

# High stakes

**In the sixth in a series of articles on fee management, partner Ori Wiener of Møller PSF Group discusses how to successfully implement fee arrangements**

**H**aving spent considerable time, resources and effort on improving their fee generation capabilities, many firms promptly proceed to throw away much of the hard-fought financial gains by poor implementation of their fee arrangements and matter management.

One law firm estimates to be losing approximately 15 per cent of revenue because of poor matter management and billing practice; this may be a conservative estimate. This inattention is even more striking when considering that profit gains in these areas do not involve clients, are almost totally under a firm's control and can, in fact, materially improve client relationships.

Earlier articles in this series on fee management explored how law firms invest considerable time and effort in raising their fee-generating capabilities. Ways of doing this include increasing capabilities in business development, pricing, fee structuring and fee negotiation.

The above-inflation rise in city law firm fee rates attests to the success of these efforts, as documented in a plethora of surveys, such as those conducted by Deloitte or Altman Weill. However, these sources also point to increasing client unhappiness with respect to this rise and especially the lack of the transparency (i.e. predictability) of fees.

Clients have increasingly begun to question their bills, demanding discounts or write-offs, particularly when a bill has mushroomed far above the original estimate or budget, even if the additional costs were due to additional client demands during the course of a matter.

"I feel that my clients appreciate the quality of work delivered by my team and myself less and less over recent years, even though we have been working even harder to deliver the results they wanted," a European partner of a major international law firm observed recently.

"What typically happens is that a few weeks into the matter unexpected complications set in or, even more often, the client change their mind or add additional issues for us to deal with, resulting in more work," he added.

"By the time the matter reaches its conclusion, the bill has exceeded the initial estimate or budget by a significant margin and sometimes even by a multiple. When we submit the bill, the clients express surprise and demand that we honour the original estimate or budget. Even when we are able to justify the additional costs, many clients implicitly or explicitly demand a write-off, threatening the loss of future business if we don't comply".

This experience has been broadly echoed by many partners over the past 12 months.

Lawyers thus frequently find themselves in the unenviable position of having to engage in fee negotiations at precisely the two points in the lifecycle of an assignment during which they have the least power:

1. before the assignment, when the competitive pressures are at their greatest, and
2. after the matter has closed, when the client has little additional need of the lawyer's services.

Partners report that clients are becoming increasingly aggressive in asserting pressure on fees and that this trend has continued beyond the credit crunch.

When looking into the root causes of cost overruns, firms and partners frequently discover that a significant amount of the additional costs are due to poor matter management. As a consequence, firms have started to make major investments in the matter management skills of their partners and senior associates.

However, firms have generally failed to understand the relationship between the initial fee agreement and its implementation as part of a broader matter/fee management approach.

