



IP Innovations: Managing Legal Cost and Alternative Billing Arrangements

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Historical Context and Evolution



Ancient history: pre-1970s

- Close relationship between business clients and outside lawyers
- Trusted counselors: full service
- In-house counsel mainly scribes, performing routine work
- Fee set and paid with minimal oversight: legal fees “task based”; annual retainers; and “eyeball” costing
- 1908: Contingency work declared ethical; billable hours rare.
- 1950: Time keeping routine, billable hour use increases
 - 1958 ABA asserts only 1300 BH/Yr.

What is the basis for a fee?

1908 ABA Canons of Ethics – “Fees”

Factors in determining **reasonable fees**:

- Time and labor required, novelty and difficulty, skills
- Likelihood that the matter will preclude other employment
- Fees customarily charged in the locality for similar service
- The amount involved and results obtained
- Time limitations
- Nature and length of the professional relationship
- Experience, reputation and ability of the lawyers
- Whether the fee is fixed or contingent



Growth of in-house counsel: 1970s to 1980s

- Gradual growth in number and size of in-house law departments, especially during the 1980s, mainly to replace / reduce growing outside counsel costs
- Corporations engage multiple firms, rise of competition
- Billable hour requested, accepted
- Minimal cost pressure, budgeting: firms billed, clients paid
- Modest tracking and analysis of legal spend, despite emergence of case/matter management systems for law departments
- Legal budgeting thought to be difficult, perhaps impossible—
- Couldn't predict legal spend, outcomes—"foreign language"

Memories: the 1990s

- Significant increase in quality and sophistication of clients
- More powerful in-house departments, many doing strategic work
- Focus on controlling legal fees: stricter outside counsel guidelines, adoption of legal fee auditing
- Task-based budgeting and billing (UTBMS)
- Growing sophistication of matter management systems; emergence of the Legal Electronic Data Exchange Standard and electronic billing
- Preferred provider programs: discounts, alternative fees
- Consolidation: e.g., DuPont, Alcoa, Stanford
- In-depth data tracking, analysis possible
- Despite all this, still business as usual at many corporations

Recent times – that is, until late 2008

- Legal fees continue to increase, legal needs more complex
- Too many preferred providers, hundreds of firms
- Superficial use of preferred firms increasing rates, not managing matters
- Companies want to work with fewer firms, and on different terms
- Firms need to actively engage with clients to reduce legal fees
- Trust key: quality of representation; staffing; right work for the matter; value for fees; investment in business
- Goal: fewer firms on better terms; return to the “trusted counselor” model – but with financial control and accountability
- Budgeting and tracking critical, even with preferred providers

2002 ABA Commission on Billable Hours

- **Professional Impact**: Decline in collegiality; increased associate departures; decreased community involvement; sets up conflict between client and lawyer interests
- **Client Impact**: Does not foster planning or risk benefit analysis; no cost predictability; poor value equation; discourages communication; client pays for incompetence, training, turnover, and padding
- **Firm Impact**: Penalizes efficiency; encourages excessive lawyering; lawyers compete based on rates



So, why do billable hours refuse to die?

2002 ABA Commission on Billable Hours

- Simple, comfortable standard familiar to both sides
- Clients like it because:
 - Hourly billing reduces transaction cost
 - Hourly billing works for any matter
 - Sometimes we can't calculate value of services
 - Most large firms have institutional clients and a trust relationship
- Firms like it because it:
 - Aids lawyers in running their business
 - Fits lawyers' risk aversion
 - Allows firms to compare cost per hour

Key insights

- No silver bullet techniques lurk out there
- In-house skills and resources can reduce or increase outside costs
- Close oversight and cost-conscious decisions by in-house counsel limit costs the most
- End-to-end analysis of drivers of outside costs provides the best insights (it's a “system”)
- Technology helps but is not a panacea
- Inside counsel need incentives to overcome resistance to cost control
- Client and law firm incentives need to be aligned, and risks and rewards shared



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Data from the
Hildebrandt Law Department Survey



Hildebrandt Law Department Survey (HLDS)

- Now in its fifth year at Hildebrandt (15 years prior at PwC).
- The “Survey of Choice” among leading law departments – most representative of Fortune 500 companies.
 - 18% of our 2008 participants are Fortune 100 companies
 - 54% are Fortune 500 companies
- Enables law departments to compare their performance against a wide range of peer group companies on law department management topics beyond the legal staffing, spending, and compensation statistics.
- Including: organization, structure and reporting relationships; outside counsel retention, evaluation and management practices; intellectual property; forecast for legal services by practice area; work demands and cost allocation methods.

