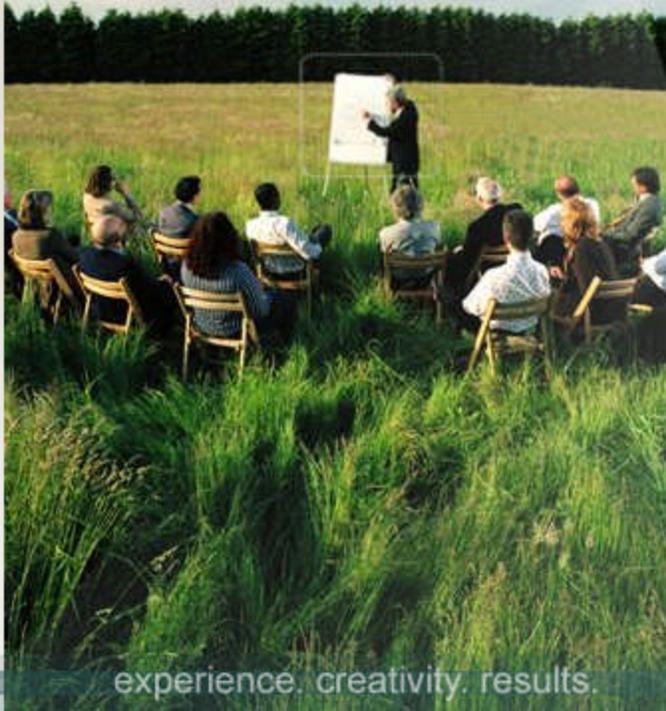


Using Value-Based Billing To Align Outside Counsel and Client Incentives

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Center

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Agenda

1. Trends in Value-Based Billing
2. Analysis of Value-Based Billing Paradigms
 - a. Fixed Fee
 - b. Budgeted Fees with Collars
 - c. Blended Rates
 - d. Reverse Contingency
 - e. Success Fees
 - f. Holdbacks
3. New Frontiers in Litigation Finance

Are “Alternative Fee Arrangements” Still “Alternative?”

- » “94.5% of law firms offer some alternative fee arrangements (AFAs), and all firms with 150 lawyers do so”

Altman Weil, *Law Firms In Transition* (2010)

- » “In a 2009 survey, 43% legal departments reported spending more than 10% of their budgets on non-hourly billing arrangements – up from 27% of legal departments that did so in 2008”

ACC Value-Based Fee Primer (July 2010)

What's Driving the Trend?

- » Increased focus on value: “Corporate counsel describe their ‘single largest unmet need’ as ‘better value from law firms’”
Association of Corporate Counsel, *ACC Value-Based Fee Primer* (July 2010)
- » Renewed focus on increasing efficiency and reducing legal spend as companies cut costs across the board
- » Viewing litigation through the lens of cost/benefit analysis
- » Better alignment of incentives between client and outside counsel
- » Opportunity to better manage the relationship with outside counsel

What is Value-Based Billing?

- » Compensating outside counsel for meeting pre-determined “metrics”
- » Often, but not always an “off the clock” arrangement
- » Typically commits outside counsel to have “skin in the game”
- » Focuses compensation on results, efficiency and cost-effectiveness, rather than on effort expended

Goals of Value-Based Billing

- » Create a sustainable, long-term relationship between the client and its outside counsel
- » Involve outside counsel as a partner in helping in-house counsel meet their metrics
- » Focus relationship on solving the legal issues, and not on the terms of engagement

Paths to Better Value

1. Fixed Fee
2. Fixed Fee with Collar
3. Blended Rates
4. Reverse Contingency
5. Success Fees
6. Holdbacks

Fixed Fees

- » A pure, “off the clock” arrangement
- » Can cover phases of litigation, a single case, or a portfolio of work
- » Price outside counsel services based on “what it should cost”
- » Raises potential “windfall” issues in both directions

