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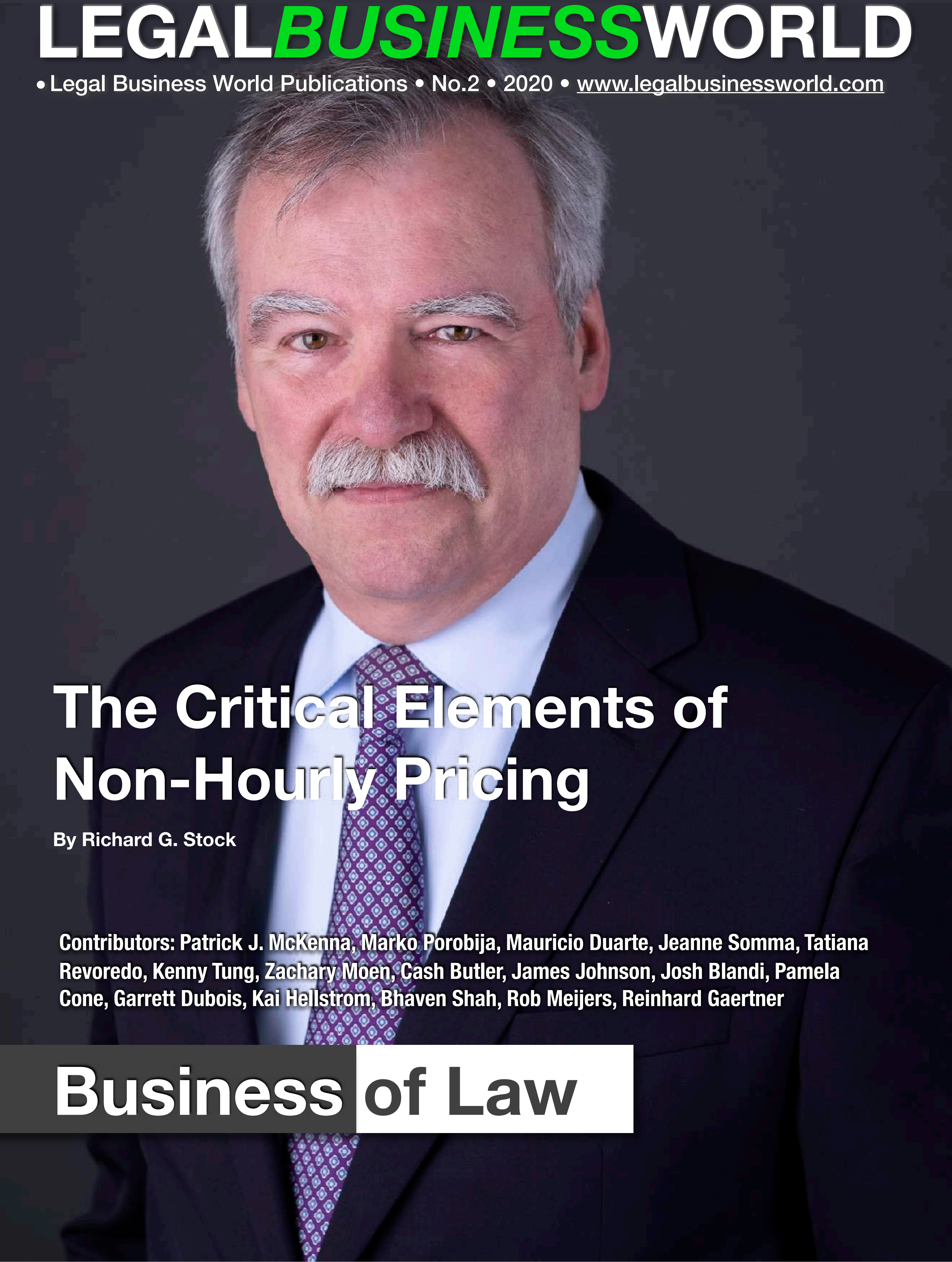

The Critical Elements of Non-Hourly Pricing

By Richard G. Stock

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Business of Law

The Critical Elements of Non-Hourly Pricing

By Richard G. Stock, M.A., FCIS, CMC, Partner with Catalyst Consulting

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

Companies have managed legal sourcing processes for more than 20 years. A great deal has been achieved. There is less improvisation about who gets the work. There is more predictability in pricing. And in many instances, convergence in the number of firms has come along nicely – to the point that some organizations have announced that their panels of law firms are stable and that they will no longer be issuing RFPs. Otherwise put, “the work is the firm’s to lose”.

Some companies are entering into Strategic Partnering arrangements with their preferred law firms. These are typically long-term arrangements where the legal teams, the work allocation, the service delivery requirements, technology and pricing are agreed. There are important differences between this approach and the more traditional panel of firms with heavily discounted hourly work or fixed fees for commodity work. Traditional panels can be cost-effective under the right conditions, but they cannot be characterized as strategic for three reasons.

Three Missing Links

Firstly, the business and financial incentives for the company and the law firm are not aligned. The law firm's business model is to maximize the number of hours it works, bills and collects while the client wants to encourage productivity, appropriate delegation of tasks, and lower costs without compromising results. An hourly-based fee arrangement mitigates the company's objectives.

