

# Considerations in Formulating a Mutually Advantageous Alternative Fee Agreement: Putting “Skin in the Game”<sup>†</sup>

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## I. INTRODUCTION

In today’s competitive legal market, law firms must be willing to “put skin in the game”<sup>1</sup> by utilizing creative alternative fee arrangements. Indeed, clients have become increasingly dissatisfied with traditional hourly fee arrangements and are now seeking more creative fee arrangements to meet their legal needs. Therefore, law firms and their lawyers can greatly benefit from an awareness of the alternative fee arrangements available.

Simply put, clients are increasingly dissatisfied with traditional hourly fee arrangements because such arrangements do not encourage lawyers to work efficiently or with purpose. Hourly billing was instituted to maximize lawyer efficiency.<sup>2</sup> The hope was that hourly billing would allow lawyers to maximize their earnings while charging clients only for time spent

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<sup>1</sup> A term coined by investor Warren Buffett, referring to high-ranking insiders demonstrating confidence in the company they are running by investing their own money in the enterprise.

<sup>2</sup> Susan Sabb Fortney, *The Billable Hours Derby: Empirical Data on the Problems and Pressure Points*, 33 FORDHAM URB. L.J. 171, 171 (2005).



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working on their cases.<sup>3</sup> Unfortunately, that hope has not been realized. Instead, the standard hourly arrangement often fails to provide attorneys with an incentive to work efficiently because it does not reward an especially outstanding performance or a quick resolution.<sup>4</sup>

Unlike the traditional hourly billing scheme that inadvertently rewards inefficiency and provides payment regardless of result, alternative fee arrangements can be structured to promote those qualities that are important to the parties – efficiency, success, and cre-

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<sup>3</sup> *Id.*

<sup>4</sup> For a discussion of some of the pitfalls of hourly billing see Donald C. Massey and Christopher A. D'Amour, *The Ethical Considerations of Alternative Fee Billing*, 28 S.U. L. REV. 1111 (Spring 2001).

ative thinking.<sup>5</sup> There are many types of fee arrangements beyond the standard contingent fee agreement and hourly rate agreement.<sup>6</sup> If properly tailored to the type of work being performed, these alternative fee arrangements can increase overall efficiency, resulting in both savings for the client as well as increased earnings for the law firm.

Accordingly, lawyers can benefit from being aware of the variety of fee structuring arrangements that they can use to attract new business or to provide greater incentive for existing clients to send the lawyer increased business. Indeed, some clients are now insisting upon the use of alternative fee arrangements and will not assign work on an hourly basis. Thus, the firm that refuses to expand its billing horizons past traditional hourly billing arrangements will lose the opportunity to work for such clients.

This paper provides an overview of the types of alternative fee arrangements that can be used in legal services contracts, as well as pointers on how to tailor these arrangements to enhance the needs of both clients and counsel.

## II.

### OVERVIEW: TYPES OF ALTERNATIVE FEE ARRANGEMENTS

While a creative law firm can craft a fee arrangement to fit nearly any client's objective, some alternative fee arrangements have become more common than others. Some of these more common alternative fee arrangements are described below.

#### 1. Contingency Fee Agreements

Traditionally, in a flat contingency fee agreement, the attorney receives a percentage of the money recovered by the client. However, contingency fee agreements may be varied in at least three ways to reflect the parties' mutual goals in the litigation. First, the attorney's fee percentage may vary depending on the amount of money recovered. Second, different percentages may apply based on whether the matter settles or goes to trial. Third, the agreement may include a guaranteed reduced hourly fee that is credited against the percentage fee if the client wins.

#### 2. Defense Contingency Pricing

Fee arrangements may also be based on the particular result obtained by defense counsel. More specifically, the parties may agree to reward defense counsel for achieving desired

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<sup>5</sup> See, e.g., Theda C. Snyder, *Incentive Legal Billing in Litigated Cases*, L. PRAC. MGMT., Apr. 1998, at 25; Thomas L. Sager, *All Corporate Lawyers Should Embrace Alternative Billing*, CORP. LEGAL TIMES, Aug. 1997, at 13-14; Peter D. Zeughauser, *Using Alternative Fee Arrangements to Improve Client Relationships, Law Firm Profitability and Results*, L. PRAC. MGMT., Apr. 1997, at 22; Dick Dahl, *Share the Pain, Share the Gain*, 82 A.B.A.J., June 1996, at 68; Darlene Ricker, *The Vanishing Hourly Fee*, 80 A.B.A.J., Mar. 1994, at 66.

