BEYOND THE BILLABLE HOUR

A Practical Guide to Alternative Fee Arrangements

rocket matter

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Introduction

The death of the billable hour has been greatly exaggerated. Sure, it may be inefficient and prone to abuse but it's entrenched in the law firm business model and culture. But change is underway.

As law firms face more competition, and with individuals looking for affordable options and corporations under pressure to reduce costs resulting in more work being handled by contract lawyers and in-house legal departments, clients are demanding predictable costs with efficient and transparent billing practices. In other words, they want alternative fee arrangements, and law firms must comply or lose the business.

In this practical guide, you'll learn about the alternative billing models firms are using, such as fixed or flat fees, contingency and reverse contingency fees, value or success based fees, and popular hybrids or combination fees. These flexible fee arrangements may be per engagement, firm wide by client, or matter-specific and can help establish and nurture long-term relationships that is of optimal value to both the client and firm.

How Many Alternative Fee Arrangements Are There?

A firm can have as many different types of arrangements as they have clients. However, it helps to have a core few to work with so clients and the firm don't feel overwhelmed with too many choices. Here's a summary of the more commonly used alternative fee arrangements, many of which can be, and are often, combined to form a hybrid fee model.

Fixed or Flat Fee – The firm negotiates an agreed-upon cost for handling a case or matter. This is generally simple and straightforward, and is among the most popular alternative fee option. The advantage for the client is predictable cost, and for attorneys, the catalyst to improving processes, productivity, and technology. The downside for the firm is unexpected costs, so these arrangements are most useful for routine legal services with little or no risk for complication.

Contingency Fee – Another popular option is a contingency fee model where the firm assumes the outcome risk: the firm gets paid only if the case is handled successfully – collecting a percentage of the settlement or money won at trial. This is often used in cases such as personal injury and workers' compensation where money is being claimed. Regardless of the outcome, the client generally pays for court filing fees and other administrative functions related to the case.

Reverse Contingency Fee – The fee is based on the difference between the amount being demanded from the client by the party making the claim, and the amount obtained from the client — usually, a percentage of the amount saved for the client.

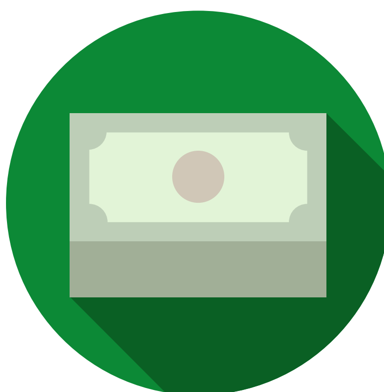
Success Fee – The client and the firm first define what results will constitute "success." The firm then charges the client a reduced base fee up front with an additional fee due if the outcome of the case is successful. The firm shares in the downside (reduced base fee) and the upside (additional fee for successful outcome). The upside for the client is a lower base fee and incentivizing the firm to obtain a successful outcome.

Retainer Fee – This popular fee arrangement is when a client pays a fixed recurring fee over a period of time for specific work. When the period expires, the arrangement is reviewed and adjusted. It provides predictable costs and attorney availability for the clients. A typical retainer agreement runs for one year with a fixed monthly fee.

Hybrid Fee – Any combination of the fee arrangements listed here is considered a hybrid fee arrangement. Hybrids appeal to cost-conscious clients while allowing the firm to maintain cash flow. A typical hybrid arrangement may involve negotiating a lower hourly rate with a contingency fee model allowing the client affordable access to legal services with the promise of a payout to the firm if a favorable outcome is achieved.

Some fee arrangements are better suited to transactional work while others may find a comfortable home in litigation firms.

So, just how many alternative fee arrangements are there? As many as you need, crafted to fit the needs of a particular client, matter, or case.



Fixed Fees or Flat Fees

In a fixed or flat fee arrangement, the firm negotiates an agreed-upon cost for an agreed-upon amount of work, such as handling all work related to a particular matter, or for a distinct piece of work in the matter.

Through an interview with the client, the firm determines the complexity of the project and the amount of time it would take the complete the matter. The firm and client then negotiate an appropriate flat fee for the duration of the engagement. The fee can be paid up front, when the work is completed, in installments tied to stages of a matter, or in periodic installments such as monthly or quarterly.

In this arrangement, the client gets predictable costs and the firm is incentivized to be productive and efficient in its pursuit of a successful resolution of the matter for their client. A flat fee arrangement is especially popular with in-house counsel as it provides predictability in budgeting.