Participant Profile – All Participants

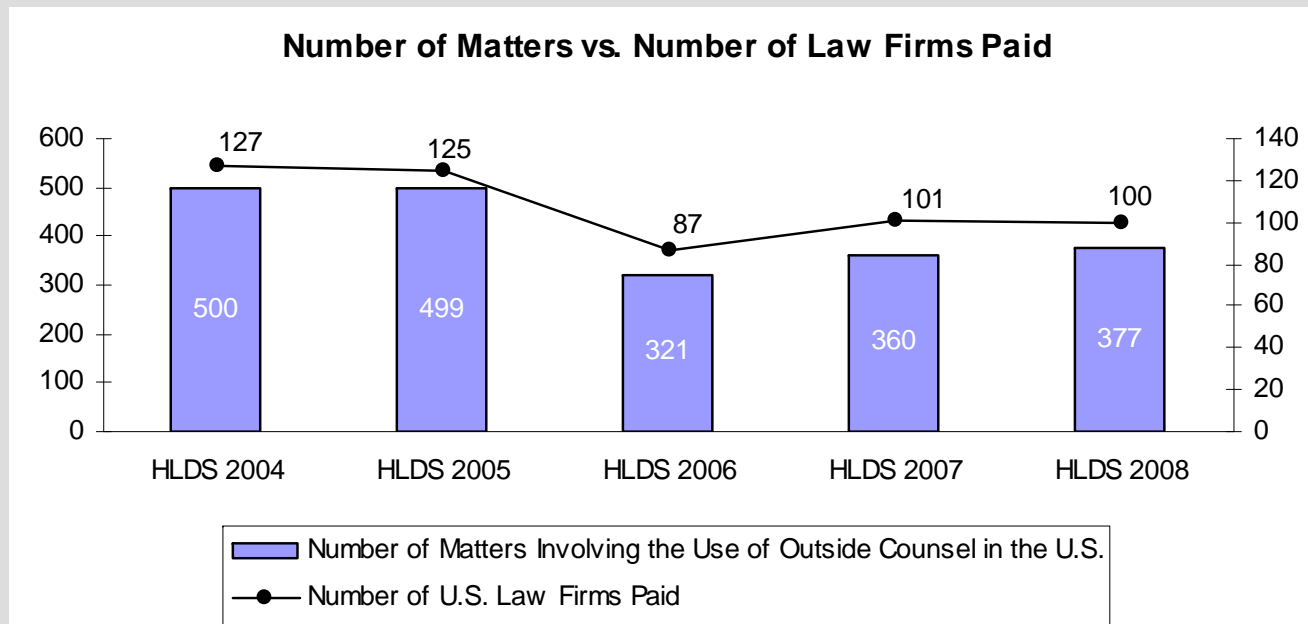
The profile of the median company is one with \$9 billion in worldwide revenues, nearly 20,000 worldwide employees, and a law department employing approximately 30 lawyers and 60 total staff worldwide, with almost \$30 million in total global legal spending.

	HLDS 2008
Median Worldwide Revenues	\$9 Billion
Median Worldwide Employees	18,605
Median WW Lawyers	27
Median WW Law Department Staff	60
Median WW Total Legal Spending	\$28.4 million

Outside Counsel Management

HLDS collects information on a range of outside counsel management practices related to selection, retention, billing arrangements, budgeting, and the number and types of work handled by outside counsel.

The number of matters handled by outside counsel and the number of law firms used in the U.S. has remained relatively stable since the 2007 Survey.



Convergence

- Convergence was much talked about in the 1990s, but only took hold in a significant number of companies during this decade.
- The percentage of companies reporting some level of convergence activity has been stable over the past two survey years.
- Over half (56%) of the participants indicated that they are engaged in convergence activities.
 - Of this group, 24% have completed the process and 24% are in progress.
- The only change from last year's results is in the percentage of companies planning to embark on a convergence program.
 - It has increased from 6% to 8% this year.