Fixed Fees In Practice: National Litigation Counsel

- » Major company facing multiple lawsuits over environmental issues
- » One firm coordinating all experts, discovery, strategic positions, with optimum delegation of work to less expensive local counsel
- » Annual flat fee (coupled with holdback)
- » Long term cases supported investment by firm in dedicated staffing
- » Highly predictable cost to client; better quality of result from consistent positions; duplication of effort eliminated

Budgeted Fee with Collar

- » Client and counsel agree on a budgeted fee, but subject to a “collar” set as a percentage of the budgeted fee
- » Work is measured at an agreed hourly rate
- » Inside the collar, no true up occurs
- » Outside the collar, the client and law firm share the savings or over-run in agreed percentages:
 - E.g., \$1,000,000 per year with 10% collar. If hourly billings were \$1,250,000, rates charged for last \$150,000 are significantly discounted, so risks of overruns is shared but in a pre-agreed manner
 - If hourly billings were \$800,000, firm would receive percentage of the under-run as an efficiency reward, with balance going to client
- » Collar can be adjusted for each phase of litigation to account for varying degrees of cost predictability (e.g., motions to dismiss vs. expert discovery)

Collars in Practice: Antitrust Litigation

- » Large telecommunications company was sued in class action alleging illegal tying
- » Initial analysis showed that claim had little ultimate merit, but fact issues and risk of class certification threatened protracted litigation
- » Client wanted predictable litigation costs and was reluctant to sink substantial fees into protracted litigation of a weak claim
- » Client was sensitive to the unpredictability of the amount of work needed and thus difficulty in setting the amount of the fixed fee, especially once case proceeded to fact discovery
- » Quarterly budgeted fee with collars resulted in lean, even work flow, with predictable client costs
- » Collar hedges against law firm bearing entire risk of unanticipated events

Blended Rates

- » One hourly billing rate for attorneys that typically bill at different standard rates
 - One rate can be established for all partners, counsel, and associates on a matter;
 - Or, rate can be blended at each level

- » Blended rate can be set per matter or across a portfolio of matters

- » Won't work where the work is largely done by a single lawyer, or level of lawyer (e.g., sophisticated antitrust counseling)

Blended Rates in Practice: Insurance Coverage Litigation

- » Law firm handles portfolio of insurance coverage litigation for major insurers and reinsurers
- » Work is very rate-sensitive
- » Repeat litigation with similar issues across all cases
 - Value to having core team with experience in litigating cases
- » Blended rate works because:
 - heavy senior attorney involvement not necessary
 - junior attorneys can quickly build up experience and expertise on common issues
 - Firm is rewarded for efficient allocation of work and ability to develop expertise of dedicated team to manage litigation portfolio

Reverse Contingency

- » Traditional contingency fee model adapted for defense work
- » Reverse contingency fee is based on how much the firm saves the client through the litigation
 - Agree on “fair value” of the exposure the client faces if it loses the litigation, as well as costs of full litigation
 - Fee is set as a percentage of the difference between the estimated exposure and the amount, if any, the client ultimately pays in damages or settlement, plus avoided litigation costs
- » Can be used as pure reverse contingency, or in conjunction with either discounted/capped hourly rates or a fixed fee
- » Incentivizes success and cost minimization similar to a contingency fee

Reverse Contingency in practice: International Arbitration

- » Breach of contract claims between hotel chain as property manager, and property owner involved both affirmative claims by our client and counterclaims

- » Fee structure combined a modest fixed fee, with traditional contingency for claims and reverse contingency for counterclaims:
 - Contingency: 10% of any arbitration award
 - Reverse Contingency: 1% of the total value of the counterclaims dismissed

Success Fees

- » Overlay any fee structure
- » Agreed upon lump sum or percentage of recovery or savings
- » Requires up-front agreement on what “success” is, and when it has been achieved

Holdbacks

- » Overlay any form of fee structure
- » In-house and outside counsel meet at agreed intervals to assess performance and determine payout of holdback
- » Goes beyond single case “success fee”, and is not completely tied to outcomes

