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SKIN IN THE GAME – HOW TO REACH APPROPRIATE FEE AGREEMENTS

Tax law changes notwithstanding, corporate counsel waiting for a corporate blank check on spend may be holding their breath for some time.

BY DAN PANITZ



No one enjoys being taken for a ride, with the possible exceptions of playing with our children or one from our transportation provider of choice. That said, it's no surprise corporate counsel faced with the demand to reduce spend need to understand how to properly manage their 2018 legal service providers in terms of cost predictability, service quality incentivization, and performance transparency.

Tax law changes notwithstanding, corporate counsel waiting for a corporate blank check on spend may be holding their breath for some time.

This article discusses a new approach to legal service provider (LSP) fee agreements, with particular focus on properly incentivizing legal service providers to act in the most efficient manner to ensure mutually beneficial outcome. Tall order that it may seem, to move forward we must first look back.



Since the early 2000s, corporate clients began driving outside counsel toward alternative fee agreements (AFAs), which have included flat fees (per mat-



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ter), contingency fees, fixed fees (for a docket of matters), success bonuses (gain share), and other blended fee options. After nearly two decades of these variations being employed, we have established proven methods to structure “**appropriate**” **fee agreements** which can be tailored/measured in terms of legal issue efficiency and aggregate spend reduction.

What's Missing From the Menu?

Assuming most corporate counsel are familiar with fixed or flat fees for a pre-defined service, several frequently utilized alternative fee models remain with one notable gap across the board: **each one lacks LSP financial incentives for process efficiency.**

Let's begin with the *Task or Unit Based Billing Model*, where

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specifically identified tasks are broken out separately within contemplated legal services as distinct fee measures (i.e., legal drafting versus research). This is often used in complex litigation or transactional matters where budgeting is required by the client.

Nothing within *Task or Unit Based Billing* incentivizes an LSP to perform specific tasks efficiently from a process standpoint. In fact, the opposite may prove true whereby an LSP could be actually incentivized to utilize lesser resources/processes on less profitable tasks given its margin is realized elsewhere. Whether or not this reduces the quality of overall service performance may vary, but it would be hard to argue that it is elevated as a result.

The same is true for a *Blended Hourly Rate*, where instead of specific hourly rates for different levels of service provision, a single rate is applied to all hours billed on a matter regardless of whether it's for a more senior person within the service provider (frequently offered by large law firms to corporate clients). Other than optics, what would incentivize an LSP not to bottom load service provision (use its least expensive resources) under a *Blended Hourly Rate* given that would arguably capture the largest margin?

Both *Percentage Fees* (based on the amount involved in the matter being handled) and *Contingent or Success Fees* (based on the results achieved) are outcome determinative and not judged upon process efficiencies in flight.

With a *Fixed Fee + Hourly model* (where a portion of the matter charged on a fixed or fat-fee basis, and a portion charged on an hourly rate basis), we begin to see a hybrid approach. A good example would be a real property transaction in which an LSP might provide documentation services on a fixed fee, while client meetings/other non-related services are billed on an hourly basis. Unfortunately, this does not incentivize efficiencies to control the number of hours billed or the quality of resources dedicated to the fixed fee portion of services.

A *Fixed Fee + Success Fee model* (an example might be a securities offering where a fixed fee is charged for the documentation and a success fee is charged if the offering closes) also does not incentivize LSP process efficiency as the LSP does not assume any real exposure other than something not gained (the success fee) by virtue of predominantly external events other than its own performance which may affect a given closing.

Hourly Rate + Contingency Fee models generally consist of a reduced hourly rate (such as for litigation) with a lower percentage contingency fee upon success. Here, the LSP is incentivized to use its least expensive resources to reach the best margin in hopes

of an even bigger win fall upon a triggering event (which may or may not be wholly external).

Putting an LSP's Money Where Its Mouth Is

Every LSP would likely tout their ability to provide services at a high level of efficiency, but do they really? The bottom line is an LSP would have to own some level of financial exposure on its process efficiencies for it to be properly incentivized in providing top quality end-to-end service.

Here's an example:

A number of LSPs currently provide eDiscovery services related to investigations and litigation, where the spend result is that the more data pushed through the process (from collection – to processing – to hosting – to review – and finally production), the greater the overall spend.



In an area dominated by unit rates (usually charged on an hourly and/or a per gigabyte basis), most LSPs providing eDiscovery services are actually incentivized to act less efficiently in order to have more data hosted (traditionally yielding the highest margin) and reviewed (traditionally the highest cost in discovery).

Can an LSP reduce data defensibly in a more efficient manner? Most definitely yes.

The eDiscovery industry data reduction (cull) rate prior to hosting and review is approximately 75% and at least one proven methodology exists to reduce data at 90% or higher prior to hosting and review. *The net-net difference between a 75% data cull rate and a 90% data cull rate prior to hosting and review is a 60% total spend reduction on the matter.*

By requiring your LSP to guarantee a 90% data cull rate where appropriate across your investigations and litigation and the LSP

assuming the cost differential for hosting/review should their service provision yield less than a 90% data cull rate for the same, the LSP now has skin in the game and their service quality is interwoven with their financial exposure.

Next, tie-in metrics reporting within the fee agreement to ensure LSP commitments are ongoing and transparent and voilà, you now have properly incentivized process efficiencies and service performance within your LSP fee agreement. The extension of this exercise can achieve top line item process efficiencies (and measurable spend reduction) through data consolidation, re-use, disposition and overall program governance.

Incorporating process efficiency guarantees from an LSP in the form of SLAs with financial guarantees can be adapted to Appropriate Fee Agreements of many varieties, including fixed fee, task/unit based fee, contin-

gency or success fees or even an hourly model through a mutual understanding of the legal service to be delivered and reasonable SLAs around the same.

At the end of the day, by requiring skin in the game you will find your LSPs may move from the vendor box to one approaching a partnership of sorts where your mutual interests are ultimately aligned.

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