Due to unpredictable factors related to litigation, fixed or flat fee arrangements are more common for transactional work. However, to address the fear of underpricing their services, firms can add a provision to reassess and renegotiate the contract based on factors that may influence the length and breath of the engagement. Setting a fixed fee for each stage of the engagement can also mitigate unease.

Establishing and building trust with open, ongoing communications, clarity, and transparency is key to making this type of alternative fee arrangement work.

Adopted early by solos and small firms–and used as a competitive advantage in their marketing efforts–for practice areas as diverse as estate planning, business incorporation, intellectual property, bankruptcy, and criminal defense - flat fees are gaining traction at law firms of all sizes.

Contingency Fees

The Contingency Fee Arrangement. Seems like a simple concept: If the lawyer does his/her job, everybody gets paid. Sounds like a win-win, right? - in a perfect world - yes. But, there are many frustrations that can surface unexpectedly when using this type of payment system. Let's break down the specifics of contingency fees so you can determine whether it's a good fit for you and/or your clients.

Through contingency fees, lawyers accept a fixed percentage (usually one third) of the funds that are successfully recovered for the client. While the law does not generally regulate the amount a lawyer can charge, fee percentages are fairly uniform throughout the country due to high competition. Usually, more complex and time-consuming cases will require higher fees dues to higher risk to the firm and overall cost expenditure.

Thanks to today's media representation of lawyers and firms, many clients who have had no experience with attorneys are under the impression that they all work on contingency fees. In reality, this kind of fee arrangement is only available for a handful of areas of law.

In the real world, contingency fees can only be used in cases where money is being claimed, including but not limited to:

- Car accidents, boat accidents, work accidents, and other personal injuries
- Fair Debt Collection Practices Act violations
- Defective products that cause injury

- Employment law and hourly wage issues
- Large debt collection

In theory, the contingency fee arrangement sounds like a dream. The client doesn't pay unless the lawyer wins, which in turn incentivizes the lawyer to work extra hard on handling each case. While this "all or nothing" payment system might seem like the perfect arrangement, contingency fees have been a thorn in the side for many an attorney.

Clients will normally hire a lawyer on contingency when they cannot afford to pay the lawyer's hourly rates. Though there is little investment for the client, there is always the risk that the firm will get paid nothing if the case is lost. There is also the risk that the payment will be delayed until it is collected from the opposing party.

Another factor that affects contingency fees is the amount of out-of-pocket expenses needed to cover a case. Some lawyers require the payment of costs expended if the case is lost, which is something that many clients are not aware of. Imagine the wrath of the unhappy client who loses their case AND is forced to pay expenses? No thank you.

As an attorney, you must make sure that you do not take on contingency cases if it is a bad deal. For example, avoid this type of fee arrangement for small financial cases, complex cases, and overall time-consuming cases. On the other hand, contingency fees are perfect for simple cases that have the potential to win a lot of money. As long as you are highly selective about the cases that you work on contingency, both you and your client can reap the benefits of this highly varying fee arrangement.

Reverse Contingency Fees

While most attorneys are aware of and have probably performed at least some work on a contingency basis at some point in their careers, there is also a not-so-common alternative fee arrangement known as a reverse contingency (or reverse contingent) fee that may help add to your firm's revenue potential. The reverse contingency fee is basically a percentage of the difference between the amount a third party originally demands from your client and the amount that client must ultimately pay the third party, after the settlement or judgment.

That may sound like a mouthful, but the reverse contingency fee may actually be a tool for better aligning the law firm's interests with those of the clients, in some cases. Assuming the amount in dispute is reasonably determinable, the case has a reasonable probability of success and the savings to your client are real, a percentage-based fee might make a lot of sense to your firm.

As an example, let's say your firm agrees to a reverse contingency arrangement with a client who is potentially exposed to a $1 million liability from a trademark infringement case. Your firm is offering to take 30% of the difference between that and a lower amount that you believe you can settle the case for. If that amount works out to be $300,000, then the firm's fee would simply be the difference ($700,000) between those two figures times 30% or $210,000.

What client wouldn't want to pay their attorney only when they perform? At first glance, the reverse contingency fee seems like a good way for an experienced attorney, who has navigated this type of case before, to put their money where their mouth is. The catch, as in so many things, lies in preparation and due diligence. Arriving at an accurate benchmark number can be challenging.

In addition to a reasonable assessment of the potential settlement or verdict in question, entering into a reverse contingency fee arrangement means the lawyer must be very careful in disclosing the terms and obtain informed consent from the client, to the fee arrangement. It also means very careful evaluation of the potential amount of the case settlement or verdict. Too high and you've made the fee unreasonable. Too low and you may be working for far less than you deserve. Another challenge may include being able to draw from little established procedures or personal experience when negotiating and setting the fee arrangement for a particular case.