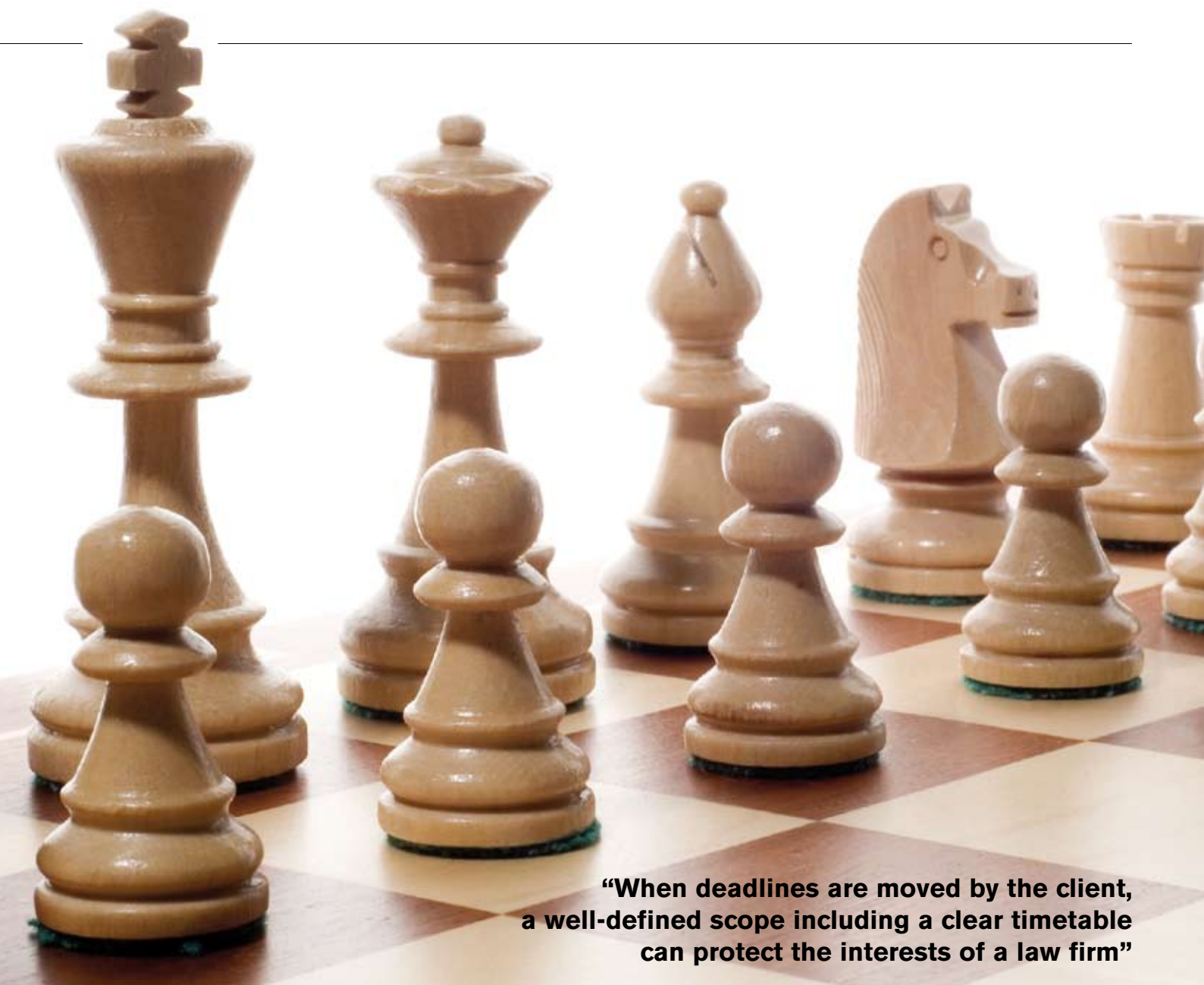
To understand this better, it is worth going back to the start of the issue.

## **Getting the agreement right**

Any lawyer understands that the benefits of having a good contract include transparency and clarity in connection with future unpredicted events to protect the interests of both sides. Fee agreements are no exception to this.

The negotiations to reach a fee agreement are critical in ensuring that it clearly stipulates the following.

- **The scope of work to be done** (such as the nature of the work, number of jurisdictions, areas of legal expertise involved and number of entities covered).



**“When deadlines are moved by the client, a well-defined scope including a clear timetable can protect the interests of a law firm”**

- **Deadlines for the delivery of the work** (this could be for all or part of the work, i.e. broken down in phases or key milestones).
- **The approach to charging** (whether it's an hourly rate, fixed rate, value-based rate or a mixture). This may also include options relating to success or failure (such as abort or success fees, performance fees).
- **What each side is responsible for** and any non-legal issues or preferences (such as speed of response, agreed principles regarding governance/project management and billing procedures).

Subsequent problems often originate here – one of the most frequent types of

problems occur when the scope of work is only defined vaguely or not at all. Consequently, any increases in the scope of work cannot be used to justify cost overruns.

“What many partners still haven't accepted is that there is a price for a job and a job for a price” John Morton, a fee consultant and negotiation trainer, has noted.

“Many partners resist applying this concept for fear of antagonising their client, even though it is precisely this principle that operates at the heart of many of the contracts they advise their clients on. Having a clear scope at least provides the basis for a grown-up discussion regarding changes to the fees”. When deadlines are moved by the client, a well-defined scope including a clear timetable can protect the interests of a

law firm. Changes to a timetable can work to the law firm's disadvantage in both directions, i.e. when deadlines are moved back or forward.

“It always amazes me how clients focus on the quantum of work to justify keeping the fees unchanged when we extend a timetable, and switch to a time perspective to argue for lower fees when a timetable is shortened,” commented a magic-circle partner.

In both cases, law firms could face rising costs. Extending a timetable clearly engages the team for longer, preventing them from working on other matters. Shortening a timetable is frequently associated with higher pressure, stress, late hours and raises the risk of mistakes, which ultimately could cost a firm dearly in terms of compensation, rising insurance costs and reputation.



**“Even when a fee agreement is well crafted, poor implementation can result in lost profits or relationship problems”**

### Implementing the agreement

Even when a fee agreement is well crafted, poor implementation can result in lost profits or relationship problems. Reasons for this include the following.