<sup>6</sup> Anthony E. Davis and Julianne Splain, *The Alternatives to Hourly Billing*, N.J. LAWYER, Apr. 2004, at 54.

results or for furthering the client's goals. For example, the client may decide that it does not want the settlement or judgment amount to exceed a particular figure, the target figure. The fee agreement would then provide that if defense counsel is able to settle the case for less than the target figure, or if any judgment in the case falls below that figure, counsel receives a percentage of the difference between the settlement or judgment and the target figure. Also, the agreement may specify that different percentages may be applied based on whether the matter settles or goes to trial.

### 3. Blended Hourly Pricing

Under a blended hourly pricing arrangement, the client is billed at the same rate for all work performed, regardless of the seniority of the lawyer performing the task. Simply put, a single blended rate offers the same rate for both senior and junior attorneys and may apply to the work of partners and associates. Generally, this structure works best for routine work that does not require a high level of knowledge or expertise of senior lawyers.

### 4. Fixed-Fee or Flat-Fee Pricing

In a fixed fee agreement, all work on a case is performed for a single fee regardless of the time spent or the outcome of the case. Generally, this fee structure works best in routine, predictable types of litigation. Notably, however, the allocation of various costs must be determined up front.

### 5. Fee Cap Pricing

Fee cap pricing is a flexible type of arrangement, in which a cap is set on some element of billing. The fee may be capped by the entire case, by a time period, by task, or by phase of the case. Billing may be simplified, but estimates must be accurate, or the attorney can sustain financial loss. Such fee arrangements may also be used in conjunction with incentive bonuses.

### 6. Discounted Hourly Pricing

A lawyer may choose to reduce his or her normal hourly rate by a given percentage, typically ten to fifteen percent. Or, a volume discount may be given where the discount sets in or grows as a client's total billings reach certain agreed-upon levels. Likewise, hourly rates may be frozen over the life of a given matter. Discounts can also be given based on the attorneys' seniority or the length of time that a case remains pending. Different types of work can be billed at different hourly rates; for example, document review can be billed at a lower rate than trying the case. Counsel might also offer an introductory rate to attract new clients or establish a new area of practice. Counsel may require the client to refer a certain amount of work in exchange for the discount.

### 7. Task-Based Pricing

In task-based pricing, each task that may be performed in litigation has a set cost. For example, a set price is chosen for all depositions, dispositive motions, or discovery prepara-

tion, regardless of the time spent or the complexity of the matter. While billing and budgeting are simplified under such arrangements, attorneys must be careful to price tasks correctly and manage the time spent on each task.

#### 8. Blend of Hourly and Contingent Pricing

Under a blended hourly and contingent pricing arrangement, some tasks or phases of the case may be billed at an hourly rate, while the outcome of the case will be based on a contingency arrangement. For example, depositions and motions could be billed at an hourly rate, and counsel would receive a percentage of the money recovered by the client. Or, all work may be billed at a very low rate, on top of which the attorney would receive a contingency fee when the matter is successfully resolved.

#### 9. Budget Ceilings

This type of arrangement requires the attorney and client to establish a budget, and the costs set out in the budget, or some small percentage above that amount, serves as the cap for various phases in the budget. Alternatively, the client and counsel can agree that any cost overages could be rolled over to the next billing cycle.

#### 10. Advice-Only Retainer

Under an advice-only retainer, a flat monthly fee may be paid to an outside expert consultant for analysis and advice. Generally, however, these arrangements provide that the flat-fee covers only a certain number of hours per month.

#### 11. Performance Bonuses

The client may offer counsel a bonus for extraordinary performance in addition to an hourly rate. This arrangement is another way to shift part of the risk-reward aspects of litigation to outside counsel. For example, the fee structure may provide for greater bonuses for early termination of a case, achieving a result for less than the budgeted amount, or case outcome.

#### 12. Other Incentives

A law firm may also provide services beyond legal advice. For example, the firm may offer to provide material to a client's legal department's intranet site, offer participation in training programs, or offer IT assistance to a small business. For larger clients, the firm may subcontract out and oversee the work of outside litigation support vendors, expert witness firms, providers of coding and scanning, and temporary services.

Fee arrangements for these additional services can also be tailored to provide an additional incentive. For example, law firms may offer a discounted rate for prompt electronic payment, or, conversely, they may offer back loading or front loading where it suits a client's budgetary needs.

### III. CONSIDERATIONS IN FORMULATING THE AGREEMENT

Formulating an alternative fee arrangement to meet both your client's and your own needs can be difficult. However, taking certain steps can make this process much easier. Some of these steps are outlined below.

#### 1. Listen to the Client

For alternative fee arrangements to work, a law firm must align its goals with the client's goals and objectives.<sup>7</sup> Therefore, the client's key expectations and the goals of the litigation should be stated early in the process.<sup>8</sup> Give value to the client as defined by the client. It may also be helpful to give the client a choice of several potential options.

