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Time is Money: Alternatives to the Billable Hour

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Uncertainty is rarely a good thing. Just as clients would prefer not to be uncertain about the outcome of a legal dispute, they also don't want to be surprised by the amount of their legal bill.

As a result more firms are increasingly open to using alternatives to the billable hour. As clients of all types push for greater predictability of their legal fees, many firms are structuring flat fees, fee caps, hybrid contingency fees, fees based on achieving specific milestones or completing specific tasks, and even equity-based fees. The exact fee structure usually depends on the nature of the work being done and the client's needs.

Just how well this move toward non-hourly billing will sit with law firms, particularly smaller firms, remains to be seen. "Attorneys are risk averse" and may not welcome alternatives, says Jim Calloway, director of the Oklahoma Bar Association's management assistance program in Oklahoma City, and a member of the *SFB* editorial advisory board. In reality, alternative fee arrangements are already prevalent. "A lot of lawyers use flat fees for routine work like drawing up a will or handling a bankruptcy filing," he says. "They just don't think of that as alternative billing."

Some firms are embracing alternative fee structures as a way to strengthen client relationships and gain a competitive advantage in the marketplace. Marlon Hill, a partner with delancyhill, a five-attorney firm based in Miami, says that, in some cases, at the client's request his firm uses flat fees for work such as handling an application to secure a trademark or a property lease because it is relatively easy to calculate the amount of time such work requires.

In other cases, Hill suggests alternative fee arrangements if he knows or senses a client is facing financial constraints. Such clients often feel more comfortable with flat fees, but Hill is also willing to barter if the client has goods or services the firm needs, such as Web site development. He estimates that his firm uses alternative fees, including flat fees, in about 20 percent of its work.

"Many of our clients are small businesses that are sensitive to budgets," says Hill. "By proactively exploring different fee options, you can find a way to help the client." He notes that many small businesses are becoming more sophisticated when it comes to discussing fees and that suggesting an alternative fee arrangement is a good way to reinforce the client relationship.

Smaller firms with their relatively low overhead have much more flexibility when it comes to setting fees than larger firms. Indeed, some referrals from larger firms are based, at least in part, on a smaller firm's ability to structure alternative fee arrangements.

"Larger firms that won't do any kind of non-hourly billing will refer clients to our firm for specific matters" when

the client insists on alternative billing, says Richard Cohen, a partner with Akabas & Cohen, a seven-attorney firm in New York City.

DIFFERENT FEES FOR DIFFERENT SITUATIONS

Flat fees are perhaps the most prevalent type of alternative fee and can take many forms, such as per assignment or flat fee per billing cycle. But, flat fees are not appropriate for all legal work. In general, routine, ongoing types of work are most appropriate for flat fees.

FLAT FEES

A firm can set a flat fee for a specific transaction, such as drafting a will. For more complex, but still straightforward work, a firm can charge a flat fee for a portion of the work and bill hourly for anything beyond that. For example, Akabas & Cohen charges a flat fee for drafting a shareholder agreement, then charges hourly for revisions because of the uncertain nature of that part of the work. In this case, the flat fee for the first draft would vary based on the complexity of the agreement.

"We listen carefully to what clients want and then estimate the cost of a first draft," says Cohen. "Beyond the first draft, we can't estimate the fee because it generally depends on things beyond our control, such as the shareholders' actions."

For one of its long-term clients, Akabas & Cohen charges a set monthly fee. Cohen says the firm offers this type of fee only to clients that have a steady flow of fairly routine corporate legal work. "The fee might vary by the month, but we usually can project fairly closely what it will be for the year," he says.

For the monthly amount, the firm reaches an agreement that will be in effect for six to 12 months, and then re-estimates and re-sets the fee for the next cycle. This monthly fee does not cover extraordinary or complex deals, such as mergers, acquisitions, or initial public offerings. "However, we handle that type of work fairly regularly, so it could be covered by a flat fee, depending on the deal and the client," says Cohen.

EQUITY-BASED FEES

Michael Membrado, whose firm M.M. Membrado & Associates is based in New York City, focuses his practice on handling corporate matters for start-up or development-stage companies with limited cash. In some cases, Membrado will accept a portion of his fees as equity-based compensation in the form of common stock or warrants.

"Equity-based fee arrangements occur most frequently with public company clients with which I have had a relationship for some time," he says. "Because this is similar to making a cash investment in a company, I insist on knowing everything about the company, its finances, and its management team."

Also, because he prefers cash, Membrado deems equity-based fee arrangements to be a concession. The formula used to determine the portion of fees to be taken in equity can vary greatly and be fairly complicated.

In other situations, Membrado accepts deferred payments. In these cases, he bills by the hour (his current rate is \$390 per hour), but the client does not get billed until the matter reaches a predetermined conclusion, such as the client securing venture capital financing.

"I structure these arrangements so that the full amount of the deferred payment is greater than the total of my hourly fees to reflect the fact that this is risk-based compensation," says Membrado. Such payments generally occur within 30 to 180 days after taking the case.

