



Making Arrangements

Finding the Best Way to Pay

By Irwin R. Kramer

“Time is an attorney’s stock in trade.”
— Abraham Lincoln

Although Lincoln’s remark has long been quoted by those justifying the billable hour, it is not likely that this famous lawyer ever filled out a time-sheet. The billable hour had yet to be invented, nor were there legal billing auditors to question the honesty of Honest Abe.

In Lincoln’s time, lawyers and their clients negotiated flat fees at the start of a case. Those who could not agree on the value of an attorney’s services never formed a relationship. With the advent of hourly billing, attorneys and clients no longer fuss over fees before commencing representation.

Now they debate the cost of defense after forming a relationship, billing time and issuing invoices.

With or without the help of outside auditors, the perception of inflated billing practices and unnecessary tasks has led to an erosion of trust that may tarnish even the most favorable results. However unfair, this perception is born of a system that turns inefficiency into profit, and penalizes those who strive to expedite the resolution of cases or do anything to streamline their work.

By placing the lawyer’s interests in conflict with those of the client, the billable hour strains the relationship with every tick of the clock. Technology may eliminate many repetitive tasks, but lawyers who succeed at cutting the

time from a given task will do likewise to their paychecks.

There must be a better way.

Finding a Solution

To experiment with AFAs, carriers and their counsel must be willing to confront difficulties rather than postpone them. They must also collaborate to analyze litigation needs and to prepare realistic budgets based on historical data. In return for this initial investment, both sides may enhance their relationship through billing systems that better align the interests of carriers and their counsel.

Unlike straight hourly billing, AFAs are not one-size-fits-all solutions. Alternatives can and should be cus-

tomized to accommodate different types of cases and varying objectives.

Many associate AFAs with flat, fixed, or capped fees. Yet even these alternatives may vary with the situation. Flat fees per case may seem simple, but they rarely work in cases of varying length and complexity. Unless a carrier can provide its counsel with sufficient volume to ensure profitability across the board, cradle to grave payments may only be feasible in routine cases with very limited tasks.

In most cases, carriers gravitating to flat fees will wish to compensate their counsel at various stages of litigation or upon the completion of certain tasks. To be fair, the parties must place a value on specific tasks or milestones based on a realistic assessment of the effort to be expended at each. Thereafter, carriers may pay their counsel for such specific tasks as drafting motions to dismiss, propounding written discovery, conducting depositions and preparing for trial.

Of course, one need not dispose of the billable hour entirely when pursuing alternatives to current payment methods. For greater flexibility in more complex cases, carriers and counsel may combine elements of flat fees, success fees and hourly fees to contain costs, reward efficiency and share the risk when things don't go as planned.

Collared Fees

Combining these elements into customized solutions, hybrid arrangements work particularly well in complex litigation where greater flexibility is required. Under a collared fee agreement, carriers and their counsel work together to set a target price for a case or set of tasks, and place a "collar" around that price (e.g., 15 percent above or below the target). If actual hourly fees fall within that range, no further adjustment is made. If these fees fall below the collar or exceed this budget, the carrier and its

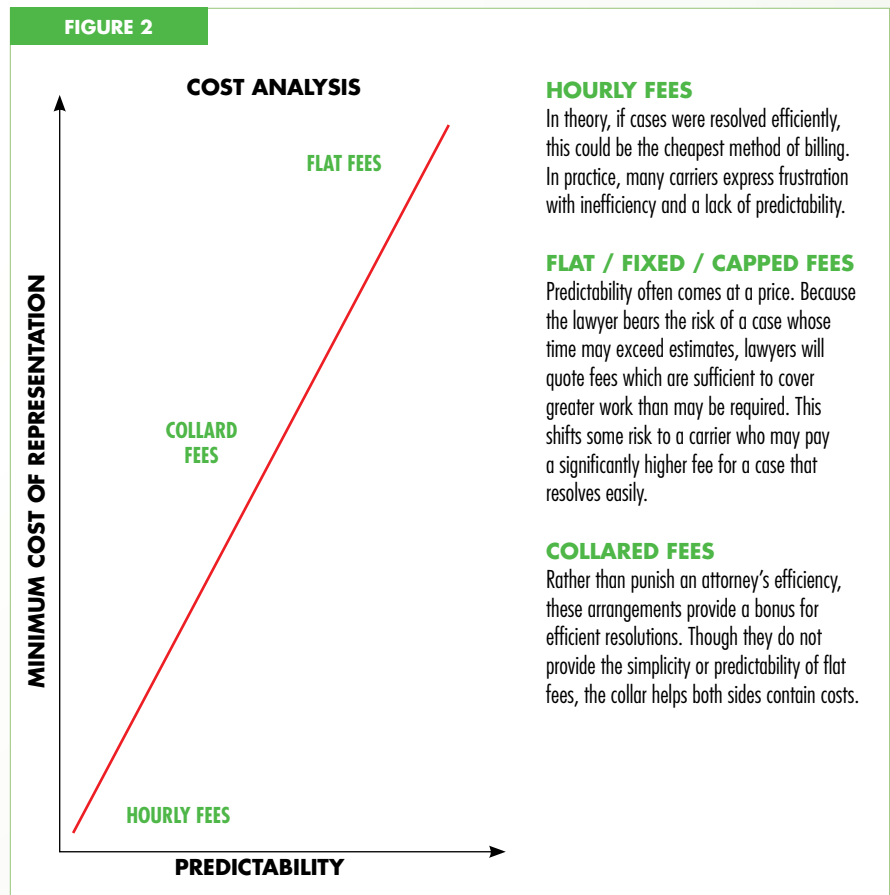
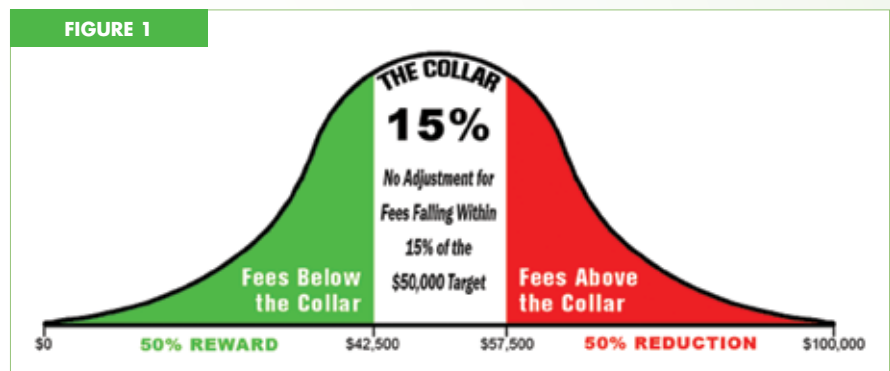
counsel share an agreed percentage of the savings or additional expense.

