By now, everyone who either sends or pays bills for legal services is tired of hearing about alternative fee arrangements (AFAs). Everyone knows that paying for legal services by the hour is an option, but only an option—and often not the best one. The use of alternatives, including flat fees, is widespread and becoming mundane in many parts of the legal landscape.

There is, however, a bit of the Wild West still left out there: complex litigation matters that are *sui generis*. Think of antitrust cases, or trade secrets cases, or complex breach of contract cases. These are cases whose course (and sometimes existence) is unpredictable. Counsel have only limited ability to control what happens. A single ruling from a discovery master can add months and millions to a defense. Intervening parties, transfer motions, an opposing party with a scorched-earth strategy, e-discovery glitches, a judge who rules quickly or not at all, a dysfunctional joint defense group, interlocutory appeals, stays . . . the list of contingencies goes on and on.

Certainly there are a few law firms like mine that market their willingness to price big cases on a flat fee basis, but suspicion and skepticism remain widespread. The use of flat fees is far from typical. More common for these cases are *faux* value billing arrangements, like discounted hourly rates coupled with fee caps. These deals have some upside from the client’s perspective, but very little from the law firms’, and the unintended negative consequences they drive is a topic for another day.

Thinking about this last frontier in flat fee pricing is worthwhile. For one thing, it’s where the action is. Unpredictable cases like these are the budget-busters. One of the rallying cries of the revolution was “No More Surprises!” Clients want predictability. A single case like this can blow the entire budget . . . so why wouldn’t you negotiate a flat fee? Here are some reasons why folks don’t—and some reasons why they should.

The Windfall

One hesitation many in-house counsel express is the potential for a “windfall.” By this, they mean a situation in which the law firm ends up pocketing a flat fee that is far greater than they would have been paid under an hourly rate arrangement. (This concern has a twin across the aisle, with many law firms’ obsession with tracking “realization,” or the percentage of standard rates that clients actually end up paying.)

The bogeyman here is called “standard value of time” (SVOT). This is the amount (roughly speaking) the firm would have been paid under an hourly rate arrangement. SVOT obviously is based on the hourly rates charged by the firm (which may be different than the hourly rates this client would have agreed to pay for this matter, but for this purpose the difference does not matter). SVOT is, most now acknowledge, not a reliable indicator of value provided. That is why we all know what “AFA” stands for. And yet, SVOT still floats around flat fee discussions like a ghost (hence the term “shadow bill”). At the beginning of an engagement, law firm and client use SVOT as the touchstone for their flat fee negotiation. The client wants to pay less than SVOT; the law firm hopes for a chance to get more than SVOT (or at least as much). At the back-end, client and law firm both rush to compare what they paid/received to what they would have paid/received (i.e., SVOT), and declare victory or failure as a result.

A flat fee should reflect the value to the client of securing that law firm’s representation in that matter. Both client and law firm should do their best to identify and discuss the things that might go wrong or right, but then agree on a number that encompasses and fairly allocates those risks. It should represent a fair price to handle a matter, come what may. It should not be tied to SVOT, and it should not be evaluated against SVOT. Hindsight is no friend to value billing.

It is worth noting that pricing without regard to SVOT is not the same as pricing without regard to cost. In making its internal business decisions regarding
how to price a matter, a law firm must consider how much the matter will cost in firm resources. Attorney compensation and benefits are the direct costs to provide attorney services and they generally must be allocated to inventory: work hours.

Lawyers will always need to keep track of the time they spend, in order to know how much the matter is costing the firm in firm resources, and to determine whether and how profitable matters are. Clients will appreciate that a flat fee is based on some estimate of likely cost in attorney time. If a matter requires more resources than expected, the law firm may lose money. Law firms, like their clients, cannot make a practice of that. But the oft-repeated “kill the billable hour” should really be “kill hourly rates.” There is no role for hourly rates in proposing, or evaluating, flat fees.

Avoiding the Zero-Sum Game

Having decried hindsight, the reality remains that when a big, complex case is over, either the client or the law firm is usually going to have done better than expected. Flat fees in commoditized litigation can be based on data and analysis, but flat fees in complex, sui generis cases defy that approach. Unexpected things will happen. Assumptions will be proven wrong. Someone outside the situation—the client CFO, the firm’s finance committee—will invoke the ghost of SVOT, and eyebrows will be raised.

But the “windfall/bath” mindset can really only take root where the law firm and the client do not have an enduring relationship and are not interested in building one. In that world, each is forced to try to make money on the matter, because there is only the one matter. But in the stock market, those who can diversify and take a longer view do better. Longer-term relationships, encompassing several matters and/or more than one budget cycle, are necessary for successful flat fee pricing in big cases. In that world, law firms can price any given matter based on the overall relationship, and take more risk. Clients can be assured that if one matter is settled sooner than expected, the next one will be priced more aggressively. Law firms can even deliver flat fee pricing on an annual basis, so that an unexpected lawsuit does not have budget impact in the year it hits.

And that is the real upside of using flat fees in complex cases. They drive us back to relationships, and put client and law firm back in it together for the long haul. Law firms learn and know their clients’ business inside and out, and from year to year. Clients are not afraid to pick up the phone and call on their lawyers for informal advice, even when there is no big case pending. Each wants the other to profit and succeed. In that world, both client and law firm accrue benefits that far exceed the risk posed by negotiating a flat fee for a single case, even a big one.

Tearing Down the House the Billable Hour Built

There is another reason to hope that flat fees become the norm in big case litigation. Discovery in the United States has to be the single most inefficient process ever devised. The substantial majority of time and money spent in big case litigation is spent in discovery: e-discovery and production of irrelevant data and documents by the millions, seven-hour depositions of insignificant witnesses by the dozens, motion after motion on such matters as where to conduct depositions or which proposed pretrial schedule is more reasonable. And it is a challenge to explain to our colleagues in Europe—who seem to find a way to litigate without much of this mess—why the quality of justice is so greatly enhanced by these efforts that they are worth their astounding price tag.

These practices are the progeny of the billable hour. Lawyers on flat fees (or contingent fees) abhor inefficiency and avoid the discovery morass. They do not mess around with unnecessary depositions or hunting down documents at the far reaches of relevance. They figure out what’s truly important, go get it as directly as possible, and move on. As their numbers grow, pressure on the system to increase in efficiency will increase. Over time, it could be that the market may trim the discovery process back down to size, to the benefit of us all.

Flat fee pricing for large, complex litigation matters is risky. But true value-based billing requires a certain amount of bravery and commitment by clients and law firms, in exchange for which rewards are guaranteed.

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