A NEW LOOK FOR CONTINGENCY FEES

Firms that work on contingency sometimes structure hybrid contingency arrangements if requested. Thomas Patterson, a partner with The Patterson Law Firm, a six-attorney litigation firm based in Chicago, offers clients a hybrid contingency arrangement in which the firm works for half its hourly rate with a contingent payment for successful cases.

The elements of these arrangements are open to negotiation. For example, if the case involves a \$1 million

claim, Patterson might work for \$125 an hour or half his regular hourly rate, bill those amounts throughout the case, and then collect the contingency payment less the total amount billed hourly to that point. "This sometimes makes clients more comfortable and does not present a risk to the firm's overhead," says Patterson. "This blended contingency lets the firm maintain cash flow, but also gives it a stake in the outcome of the case, which clients appreciate."

In some situations, a firm's contingency is not a percentage of the amount of the judgment or settlement, but a multiple of the hourly rate for the hours billed on the case.

Akabas & Cohen has also structured different types of hybrid contingency arrangements. One arrangement features a gradual increase in contingency payment as the case moves forward. For example, a case would start out with a set contingency fee for the firm. From there, the firm would earn a certain portion of that fee at specific milestones. For example, the firm might earn 20 percent to 25 percent of the contingency when the complaint is filed and another 30 percent during discovery.

KEEPING AN EYE ON THE BIG PICTURE

Overall, alternative fee arrangements are about much more than fees. They represent a new approach to managing a firm, its work, and its client relationships. It is up to each firm to determine the best arrangement for the situation.

MANAGING A FLAT FEE ARRANGEMENT

"We had a choice," says M. Bradley Gilmore, a partner at Parker, Lawrence, Cantrell & Dean in Nashville. "We could lose the client, or be dynamic enough as a firm to respond and change the way we bill this client and manage the work we do for it."

Gilmore and his partners needed to adapt to wishes of a client that had suggested moving to a flat-fee billing arrangement, because it wanted to ensure the predictability of its legal fees. Parker Lawrence, a 12-attorney civil practice, had been doing work for the national department store chain for several years. The client's work was somewhat routine and predictable -- the retailer was self-insured and needed ongoing legal help handling workers compensation cases and defending against personal injury lawsuits.

Because the firm had been working with the client for some time, the partners were able to determine the average amount of time spent on each case. "We knew that not all cases go to trial and that a certain number would be closed early with a summary judgment or dismissal or would be settled," Gilmore explains.

The first step was to negotiate a flat fee. The firm's partners calculated their bottom-dollar number fees based on the average cost per case the firm had billed to that point in the relationship. If the client would not pay a flat fee at or above that amount, the partners felt comfortable walking away.

Once the firm and the client agreed on a flat fee, it was up to the firm to manage its work and attorney and staff utilization to make sure the relationship remained profitable. The partners quickly realized that they had to fundamentally rethink the way they structured, accounted for, and completed work for this client.

"It was a risk, but it was a risk that had a good payoff," admits Gilmore. The risk was that the firm could expend more resources making changes to manage the client's workload and handle its cases than would be covered by the flat fees the firm was collecting. However, if the firm managed those risks, the payoff would be a steady flow of profitable work.

The firm agreed to take half its fee when a case was opened and the balance upon completion. To even out cash flow, the attorneys continued to record the time they worked on cases and held the first half of each fee in escrow until the firm had "earned" that money. If there was extra money left when the case was over (e.g., the firm's fee based upon hours spent on the case, was less than the fixed fee), the firm would move the money over to its general operating account. If a case ended in a summary judgment, the firm would get the second half of its fee sooner. If a case went to trial, there was a chance that the flat fee would not be enough to cover the firm's expenses.

Nevertheless, the firm also made sure it had a built in "squeal factor" that allowed it to ask for a higher fee for particularly complex cases for which the flat fee was not appropriate. Gilmore estimates that the firm used the

squeal factor just two or three times during the several years that the flat fee arrangement was in place.

Even then, the firm had to be flexible. "In one case, the client didn't want to pay an hourly rate, but it also recognized the complexity of the case," says Gilmore. In that situation, the firm negotiated an arrangement that paid the firm three times its usual fee if it won the case and only the regular flat fee if it lost the case. The firm did end up losing that case and honored the agreed-upon fee.

Once the fee arrangement was in place, the firm needed to make some internal changes to its billing system. "Our traditional hourly model, billing guidelines and budgets, and quarterly bills would not work with this arrangement, so we had to do a lot of extra work to get paid," says Gilmore.

On the positive side, while working for a flat fee, the firm's attorneys did not have to worry about the client when staffing cases. "We staffed our cases as needed and it was up to us to make that profitable," says Gilmore. The firm had more freedom to include paralegals in initial case meetings without the client's permission and to hold meetings with paralegals, associates, and partners without being worried about non-billable time. Parker Lawrence was also able to use such meetings to share ideas and brainstorm ways to resolve cases early.

"We were able to take advantage of others ideas and use a team approach without hourly billing concerns," says Gilmore. The firm still does work for this client, but the firm does much less work for the client now. The reasons for that have nothing to do with fees. Gilmore says the firm would use a flat fee again if a client wanted it and the nature of the work lent itself to flat fees.

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