Holdbacks in Practice: Client-wide Portfolio

Managing an Entire Portfolio of Matters for Large Client

- » Handled a broad range of product liability, toxic tort, government contracts, antitrust and IP counseling and litigation for large, long-standing firm client
- » Previously used discounts off standard rates and volume discounts
- » Moved to a two-year, client wide hourly engagement with a 15% holdback across entire portfolio of work for client, coupled with commitment to matter-specific value based arrangements
- » Payment of holdback based on client's determination of results, creativity, cost-effectiveness, efficiency, responsiveness and attention to corporate goals
- » Result:
 - Simplified rate negotiations
 - Skin in the game for the firm
 - Valuable feedback on performance and areas for improvement
 - Increased client acknowledgement of value in long term relationship

Holdbacks in Practice: Antitrust M&A

- » Client valued speed to close, but did not want to incur large fees on a deal that would not be permitted to close
- » Established fixed fee of \$125,000, and offered client choice of holdback amount (ultimately \$65,000)
- » If FTC clearance obtained at first milestone, client pays 10x holdback amount. As clearance takes longer, the multiplier decreases (but the aggregated amount held back increases)
- » If no FTC clearance, no payment of holdback.
- » Compensates firm for delivering what client valued – quick, affirmative outcome
 - Compare to hourly billing incentives, which is not linked to outcome, and does not discourage protracted investigation

Choosing a Fee Structure

What are the client's goals?

1. Predictability of legal costs
2. Reducing aggregate spend
3. Minimizing downside
4. Incentive to pursue high-risk litigation opportunity
5. Value and importance of a win

What is the nature of the matter?

1. One-off or repeat litigation
2. Size and complexity of case
3. Level of confidence in cost projections
4. Flexibility of staffing options

Escape Clauses

- » Useful to address:
 - Unknown unknowns
 - Known contingent events

- » Equitable terms of engagement
 - Allocation of risks
 - Sustainability of relationships

Beyond Legal Fees: Third-Party Litigation Finance

- » What is it?
 - Investments in commercial claims, ranging from purchase of claims to sharing recoveries with client
 - Litigation risk insurance
 - Loans to law firms

- » Who provides it?
 - Alternative litigation finance providers (Juridica Capital Investments, Burford Group)
 - Hedge Funds (extent of participation in litigation finance unknown)
 - Zurich NA (litigation risk insurance)
 - Lenders to law firms (Counsel Financial, Oxbridge Financial Group)

- » Trends
 - Currently focused exclusively on financing plaintiffs
 - Appears to be growing in the U.S., but limited information available about how widespread it is today.
 - What does the market say: Juridica Investments, leading litigation finance firm, raised over £100 million in two IPOs, and share price has increased 24% since trading began
 - In the U.S., there is potential for conflict with ethical rules and calls to ban the practice for policy reasons

Investments in Commercial Claims

- » Clients face few incentives to fund high-risk/high-reward litigation opportunities (antitrust recovery, patent)
- » Large law firms have an economic structure that magnifies the risks of pure contingency cases
- » Investors are facing diminishing returns on traditional asset classes
- » *Litigation financing firms attempt to solve all three problems:*
 - Firm takes litigation on contingency with no out-of-pocket cost for client
 - Firm receives steady stream of revenue based on fees incurred
 - “Shares” in judgment or settlement are sold to investors, and investment capital finances additional litigation opportunities

Litigation Risk Insurance

- » Outgrowth of “loser pays” regime in UK
 - Litigation risk insurance is common in UK where all parties face risk of paying opponents’ legal fees
- » Insurance policy that covers opponents legal fees in the event company loses a breach-of-contract claim
- » Product currently offered in U.S. by Zurich NA, together with Sonoma Risk Insurance Agency
- » *Terms:*
 - Can be purchased within 60 days of filing lawsuit
 - Policy term lasts duration of lawsuit
 - Coverage triggered by adverse summary judgment ruling or verdict
- » Like investments in commercial claims, product lowers cost of pursuing litigation by shifting risk and may encourage more litigation