All in all, the reverse contingency fee fits well within the spectrum of pay for performance. As such, it may be a valuable tool to earn new business and to generate satisfaction among a percentage of your clients, especially those who have faced similar litigation in the past, and have a solid appreciation of the value your work brings to their bottom line.

Success Fees

The Success Fee is a billing method that law firms can employ to incentivize positive outcomes for their clients. This fee arrangement, which focuses on value efficiency, rather than hours worked, benefits both clients and attorneys while increasing the likelihood of success.

While they are both considered to be “risk sharing” fee arrangements, success fees should not be confused with contingency fees. Contingency fees are only paid if a lawyer handles a case successfully. With a success fee arrangement, a reduced base fee is paid up front while another portion is awarded for successes achieved. These “successes” might include such things as achieving a desired schedule, winning a deposition motion, early resolution, etc.

Success fee arrangements require significant thought and communication at the onset of each case. There must be a great deal of focus in defining what the client’s objectives are so that both the lawyer and client specifically understand what constitutes each level or marker of success. Law firms are then encouraged to work thoroughly and efficiently to reach each of the predetermined success “goals.”

In the event that a case is not resolved successfully, the law firm may forfeit a percentage of the fees that they had previously collected. This further encourages counsel to work diligently towards a favorable outcome for their clients.

This particular fee structure is often used in defense cases, or in other situations where the client is not solely seeking monetary compensation. For example, success fees would work well for patent cases, but not personal injury cases where the client is seeking a monetary settlement. It is a good option for clients who prefer predictable costs, timing, and have clear goals.

In the end, both the client and the law firm stand to benefit from the success fee arrangement. On the client's end, case expense is reduced if there is no successful outcome. On the other hand, the law firm stands to make premium returns if they deliver a win for their client.

Retainer Fees

Mentioning the words “retainer fees” around a potential new client can sometimes be a nerve-wracking task. It may conjure up thoughts of being locked down or being trapped in an agreement where they can no longer make changes or escape from. But, retainer fees (a down payment for work to be done and gains from which that work will be billed), when considered as part of a complete custom fee package, can actually help enable both your client and your firm. If positioned properly, your client should now feel comfortable that the firm’s work will begin as promised and continue without interruption. A retainer fee also shows that the client is as committed to the matter as the firms is – building trust and enhancing a potential long-term relationship.

There are basically three types of retainer fees your firm can employ: a classic retainer, a security retainer, and an advance payment retainer.

The classic retainer is one that is earned in its entirety by the firm upon receipt. An example of a classic retainer might be an upfront fee to ensure a lawyer’s availability during a specific time period. This type of retainer fee is usually designed to kick-start the relationship, but may, in some cases, encompass the entire engagement.

A security retainer is one in which a client retains interest in those monies until such time as services are rendered. In this case, the firm is basically holding the funds in escrow for a client. As such, the fees should reside in the firm’s trust account, as directed by states’ ethics rules, which gets reduced gradually as the fees are earned.

In the case of the advance payment retainer, as in that of the classic retainer, the lawyer retains ownership immediately, with one important difference. If the engagement ends before the depletion of the funds, the balance is subject to a refund due the client. Like classic retainers, the initial deposit typically goes into the firm's own account.

The firm can also employ an evergreen retainer, which is a special situation that requires automatic replenishment when it reaches a certain balance. The firm and the client agree to the minimum replenishment level, and typically, work will cease when the balance dips below the agreed-upon minimum until it is replenished. An evergreen retainer ensures that there are always funds available throughout the case, no matter the stage.

Retainer fees can apply across the board (especially in evergreen format), or they can be part of a mixed-fee arrangement that utilizes an initial retainer, and then converts to hourly or flat fee work when initial funds are depleted. Combining fee arrangements in such fashion can help anchor the relationship and get the case off to the right start, while allowing for some billing flexibility on the back end.

Retainer fees can also help facilitate a more professional relationship with special clients, who want to be able to pick up the phone and talk to someone at your firm when a need arises. In addition, because they're collecting the funds up front, many firms are able to offer a discount off standard billing rates. Of course, attorneys need to do their due diligence and make sure they check with applicable state guidelines, but leveraging retainer fees can be an important part of establishing better short and long term client relationships.