- **Poor communication of the fee arrangement.** This can result in team members (particularly on large complex, cross-border matters) failing to be compliant with the terms of a fee agreement and applying the wrong rates or discounts.  
Should clients find out about non-compliant charging resulting in higher-than-agreed rates, this can have a serious impact on the relationship or, at the very least, the credibility of the lead partner.
- **Partner involvement isn't properly managed.** In some cases, a fee

arrangement may only make financial sense if the team is managed in accordance with it. The classic example of this is agreeing a blended rate and then failing to ensure that partner involvement is managed to the most appropriate level.

- **Carve-outs aren't applied.** There have been a number of situations in which major panel agreements stipulated carve-outs to agreed discounts, but in which partners eligible for these carve-outs nevertheless applied the discounts.

To make the most of its fee arrangements, a law firm should ensure that those who are negotiating fees are properly skilled and supported, and that the proposed fee arrangements are carefully designed and thought through to ensure a

fair balance between the needs of both the client and the law firm. This includes as detailed a scoping of the work as possible.

Other measures which would support efforts to optimise fees include clear communication of the terms of a fee agreement to all team members, to ensure compliance with and charging of what is allowed. This would on the one hand prevent any potential relationship disruptions if the wrong fees have been applied and, on the other, ensure that when a firm can charge a premium that it does so.

### Changes in scope of work

Critical to good fee implementation is active monitoring of the matter to detect any changes in the scope of work. Once the client asks for a change in scope, including a change in the

## OPTIMISING FEE AGREEMENTS

### DO

- ✓ Apply clear criteria for pursuing or accepting the right kind of work or client. Dilutive work can often be avoided at this stage.
- ✓ Define the scope and timetable of the matter as clearly as possible. This will provide the strongest basis for any renegotiation that may need to take place.
- ✓ Communicate the terms of the fee agreement to all team members. This will minimise the risks of inappropriate rates being applied.
- ✓ Apply carve-outs wherever possible. It is worth spending some time and effort negotiating these as, mid-matter, clients will be less likely to seek additional external counsel, resulting in less competitive pressures on fees for this extra work.
- ✓ Align the structure of the team/work with the agreed fee structure. This may well require some planning ahead of any negotiation, but is worthwhile.
- ✓ Monitor the matter closely to identify potential problems, miscommunications and changes in scope or timetable. Early identification of problems or opportunities will give you the maximum scope for action.
- ✓ Bill on a regular (monthly or weekly) basis. This will do wonders for your work in progress, debtors and relationship with your finance director and his team.
- ✓ Think bigger picture. See this fee arrangement and its implementation as the basis for future fee agreements. The more time and effort you invest in this one, the less you are likely to have to invest in future ones, and the more likely you will be able to recover the maximum amount possible.

### DON'T

- ✗ Avoid giving the client regular written updates. Regular updating can prevent or minimise surprises at the end of a matter.
- ✗ Provide fee estimates based on rough 'guestimates' or wishful thinking. Try to apply as much experience or data from previous comparable matters. Sensible analysis will avoid the worst errors.

### WHEN THE SCOPE OR TIMETABLE CHANGES

- ✓ Do open new matters and bill them separately. This will help to reduce a potential perception of cost overruns.
- ✗ Don't forget to be on the lookout for opportunities to renegotiate, or at least to discuss how the change in scope or timetable impacts on fees. After all, your clients do this to their clients when they can.

timetable, the lead matter partner or the partner in charge of negotiating the fees will need to determine if the change has any significant implications for the cost of the matter and, if so, to determine the best means of addressing this with the client.

In some cases, a brief discussion to ensure this will be clearly taken into account at the end of the matter may be sufficient. In many cases, however, a more formal discussion will likely be needed, with at the very least an agreement (preferably with a written record) to review the fee agreement in light of the change.

## **“Partners commonly underestimate the pressure their in-house counterparts face in justifying fee increases”**

Even when a change in scope does not result in significant additional cost, the negotiation team should consider if it provides the client with any significant additional value. If it does, partners would do well to raise this with clients to explore the possibility of revising the fees.

Partners are often reluctant to reopen fee negotiation or raise fee issues mid-matter because clients are perceived to be set against reviewing fees mid-matter. However, few clients will object to a sensible discussion to discuss these issues, especially if they have any serious interest in maintaining a good, long term relationship with their legal advisers.

In fact, most clients would prefer to have a sensible discussion upfront to avoid the prospect of negative surprises at the end. Partners commonly underestimate the pressure their in-house counterparts face in justifying fee overruns.

Although the time and effort needed to ensure good fee implementation may be significant, partners who do make this investment find that these efforts generate high financial returns and benefit their client relationships. <sup>mp</sup>

**ORI.WIENER@MOLLERPSFGCAMBRIDGE.COM**