#### 2. Protect Your Own Interests

Carefully and realistically assess your likely costs and profitability before entering an alternative fee agreement. Consider offering alternative fee arrangements after some of the litigation is performed using traditional billing, so that you know what costs to expect, and you can develop a fair and mutually advantageous alternative fee arrangement package.

Moreover, provide for unforeseen difficulties. In a fixed-fee arrangement, for example, you may wish to include a safety valve so that the compensation arrangement can be revisited if hourly fees would have substantially exceeded the set amount. You can provide for this possibility using a "collar" set below and above the fixed fee. For example, the fee agreement could provide that if the work required on the matter costs more than anticipated, the high-end collar would be invoked to limit the amount of loss experienced by outside counsel. Conversely, if significantly less work is required, the low-end collar would protect the client from absorbing the full extent of the discrepancy.

Also, make sure the fee arrangement is clear and precise to avoid potential confusion.<sup>9</sup> Document as many potential outcomes as possible.

Regardless of the type of fee arrangement you select, it is important to keep track of your work to show that the amount billed was reasonable. As discussed in the section regarding ethical considerations below, courts apply a reasonableness standard should your contract enter legal dispute.

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<sup>7</sup> See Robert L. Haig, *SUCCESSFUL PARTNERING BETWEEN INSIDE AND OUTSIDE COUNSEL* §§ 14:14, 75:30 (West 2008).

<sup>8</sup> See James D. Shomper and Gardner G. Courson, *Alternative Fees for Litigation*, ACCA DOCKET, May 2000, at 28.

<sup>9</sup> See *Alderman v. Hamilton*, 205 Cal. App. 3d 1033 (Ct. App. 1988).

### 3. Increase Efficiency to Increase Benefits to Yourself and Client.

Alternative fee arrangements may be judged by the value they bring to the client, by the results achieved, and by the predictability of costs.<sup>10</sup> If properly structured, these fee arrangements can also be used to increase law firm profitability.<sup>11</sup>

Increase efficiency so that alternative fee arrangements work to your advantage, as well as your client's. For example, streamline processes by creating data banks. Assign a steady team to a block of work to eliminate the learning curve. Ideally, if staffing and work processes are properly tailored to the case, the client, and the fee structure, the law firm's total compensation will be greater, as will the total value offered to the client.

Also consider using alternative fee arrangements to increase profits in areas in which the firm has great expertise by providing the same high-value advice to multiple clients and prorating or amortizing the costs. Furthermore, law firms should offer discounts when needed to maintain business during downturns, to attract new business, or to account for start-up time for a new practice area.

### 4. Ethical Considerations

Regardless of the fee arrangement that is selected, the arrangement must meet the requirements of applicable Rules of Professional Conduct.<sup>12</sup>

Many states' Rules of Professional Conduct require contingency fee agreements to be in writing, and to specify whether expenses are to be deducted before or after the fee is calculated.<sup>13</sup> Any ambiguity in the agreement will be construed against the attorney and in favor of the client.<sup>14</sup> For example, in a case in which the fee agreement was silent as to whether the percentage of recovery included costs and expenses, a court held recovery would equal the percentage of the "total amount recovered" less costs and expenses.<sup>15</sup>

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<sup>10</sup> See Peter D. Zeughauser, *Using Alternative Fee Arrangements to Improve Client Relationships, Law Firm Profitability and Results*, 3 LAW PRAC. MGMT. 22 (April 1997).

<sup>11</sup> Charles S. McCowan, Jr. and Esteban Herrera, Jr., *The Law Office as a Workplace*, 43 LA. B.J. 466 (Feb. 1996).

<sup>12</sup> See, e.g., Lee A. Watson, *Note Communication, Honesty, and Contract: Three Buzzwords for Maintaining Ethical Hourly Billing*, 11 GEO. J. LEGAL ETHICS 189, 197 (1998); ABA Informal LEO 1389 (July 14, 1977); ABA Formal LEO 373 (April 16, 1993).

<sup>13</sup> See MODEL RULES OF PROF'L CONDUCT R. 1.5 (2008).

<sup>14</sup> *Tschirn v. Secor Bank*, 96-1992 (La. App. 4 Cir. 3/19/97); 691 So. 2d 1290, writ denied, 97-1416 (La. 9/19/97); 701 So.2d 172.

<sup>15</sup> See *Classic Imports, Inc. v. Singleton*, 99-2272 (La. App. 4 Cir. 6/14/00); 765 So. 2d 455.