Alternative Billing

- Alternative billing arrangements, i.e., non-hourly billing, are still uncommonly used among law departments.
- This has been true since we began covering this topic in the annual Hildebrandt / PwC / PW survey dating back to the early 1990s.
- Companies that utilize alternative billing arrangements have indicated that only 8% (median) of their total outside counsel spending is subject to these practices.



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Legal Cost Management: What Works and What Doesn't



General comments

- Within the 60-40 band of inside-to-outside spend
- Most use of outside counsel is for litigation, which is typically 50-70% of spend
- Document discovery accounts for large portion of litigation spending
- If anticipate more than \$400,000 per year spent in an area of law, consider adding inside lawyer
- Use non-hourly billing for 25% of your bills
- Concentrate spending: 75%+ with 10% of firms
- Avoid CYA[ttorney] costs
- Inject market competition into the process

Ten bad practices

- ✗ Mostly seeking discounts from hourly rates
- ✗ Aggressively auditing bills with third parties
- ✗ Permitting decentralized retention of law firms
- ✗ Focusing on low hourly-rates
- ✗ Creating detailed and strict guidelines
- ✗ Relying on task-based billing systems
- ✗ Insisting on Most-Favored-Nation status
- ✗ Obsessing on disbursements
- ✗ Freezing rate increases
- ✗ Becoming complacent with incumbent firms

Ten+ good practices

- ✓ Regional law firms
- ✓ Competitive bids on major matters
- ✓ Converge on fewer firms
- ✓ Centralize litigation and discovery
- ✓ Budgets on major matters
- ✓ Limit turnover of timekeepers
- ✓ Non-hourly bills
- ✓ Approval if 8+ hours expected
- ✓ Analyze and act on data
- ✓ Early and periodic review and assessment of case strategy
- ✓ Temporary staff/offshore

10 unproven practices

- ? Electronic billing for material savings after initial period
- ? Offshore lawyers and resources
- ? Unbundled services -- law firm doesn't do it all
- ? Client representatives on major litigated matters
- ? ADR (arbitration, mediation, etc.)
- ? Procurement's involvement
- ? Pursue recoveries, insurance, affirmative claims
- ? Normalize rates across law firms for same work
- ? Defense contingency fees
- ? Give inside lawyers financial incentives to cut costs

Smart decisions made early drive the largest cost savings.

Cost Leverage Inside Counsel Action

Very High	Use Outside Counsel vs. In-House
Very High	Select Outside Counsel
High	Negotiate Billing Terms
High	Establish Matter Budgets
Medium	Review and Evaluate Bills
Low	Evaluate Counsel



The Alternative Billing Toolbox

- Hourly-rate discounts don't count
 - 90%+ of bills to law departments are hourly
- Helps greatly to have known competition
- Hard early on to have enough visibility down the road
- Mix methods, e.g.:
 - Fixed phase
 - Discount tiers (on most-favored nation basis)
 - Holdbacks
 - Collars
 - Core teams
 - Performance bonuses
- Bonuses need to be proportionate to estimated odds of desired outcomes

The Alternative Billing Toolbox

	Basic	Progressive	Advanced
# Of Firms Retained:	Many firms used; highly distributed spending	Fewer major firms; perhaps 70-30 split	Consolidation and concentration; range of firms
Retention Practices:	Unstated criteria for retention	Guidelines, approved counsel list	Competitive bidding
Fee Arrangements:	Hourly billing	Some fixed fees and incentives	Majority of bills not based on hours
Budgeting and Billing Arrangements:	“Please send us your bill.”	Set budgets on major matters	Budgets reviewed and enforced, by phases



- One-shot matters don't matter, unless they are very large, nor do bundles of <\$250K
- RFPs take time (8-10 days min.)
- Invite firms you believe can handle the work well
- Assumptions by firms are crucial to costs, so preempt and limit them
- Tell firms the format in which you would like their proposals, in addition to free form



