

Why a Productivity Improvement Fee Arrangement?

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This is the sixteenth in a series of articles about how corporate and government law departments can improve their performance and add measurable value to their organizations.

Law firms always respond positively when asked about their experience with and their appetite for Alternative Fee Arrangements (AFAs). Some are enthusiastic for broad application, while most firms prefer to apply AFAs to individual matters only. General Counsel must insist on AFAs because law firms will never volunteer.

One simulation based on a recent law firm proposal was designed to support AFA discussions within the law department. It began with this statement from the General Counsel to the company's preferred law firms.

“Our company’s experience is that working to find the best and fairest fee structure for each engagement aligns our goals and those of our panel firms, promoting greater efficiency in the delivery of legal services and making success a shared experience. We recognize that successful and sustainable AFAs require trust.

We expect a sensible profit to be made by our panel firms under AFAs, but with the value being measured in ways other than the number of billable hours recorded.

Our company is seeking a specific commitment from firms to work with us to replace, so far as practical, traditional time-based billing with AFAs that provide greater cost-certainty and incentivize the firm’s success in delivering high quality advice efficiently. Examples of the firm’s previous experience in delivering successful value-added initiatives to clients will be well received.

However, unless a compelling pricing proposal is retained, we will default to variations of hourly-based billings in combination with detailed matter budgeting.”

Planning Assumptions for an AFA

The company identified 4 700 hours per year in its Invitation for Strategic Partnering (ISP). The hours were spread across eight categories of law and represented a total of 14 100 hours across three (3) years.

The company was able to assemble good historical data for 2018 and 2019 regarding fees and hours for each category of law and staffing patterns by experience level of lawyer. From there, it was easy enough to calculate representative hourly rates for most categories and use these as a baseline for AFAs and projected legal spend.

The ISP specified staffing ratios of partners, associates and paralegals for each category of law in order to compare blended rates across its panel firms for a 30-year reference period. In this example one firm, not the lowest priced firm, was judged to have the competence and coverage to be provisionally allocated 10 500 hours across three years - 3 500 hours or the equivalent of two lawyers per year- in the following configuration

- 1 000 hours per year of construction/major projects
- 1 000 hours per year of employment law
- 1 000 hours per year of litigation
- 500 hours (half of the annual volume) per year of M&A

Three Pricing Questions

1. What would the 10 500 hours cost if purchased in the traditional (pre-ISP) fashion over the next 3 years?

This calculation requires an escalation the 2019 baseline rate for each category by 4% per year. Thus,

- Construction at € 659 per hour in 2019 averages € 713.14 over the next 3 years and the 3 000 hours would cost € 2 139 415
- Employment at € 404.82 per hour in 2019 averages € 438.08 over the next 3 years and the 3 000 hours would cost € 1 314 227
- Litigation at € 489.06 per hour in 2019 averages € 529.23 over the next 3 years and the 3 000 hours would cost € 1 587 705
- M&A at € 637.97 per hour in 2019 averages € 690.38 over the next 3 years and the 1 500 hours would cost € 1 035 574

The total cost of the “*Traditional Option*” is € 6 076 921 (€ 578.75 per hour)

2. What would the same 10 500 hours cost using the ISP blended rate option?

- Construction at € 460.00 for 3 000 hours = € 1 380 000
- Employment at € 437.83 for 3 000 hours = € 1 313 490
- Litigation at € 441.92 for 3 000 hours = € 1 325 760
- M&A at € 467.35 for 1 500 hours = € 701 025

The total cost of the “*blended rate option*” is € 4 720 275 (€ 449.55 per hour).

What could the same 10 500 hours cost with a fixed fee combined with 10 % collar for 3 years?

One can call this the Productivity Improvement AFA. In this case, a fixed fee with a 10 % collar is designed as a shared risk / shared reward AFA which stimulates the firm to be more productive (fewer hours to reach the same objective on a legal matter) and to delegate certain tasks appropriately. It is also administratively simpler for the company to manage 36 equal monthly payments supported by regular activity reports.

Such a fee arrangement is best agreed with a *strategic partner* law firm, hence the use of an ISP (Invitation for Strategic Partnering) and not an RFP, whereby both the company and the firm make investments in innovation for service delivery, work intake and allocation, legal project budgets, knowledge transfer programs, legal technology, and management reporting.

The devil is in the details when it comes to the mechanics of such a Productivity Improvement AFA. Instead of 10 500 hours purchased one hour at a time for the three (3) years, the baseline hours anchoring the agreement are set at 9 450 hours (90%) in the belief that a good law firm can be 10% more productive with the right incentives in place. The fixed fee is based on € 449.55 and costs € 4 248 247. Payment would be in 36 equal amounts.

All hours below 8 505 (90% of the baseline) or

complexity mix. The total cost of the “*Productivity Improvement AFA*” for 10 500 hours is the same as the cost of the 9 450 hours at € 4 228 247 (€ 404.59 per hour).

Observations

The blended rate option is €1 356 646 (22.4%) less expensive than the 2019 traditional price escalated annually over the next 3 years. The fixed fee “*productivity improvement*” option is €1 828 674 (30.1%) less expensive than the 2019 traditional option escalated annually.

About the Author

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