The fee agreement should also indicate what happens if the attorney is terminated or withdraws.<sup>16</sup> Should the court ultimately be asked to decide the fee award, an attorney can lose substantial amounts of time and earnings if there is no such contractual provision.<sup>17</sup> However, the court may negate the contractual provision if it provides for an unreasonable fee.<sup>18</sup>

#### IV. EXAMPLES OF ALTERNATIVE FEE AGREEMENTS

##### 1. The Client's Perspective

Jeffrey Carr, Vice President, General Counsel and Secretary of FMC Technologies, Inc. (FMCTI), wants outside counsel to apply resources commensurate with the risk involved. According to Carr, "We don't need, can't afford, and will not pay for a 100% effort on all issues."<sup>19</sup> Thus, to provide structure for the early case assessment process, Carr developed a proprietary program called Alliance Counsel Engagement System or ACES<sup>TM</sup> (patent pending), which combines essential early and ongoing case assessment with an alternative fee structure.<sup>20</sup>

ACES<sup>TM</sup> involves a two-pronged approach: First, FMCTI defines success in a manner that takes into account the specifics of the legal issue at hand. Next, FMCTI and its outside counsel come to a "meeting of the minds" to define the goals and to decide how these goals are to be achieved. Then, ACES applies a performance-based fee structure to reward out-

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<sup>16</sup> See, e.g., *Brown v. Catalyst Recovery of La. Inc.*, 01-1370 (La. App. 3 Cir. 4/3/02); 813 So. 2d 1156 (reasoning that in wrongful termination action, award of attorney fees based on one-third of recovery was not excessive based on contingency fee contract, the time and money invested in the case, and counsel's experience.).

<sup>17</sup> See *O'Rourke v. Cairns*, 95-381 (La. App. 5 Cir. 11/28/95); 666 So. 2d 345, writ granted, 95-3054 (La. 3/14/96); 668 So. 2d 1149, aff'd as amended, 95-3054 (La. 11/25/96); 683 So. 2d 697.

<sup>18</sup> *Becnel v. Arnouville*, 425 So. 2d 972 (La. Ct. App. 1983) (concluding that contingent fee agreement violated principles of former Disciplinary Rule 2-106 when that agreement provided that if client discharged attorney, client would pay \$100 per hour for any and all professional and legal services and/or investigative work performed by attorney, his law office, investigators or office personnel, with total number of hours kept by attorney exclusively covering such part of contract.).

<sup>19</sup> John O. Kelly, *FMC Technologies Case Study: Adding Value Through Alignment of Corporate Goals and Legal Service Provider Objectives*, LEGAL THOUGHT LEADER, Jan/Feb 2002, [http://www.lawpartnering.com/press\\_detail.tmp!SKU=309838992356104](http://www.lawpartnering.com/press_detail.tmp!SKU=309838992356104) (last visited May 11, 2009).

<sup>20</sup> Gardner G. Courson and Deborah D. Kuchler, *Effective Assessment and Resolution Program: Creating an Early Resolution Program that Works, Saves Money, and Reduces Risk* (2005 FDCC Corporate Counsel Symposium submission).

side counsel for achieving the stated goals and to tax counsel should they under-achieve. The good news for outside counsel is that they will profit from exceptional performance. The bad news is that they will be held financially accountable for budget overruns, poor performance, and inefficiency.<sup>21</sup>

## 2. The Law Firm's Perspective

The Chicago firm of Bartlit, Beck, Herman, Palenchar & Scott does all of its work on an alternative fee basis. Its most common billing arrangement is a fixed rate every month, of which twenty percent is held back by the client. If the firm prevails on the client's matter, the client pays the twenty percent and frequently also pays bonuses of much more than that.<sup>22</sup>

Some clients were originally skeptical about this fee arrangement, but "[w]e insist on it, quite frankly," said Jason L. Peltz.<sup>23</sup> The fixed monthly fee allows the firm to thrive when its experienced lawyers efficiently provide for the clients' goals. They are encouraged to focus on outcome-determinative tasks rather than getting bogged down in work that does not lead anywhere.<sup>24</sup>

## V. CONCLUSION

Utilizing alternative fee arrangements can greatly benefit a lawyer and his or her law firm. Because such arrangements reward the qualities both parties value – efficiency, success, and creative-thinking – many clients now insist upon use of such arrangements. Therefore, creative use of these arrangements can help law firms keep existing clients happy and attract new business.

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<sup>21</sup> Cathleen Flahardy, *It's ACES High*, 14 Corporate Legal Times 42 (Sept 2004).

<sup>22</sup> Terry Carter, *Thrifty Litigation*, 91 A.B.A.J. 34, 35 (2005).

<sup>23</sup> ABA Commission on Billable Hours, *ABA Commission on Billable Hour Report (2001-2002)*, at 52, <http://www.abanet.org/careercounsel/billable/toolkit/bhcomplete.pdf>.

<sup>24</sup> *Id.* at 54.

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