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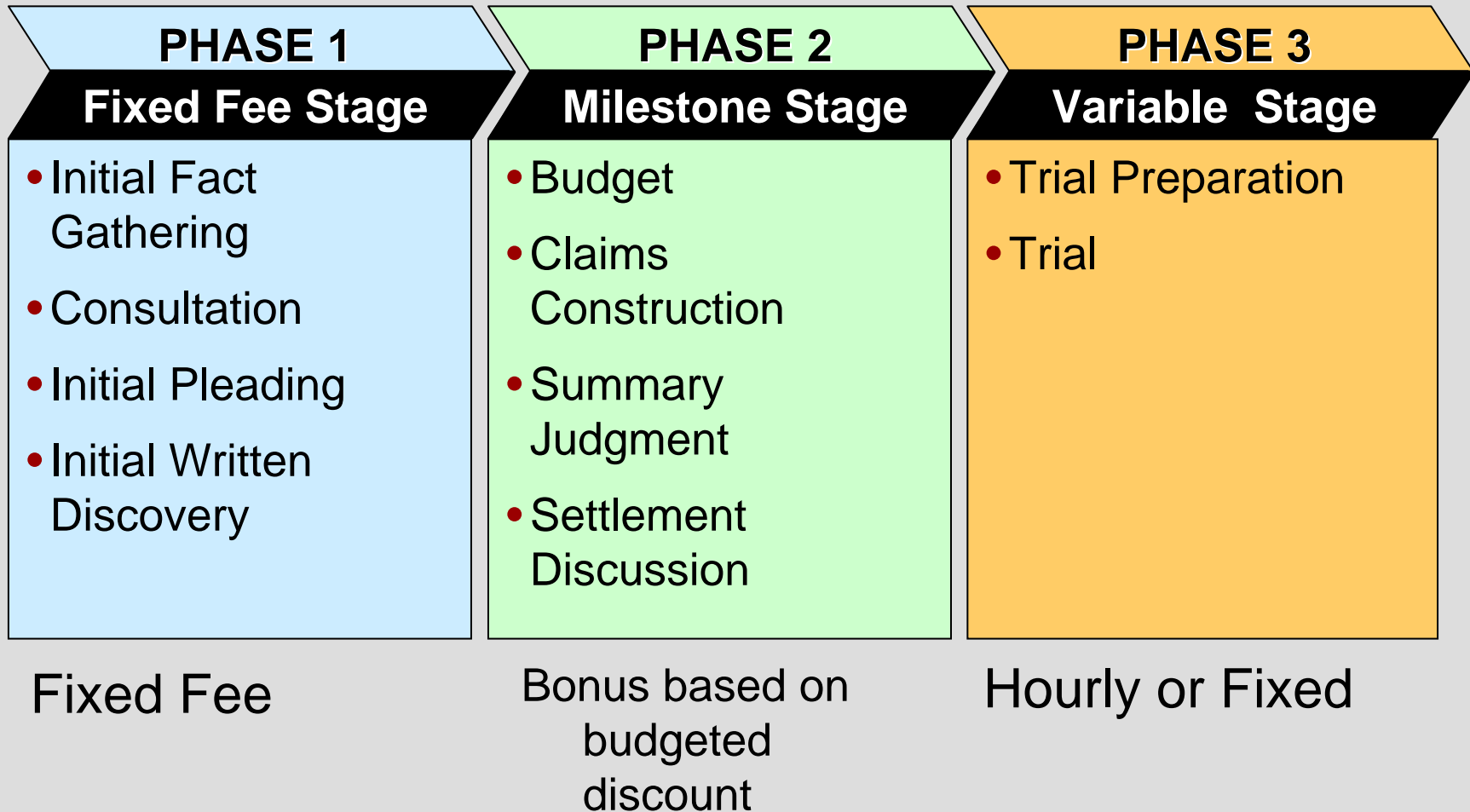
Legal Cost Management: Some Real World Examples



What does the firm need to know?

- “The idea of a flat fee is usually initially met with acceptance,’ ... [b]ut interest wanes when the firm proposes a due-diligence process to determine the scope of work.”
- Due diligence: What is
 - the nature of the matter (objective, exposure, etc.)?
 - the past history for that series of matters?
 - the extent of the proposed relationship?