Consider a complex professional liability case. In the first month of the case, the insurer pays the firm either a flat or hourly fee to file initial responses, review the matter and work with its claims adjuster to establish a litigation budget. They ultimately set a target price of \$50,000, but neither would wish to gamble on a flat fee of that amount.

Allowing a reasonable margin of error, the parties set a 15 percent col-

lar on this case. So, if everything goes as expected and total fees fall between \$42,500 and \$57,500 (or within 15 percent of the budgeted figure), the insurer would pay its counsel's regular hourly rate without adjustment (See Figure 1).

Unlike conventional billing, this method provides incentives for efficiency. If the lawyers resolve the case below the collar, they will receive a percentage of the savings. Thus, if the parties set this percentage at 50 percent and hourly fees total \$25,000, the firm would receive this amount, plus



HOURLY FEES

In theory, if cases were resolved efficiently, this could be the cheapest method of billing. In practice, many carriers express frustration with inefficiency and a lack of predictability.

FLAT / FIXED / CAPPED FEES

Predictability often comes at a price. Because the lawyer bears the risk of a case whose time may exceed estimates, lawyers will quote fees which are sufficient to cover greater work than may be required. This shifts some risk to a carrier who may pay a significantly higher fee for a case that resolves easily.

COLLARED FEES

Rather than punish an attorney's efficiency, these arrangements provide a bonus for efficient resolutions. Though they do not provide the simplicity or predictability of flat fees, the collar helps both sides contain costs.

half of the amount saved below the collar. Taking 50 percent of the difference between \$42,500 and \$25,000, the bonus equals \$8,750 — a nice incentive for efficient lawyers.

Conversely, if the lawyers exceed cost estimates, they must split these overruns with their carrier. Thus, if hourly fees total \$80,000, the insurer would only owe its counsel \$68,750. This equals the maximum collared fee (\$57,500), plus 50 percent of the fee overrun (i.e., 50 percent of the difference between \$80,000 and \$57,500).

This type of AFA places a premium on sound budgeting at the start of every case, requiring carriers and their counsel collaborate on a thoughtful litigation plan — one that gives both sides an incentive to stay on course. Should the team beat expectations, carriers achieve great savings and their counsel share this success. Yet, unlike flat or capped fees in which counsel bear the full risk of cases that take lon-

ger to resolve, the collar provides a fair mechanism in which these teammates share this risk.

Cost-Benefit Analysis

While there may not be a perfect formula for all cases, collared arrangements help to balance the costs and benefits to counsel and to carriers. This is particularly true in cases whose complexity tends to defy the predictability needed for flat fee alternatives (See Figure 2).

Hourly fees may be the most flexible, but often turn carriers and their counsel into adversaries. Flat fees may cap the carrier's exposure, but their inflexibility comes at a cost as well. Indeed, as carriers and their counsel negotiate over flat fees, they often lose sight of interests that both are bound to serve — those of the policyholder.

Where defense costs deplete an insured's coverage, policyholders may share their carrier's interest in limiting them. In these instances, the econom-

ics of fee arrangements may actually enhance and preserve coverage. This may be true under many professional liability policies, but in other cases, carriers must often incur the cost of defense without recourse against their policyholders. Where deductibles are low and the cost of defense does not deplete coverage, the insured may resist efforts to cut defense costs through flat, fixed or capped fees. Because these arrangements provide lawyers with an economic *disincentive* to work on a file, they may even place carriers and their counsel in conflict with the interests of their true client.

Given the potential for conflict, those concerned about the effect on this tripartite relationship may find collared fee arrangements to be the best way to balance the interests of all concerned (See Figure 3).

By placing smart parameters on the billable hour, collared arrangements retain the flexibility of hourly billing while enhancing efficiency. They also align the interests of carriers and their counsel by encouraging collaboration on realistic budgets at the outset of each case, improving case management, and fostering the type of teamwork that bolsters defense efforts.

Though this alternative may take some effort at the start of a case, it does not require a drastic departure from the billable hour. The status quo may have its defenders, but a system that provides each side with measurable economic incentives may stand the best chance of overcoming objections and improving the attorney-client relationship. [LN](#)

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