.6 billion. Yet Carr says throughout that time, his overall legal spend, both internal and external, has stayed relatively flat.

Another long-term, vocal champion of alternative fee models is Mark Chandler, general counsel of Cisco, the vast networking equipment manufacturer based in San Jose. "Every firm that comes to us recognizes that we operate on a fixed-fee basis," Chandler says. For the past five years or so, Chandler has been pushing to get rid of the billable hour model at Cisco, which he says suffers from a lack of alignment between his and his outside counsel's interests. "I'd be trying to create efficiencies and limit the scope of the work being done while law firms would be totally committed to success on the legal merits without giving any thought to my costs," Chandler says. He uses a variety of fixed-fee arrangements, including monthly flat fees to handle a bundle of matters and incentive-based fees, in which he pays a firm extra for a successful result on a case.

He also reports success with his use of alternative fee arrangements. Chandler, who uses about two dozen firms to handle his work, including Morgan, Lewis & Bockius, Fenwick & West, Baker Botts, and Weil, Gotshal & Manges, says until this year's sharp drop in company revenue, he has reduced legal spend as a percentage of revenue every year for the past five years.

Yet Carr, Chandler, and a handful of others were virtually alone in moving away from the billable hour. Association of Corporate Counsel president Frederick Krebs says that in-house counsel have been complaining for years about the perverse incentives created by the billable hour while doing virtually nothing about it. "To paraphrase Churchill," Krebs says, "never has so little been accomplished by so many for so long."

Law firms are certainly partly to blame for the slow pace of change. Michael Dillon, general counsel of Sun in Santa Clara, California, says that as recently as a year ago, virtually whenever he suggested an alternative fee structure to a law firm, he "would get blank stares, or a list of reasons they didn't think it was possible." Lawyers being lawyers, even those that do agree to a flat fee in theory will sometimes build in so many caveats and exceptions that it's no longer a flat fee, says Legalbill's Mukerji.

Another major hurdle is the way law firms are structured. Since the 1960s, law firms have billed by the hour and lawyers—especially associates—are evaluated largely based on how many hours they bill. Billing a matter on a flat fee basis can create a disconnect between a firm's earnings on that matter and how it values the associates that work on it. Most lawyers also are not schooled in putting together a budget except for the most routine of matters, and law firms have been slow to collect and analyze the needed data.

Law firms, however, have been quick to stress how flexible the recession has made them. "Most of our clients are reporting that their law firms are actually suggesting alternative billing arrangements," Mukerji says.

General counsel agree that there's been a seismic shift in how law firms view alternative billing. Dillon says he's been amazed by the new surge in attention being paid to creative billing models. He says that he recently asked Howrey, one of Sun's two dozen or so outside law firms, to represent Sun in a litigation. As Dillon wrote in his blog, "To my surprise, [the firm] proactively offered a variety of cost structures (including flat fee and quarterly fee caps) as an alternative to the billable hour."

Cisco's Chandler says that he, too, has seen a change in firm attitude. "Lately, even large national firms are showing interest in bidding on RFPs for big litigation matters," he says. "Five years ago, it was very hard to find firms willing to take that risk. They all said they needed to charge by the hour because they didn't know how the case was going to progress."

Clorox Company general counsel Laura Stein, who has been using alternative fee structures for about five years, says the portion of matters billed out on that basis has "increased significantly," as firms become more receptive and the company improves its in-house capability to evaluate cases early on and monitor their progress. Projects

she bids out on alternative fee bases range from "entire portfolios of work" to major M&A deals. In 2007, for instance, Clorox hired San Francisco-based Morrison & Foerster on a flat fee basis to represent it in the \$913 million buyout of natural personal care products manufacturer Burt's Bees, Inc.

For his part, Howrey litigation partner Robert Gooding, Jr., said the firm is "very conscious of the fact that many corporate clients are under extreme budget restraints." He says the firm has an in-house group of "MBA types" that prepare detailed budgets he can then use to establish a quarterly fee cap for cases. "It's an approach we've taken with Sun and other clients," Gooding says.

Fixed fees for bundles of routine litigation or transactions to bring more predictability to legal costs is another common alternative billing arrangement. That's the deal Pfizer Inc has with Jackson Lewis, which handles all of Pfizer's employment work in exchange for a preset fixed monthly fee ["The Power of One," September 2008]. A performance-based arrangement such as a hybrid contingency fee, which is not news for plaintiffs lawyers but a novelty for the defense bar, is another approach designed to align the incentives of law firm and client. For instance, clients like E.I. du Pont de Nemours and Company and Bayer AG retain Chicago litigation boutique Bartlit Beck Herman Palenchar & Scott strictly on a hybrid contingency fee basis—the firm refuses to bill by the hour. Blended rates, which fix the hourly rate a firm can charge for a matter, is a third route.