Hybrid Fees

Any combination of fees such as contingency, flat or fixed, success, retainer, hourly, and so on, is considered a hybrid fee arrangement. Hybrid fees are risk-sharing solutions that appeal to cost-conscious clients while allowing the firm to maintain a positive cash flow. A firm can have as many different types of hybrid arrangements as they have clients, limited only by the imagination of the lawyer and client, but most offer a core few solutions. Here are some of the more popular hybrid fee arrangements:

Hybrid-Contingency Fee – Firms may offer a contingency fee arrangement to clients — generally in cases where money is being claimed — where lawyers accept a fixed percentage (usually one third) of the funds that are successfully recovered for the client. Or, a better fit may be a reverse contingency fee arrangement where the firm receives a percentage of the difference between the amount a third party originally demands from the client and the amount that client must ultimately pay the third party, after the settlement or judgment.

For some, an even better solution for the firm and client may be a hybrid-contingency fee. In this arrangement, the firm offers a discounted hourly billing rate with the promise of a bonus in the event of a successful outcome. See: [Model wording for hybrid-contingency fee agreement between lawyer and client.]

Blended Hourly Rate – Not purely an alternative to hourly billing, this is a twist on the old standard where one agreed-upon rate is charged for all matters regardless of whether the

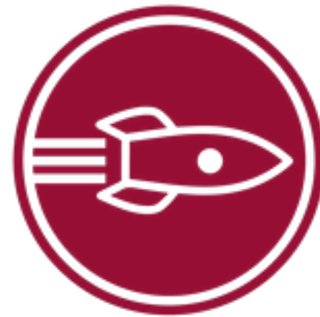
work is done by a senior or junior attorney. There is some debate as to whether this is an alternative fee arrangement since it involves billing by the hour only. We'll include it here as part of the broader definition. For a more in-depth discussion, check out: Are blended rates alternative fee arrangements?

Another alternative hourly rate is volume discount where the billable rate is reduced after the volume of work reaches a certain level during a defined period.

Hybrid-Fixed Fee – Some engagements involve complex issues or situations that cannot be easily defined. In these cases, a blend of fixed and hourly fees allow the firm and client the flexibility to get the best result while keeping costs under control and more predictable. For instance, a portion of the matter, projects within a case, or standard procedures may be charged on a fixed or flat-fee basis, while less defined engagements, like meetings which may run a few minutes to many hours, are based on an hourly fee.

Hybrid-Success Fee – In a straight up success fee arrangement, the firm charges the client a reduced base fee up front, with an additional fee due if the outcome of the case is successful. In a hybrid model, where the client and firm share in the risks associated with the matter, the adjusted base fee the parties agree to is a reduced hourly rate.

As mentioned earlier, hybrid arrangements that firms negotiate with clients, are based on each client's and each matter's unique situation, and limited only by the imagination of the lawyer and client. The core few mentioned here, however, are a good start, and useful for creating marketing copy for the firm's website and other collateral to speak to clients seeking flexibility in their billing arrangements.



About Rocket Matter

Rocket Matter is a leading cloud-based practice management and legal billing application for small to mid-sized law firms. Our aim is to help law firms run a better business by being more efficient, productive, and ultimately more profitable. The powerful, intuitive interface allows lawyers to measure their firm's performance, organize matters, communicate with clients, quickly capture time, and makes billing and invoicing a breeze.

Trusted by thousands of law firms, Rocket Matter integrates with popular applications that attorneys use like Evernote, Dropbox, Outlook, Gmail, and more. Attorneys can manage their office on the go with a robust iPad edition, and native iPhone and Android apps.

Please enjoy this guide and become part of our cutting-edge community on Facebook, Twitter, and Legal Productivity blog.

Managing Your Alternate Fee Arrangements with Rocket Matter

Rocket Matter excels in tracking hourly billing, but the application also organizes, tracks, and bills for alternate fee arrangements.

Lawyers who use alternate billing structures need to bill their clients, but they may also want to monitor and track their expenses and time. Rocket Matter allows firms to designate a matter as a contingency or flat fee or whatever billing arrangement was negotiated with the client. This allows lawyers to track their time on the matter while still giving them the flexibility to bill and invoice based on the alternative fee arrangement agreed upon for that particular engagement.

Do you bill your hourly clients on a monthly basis, but bill your contingency and flat fee matters on an as-needed basis? Because Rocket Matter allows you to distinguish between matters with different payment structures, you can still batch bill your hourly clients, while excluding contingency and flat fee matters so you can invoice them separately.

Do you have a hard time keeping track of all the different payment structures you've arranged for your clients? Rocket Matter enables you to organize, sort, and run specialized reports based on billing type, giving you the ability to view and check the progress of matters with different fee structures.