Examples of Workable Alternatives



- **Risk Success**

- For asset acquisition: If the firm is doing work on a venture investment, business acquisition, or in-license of technology, the firms agrees to be paid only 65% of standard hourly rates for any time billed if the transaction does not close and 115% of the standard hourly rates if the transaction does close
- For AOL Time Warner deal, Cravath agreed to charge only for associate hours if the deal failed to close, and a fixed fee of \$35 million if it closed

- **Reverse Contingency Fees**
 - This approach is suited to settlement negotiations, appealing judgments or other instances where the client's liability can be determined. The firm's fee increases in proportion to the firm's success in reducing the clients liability below the determined exposure.
- **Mature Litigation Cases (Products Liability)**
 - In certain types of litigation cases there comes a point where litigation follows a predictable pattern (after bellwether litigation has been tried) In such situations some firms have agreed with clients that resolution prior to an agreed upon point in the proceedings would result in a 120% payment of hourly rates and a progression beyond that agreed upon point would result in an 80% payment of fees or a 20% discount.

Managing the Matter: Budgeting

- Approximately three-quarters of all law departments require budgets, relatively unchanged over the past five years
- 56% of law departments require budgets on all matters, versus 25% five years ago
 - Consensus especially in litigation matters
- Average annual savings from budgets are estimated at 20% (ACC/Serengeti survey)
- 80% of law departments surveyed with fewer than 5 lawyers manually track budgets
- One purpose to triage cases, identify those that require active management
- Budgets are an educational tool for the business unit involved

(Source: ACC Law Department Management Webinar: Managing Outside Counsel Getting off on the Right Foot)

- Lead outside counsel should be clearly established for each matter
- Lead outside counsel will have a lead in-house counterpart
- Staff with the number and level of personnel appropriate for quality service delivered cost effectively
- Once the team is established there should be continuity of staffing. Company should not pay for “learning time”

Managing the Matter: Guidelines and Engagement Letters

- Outside Counsel Guidelines should include:
 - General requirements and expectations
 - Billing requirements - allowable disbursements/ expenses
 - Fee requirements including threshold discounts, if any (pay to play)
 - Budgeting requirements
 - General staffing procedures
 - Expenses disbursements/ non-reimbursable overhead
 - Company's express conflict waiver policy
- For any significant matter, an engagement letter is needed for effective firm management and should include:
 - Scope of work & fee arrangement
 - Define role of inside and outside attorneys
 - Lead attorney & staffing
 - File retention guidelines



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Legal Cost Management: Specific Tips for IP Cases



- Proactive, pre-litigation counseling.
 - ediscovery policies: policy *implementation* and vendor selection
 - Early claims analysis and resolution
- Awareness of NPE activity
 - Auctions
 - Aggressive patent asserters
- Anti-NPE patent purchases



Defensive Plays for Patent Cases



- We put our capital to work in your defense, buying patent rights that could otherwise be asserted against you. For a modest annual fee ... RPX members will have a license to all of the patent rights we have aggregated....

Allied Security Trust I

- AST ... was originally formed by [Google, HP, Cisco, Verizon] to obtain cost-effective patent licenses. The Trust ... enhance[s] companies' freedom to sell products by sharing the cost of patent licenses.

Funding a Plaintiff's Patent Case



“We seek to invest in portfolio companies that have valuable patents, [etc.].... We possess the investment flexibility to provide common equity, preferred stock, subordinated or secured debt which allows our portfolio companies to fund working capital for ... strategic IP licensing / litigation activities”



“We offer ... ample funding to pursue exploitation and licensing of Intellectual Property for companies and inventors that require solid resources.”



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 - Litigation financing options
 - Patent “pursuit” insurance
 - Financing costs, plus contingent fee
 - Financing entire case
 - Monetizing judgment

Technology
Insurance

IP *ISC*
Intellectual Property
Insurance Services Corporation

Additional Thoughts



"If you're found guilty and sent to prison for life I'm willing to give you a seven percent discount off my usual fee."

NYSBA Journal, Nov./Dec. 2006, p.34

- Fee arrangements should not drive strategy
- Cycle time may be as important as fees
- Busy law firms may be as useful in cost control as fee arrangements
- Fees plus unbundling, budgets, careful management
- Arrangements are asymmetrical as to risk
- Ebilling systems may struggle with non-hourly fee arrangements