Just as is the case with corporate counsel, a handful of law firms have used alternative fee arrangements for years with great success. Clients of Bartlit Beck, for instance, pay the firm a preset flat monthly fee, holding back 20-to-40 percent. If the case goes south, the client keeps the holdback. If there's a successful result, the firm gets a bonus up to five times—or more—of the holdback. Another such example is Tucker Ellis & West, a 144-lawyer firm based in Cleveland. Partner Jeffrey Healy says that when the firm was launched in 2003, it made "a real commitment" to alternative fee arrangements as a way of doing business. In the first year, Healy says, alternative fee arrangements accounted for about 7 percent of revenue. He says that portion is now 40 percent or more.

Some Am Law 100 firms also regularly take matters under a fixed-fee or incentive-fee arrangement. For several years now, Morgan, Lewis has handled certain types of commercial litigation for Cisco on a fixed-fee basis. Morgan, Lewis chair Francis Milone says the 1,441-lawyer firm has people in most of its departments who spend the bulk of their time budgeting out projects, as well as several software programs designed for that purpose.

Such examples suggest that in-house counsel could get their outside counsel to agree to a flat or performance-based fee if they really wanted it. Carr of FMC Technologies agrees. "Law firms will do what we want them to do," he says. "The real failing is on the in-house side." He says that he has talked to a number of law firms who would genuinely prefer alternative billing arrangements, but their corporate clients won't let them. "Alternative fee arrangements take a lot more engagement than many in-house counsel like," Carr says, adding that it took him a couple of years to get his own staff on board with the idea.

Tucker Ellis's Healy says his firm "almost always tells prospective clients that we are very interested in alternative fee arrangements." Despite the up-front offer, and the firm's experience and comfort level with such arrangements, it still bills out 60 percent of matters on a traditional hourly basis. "Potential clients are generally very receptive to the idea," Healy says, "but they don't always accept it, and we often encounter a healthy skepticism."

ACC's Krebs says general counsel such as Carr, Dillon, and Stein who have embraced alternative fees "are way ahead of the curve. A large number of [in-house counsel] are just beginning the process now." One of the challenges, he says, is "showing people how to do it." Toward that end, the ACC launched the Value Challenge, an anti-billable hour initiative, late last year. Carr, who is a member of the steering committee, says the Value Challenge is the first time he has seen a broad-based, concerted effort in the industry to do something about getting rid of the billable hour.

Of course, not every matter is amenable to an alternative billing arrangement. The key to long-term success, says Mukerji, is remembering that alternative billing arrangements can work only if law firms become more efficient at handling matters—and pass on their savings to clients. "It's a relationship-building tool," Mukerji says. "Law firms who want to partner with their clients need to take on some of the price risk." Charging a flat fee based on a padded estimate of what a matter would normally cost is not the way to do that, he says.

In-house counsel also need to be on the lookout for pitfalls that can spoil an alternative fee arrangement. Mukerji says matters should actually be monitored more closely, not less, to ensure that firms aren't cutting corners and to build benchmarks for future matters. Mukerji recommends that law firms, at least initially, use "shadow billing," tracking timekeeper hours on matters subject to alternative fee arrangements, and share that information with the client. Shadow billing permits the firm to compare actual time with the amount it is charging, and allows the client

to see whether it is incurring any savings as well.

Although observers disagree on the pace of change, they are virtually unanimous in their view that the pendulum will not swing back to prerecession times. Mukerji voices a commonly held opinion when he says, "There is a new wave of general counsel coming in," he says, "with a mind-shift toward looking at law as another business and not just a necessary evil."

As for Carr, alternative billing arrangements are so twentieth-century. He's already moved onto the Next Big Thing: social networking for lawyers. Carr is revisiting his company's list of outside counsel, and as part of the selection process, Carr had candidates send him tweets on why their law firm should be chosen. Saying anything in Twitter's rule of 140 characters or less—with no footnotes—is a challenge for any lawyer, but the candidates did their best. One favorite tweet of Carr's—"Firm gets \$14mm verdict and XXmm settlement in 1 day—Good God almighty which way do I steer?"—included a reference to Carr's "favorite minstrel/philosopher," Jimmy Buffett. Another—"Our long-term interests ALWAYS align w/client in effective/efficient resolutions—plus we have great wine at celebration dinners"—appealed to Carr for its "blatant but effective pandering."

But for sheer get-to-the-pointedness, one firm's tweet said it all: "We save you money—or die trying." Here's hoping they save the money. •