RISK AND CERTAINTY IN LEGAL FEES: TWO SIDES OF THE SAME COIN

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If well executed, risk sharing can provide valuable benefits for lawyers and clients alike, say Craig V. Rasile and Keith Maziarek

As the legal services sector has laboured to find its way in the new frontier of value-based billing and alternative fee arrangements, an increasing amount of interest has centred on the concept of risk sharing. While value and cost certainty continue to be of vital importance to the purchasers of legal services, the conversation has now evolved to encompass the notion that, in the true spirit of partnership, law firms should systematically share the risk of certain engagements with their clients. At its core, this sounds like a reasonable request by purchasers of legal services because there is inherent risk-sharing in the purchase of virtually every other service one can imagine. A price for certain services is agreed to, and each side assumes the risk that they will receive the desired value of the services rendered. Legal services, however, have historically been the anomaly with law firm fees always guaranteed as a function of lawyer time multiplied by fixed hourly rates, regardless of the degree to which the defined objectives were achieved.

Sharing

So what exactly does it mean to `share risk´ in the legal services context? `Sharing risk´ essentially means that a client can purchase an outcome rather than inputs, and if that outcome is not achieved, the client should not be obligated to pay the same amount as if it had been. This can work both ways, as the fruits of success can also be shared when the anticipated outcome is exceeded.
The practical dynamics of accomplishing risk sharing in the more complex realm of legal services, however, makes this a more sophisticated exercise. While not as transparent as the foregoing, there are several fundamental components that can be defined to facilitate the process. In this context, risk sharing is most commonly achieved through the pricing model used. In order to distribute the risk profile through pricing, some up-front analysis is required.

Analysis

Initially, the firm and client must identify and isolate the risk factors, which can be accomplished through the simple process of anticipating the engagement workflows. This enables the lawyer (or pricing executive) to clearly define the matters involved in a particular engagement with the highest level of potential variance. Before exploring models that enable the sharing of these identified sources of increased risk, the potential impact of these risk factors must first be analysed and quantified. Such risk quantification can be achieved by utilising ratings scales or historical data analysis, each of which have their own merits depending upon the type of legal representation involved. Clearly, quantification of the potential impact of each risk factor for the engagement is critical to assessing how risk can successfully be shared through an appropriate pricing model.
Once a measure of the potential impact of the risk factors is determined, any number of pricing models can be constructed to share the risk.

Pricing models

Preferred models include collars, success fees and fixed fees.
A collar assigns an estimated fixed fee for an engagement (or portion of it). They typically define bonus incentives for the firm if the actual work required is less than the agreed-upon fee, and

conversely, assigns a financial penalty to the firm for exceeding the estimate.

A success fee is determined based upon the specific outcome achieved. Success fees are often coupled with fee holdbacks to further incentivise firms to achieve optimal outcomes more efficiently and economically.

Fixed fees require clients to assume the risk that the price agreed to exceeds the hourly billing value they would otherwise pay, while they simultaneously secure the cost certainty clients seek. Firms bear the risk of costs exceeding the agreed-upon price, but can realise greater margins by completing the engagement in less than the budgeted time.

The concept of sharing risk, however, continues to evolve. Because firms are now increasing efforts to develop improved knowledge management tools to leverage `big data´ benefits, there are sure to be continued innovations in this area.

It is important that both firms and clients continue to learn and understand the dynamics of these arrangements in order to establish the mutually-beneficial symmetries of risk that render the best outcomes for each. If done thoughtfully and properly, risk sharing can provide valuable financial incentives for both parties.

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El sector de los servicios jurídicos lleva ya tiempo buscando modelos alternativos de facturación, como aquél basado en la provisión de valor añadido o formas de facturar en función del éxito del asunto, afirman Craig V. Rasile y Keith Maziarek de DLA Piper. Si estos sistemas se ejecutan de forma efectiva, el riesgo compartido puede ser beneficioso tanto para los abogados como para sus clientes.