Second, the company is not committing to a volume of work over time, even on a provisional basis. Instead, the firm is retained on a matter by matter basis and selected from the approved panel. Perhaps the firm is also completing a detailed matter plan and budget as part of the terms. Many law departments are reluctant to commit to a volume of work over time because they do not know the number of transactions or the volume of litigation. Moreover, they worry about "putting too many eggs in one legal basket".

Third, the traditional system of panels retained with some variation of hourly fee makes it very difficult to focus on and target innovation. A firm will improve its service delivery and reporting arrangements to the extent it is doing so for other clients as well and to the extent it can spare unbillable time or use other internal resources. This differs from setting aside a significant portion of legal fees to pay for innovation in service delivery and performance with targets in mind.

The Critical Elements

Non-hourly pricing should be designed to align law firm interests with the interests of the company. The right pricing arrangement can stimulate productivity and can focus and accelerate innovation. AFAs fundamentally change the law firm's relationship with the company if it is truly a Strategic Partner. Non-hourly pricing introduces significant predictability and stability of legal teams, reduces the administrative work for both the company and the firm, and can reduce legal costs well beyond the usual 20% discount. There are two obstacles – insufficient data and no proficiency in non-hourly pricing as applied to complex work and multi-year portfolios of legal work. There are 8 critical elements for successful non-hourly pricing.

The first is having solid historical data that goes beyond how much was spent on which firms for what type of work. It is essential to have a grasp of law firm staffing patterns for each experience level and each legal specialty. The complexity mix of matters for the company should be detailed by specialty. The distribution of work by region and sub-region should be planned as well as the distribution of work by jurisdiction. The forecast can then be reduced by about 10% for purposes of the RFP as this affects the price. Finally, the company should know the past and planned year-over-year increases in the average rates for each firm and region. Some have reported 7% going into 2020.

The second element is easy to list, hard to achieve and essential. Getting the scope of the work estimated requires good historical data from which the demand for 3 to 5 years can be estimated. The forecast must include preferred staffing patterns, volumes/hours, the complexity mix of matters, legal specialties, and the distribution of the work by jurisdiction. It can then be reduced by about 10% for purposes of the RFP, since a proper AFA can generate real improvements in law firm productivity.

The third essential element is a clear strategy for the preferred way to retain counsel, regardless of whether the work is competitively bid or sole-sourced. Does the company want to move from a panel of preferred firms to strategic partnering with counsel? Does it want a small number of firms or even a single firm to coordinate and deliver legal services with a combination of local counsel? Does the company want greater convergence with fewer than five firms overseeing 100% of the work? Is it possible to harmonize the record of instructions to be sent to firms and couple this with legal project plans and budgets for all matters beyond a given threshold? What is the most appropriate design for the AFA? Should firms be paid for performance and innovation?

The fourth element is the RFP. Is it to be a competitive process or sole-sourced and aligned with a planned allocation of work? The scope of work should be detailed as set out in the second element above. It should prescribe staffing distributions for each specialty. The evaluation and selection criteria should be specific and measurable and state whether they are weighted or not. Non-financial questions should be sufficient to evaluate expertise, coverage, technology, AFAs and the capacity for innovation.

The fifth element is pricing. The sequence begins with agreement on the staffing ratios that must be applied to each specialty across the portfolio of work across all complexities and jurisdictions. A blended rate is then calculated for each specialty – first for each year and then as a single blended rate for all years covered in the scope of work. There is good precedent to determine a blend for all specialties and across entire regions such as Europe, the UK and the US. From those building blocks, the company can customize the fee arrangement. Will it be a fixed fee for the volume of work covering the reference period?

Or will part of the fee be set aside to stimulate innovation and recognize performance?

This type of hybrid fee requires a minimum of 10% of the total fee to achieve the planned objectives for improvement to service delivery and to the effectiveness of results. There should be a significant investment by the company in the firm in exchange for an ongoing strategic contribution. All AFAs should be supported by an annual review and adjustment mechanism to share risk when the volumes, complexity mix or distribution by region varies significantly from plan.

The sixth element comes into play after the proposals have been evaluated. Qualified firms are interviewed to begin the first round of pricing negotiations. Details can include the choice of partners and the allocation of work to specific fee earners, the annual increase in rate structure, and the use of lawyers from less expensive offices of the firm. There should be a thorough discussion of the preferred AFA at this stage.

The second round of pricing discussions is part of the seventh element when the proposed allocation of work is shared with the firm. There is agreement on out-of-scope work if any, on the annual review and adjustment mechanism, and how all of this affects the proposed price of the work. Strategic Partner firms will assist in the design and hosting of a standardized record of instruction. Work intake and allocation protocols, LPM and budgeting, and billing and reporting requirements are finalized. This is especially important when the Strategic Partner is responsible to retain, oversee and pay designated local counsel.
The last critical element consists of documenting the master agreement with each firm. Strategic Partnering Agreements extend far beyond classic billing guidelines. They incorporate service delivery, pricing, review and adjustment mechanisms, operating protocols, innovation initiatives and funding, performance indicators and targets, and management reporting.

There is plenty of work for procurement, the law department and the strategic partner to manage a transition to an effective non-hourly fee arrangement. Data, preparation and trust are pre-requisites. The result must be innovative, measurable and renewable if it is to be effective.

About the Author

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