

Exton Advisors



Moving From Hours To Value: How Law Firms and Clients Can Align Their Interests

Tom Steindler · Tuesday, February 8th, 2022

Clients are increasingly demanding more mature billing models and are pushing back against the traditional law firm hourly fee model, demanding that law firms become more competitive in winning their business. Today's client, especially those with valuable litigation assets, is sophisticated and expects a more commercial approach than the standard hourly rate. After all, corporate legal departments need to drive as much value as possible to their business and utilise commercial and creative thinking to do just that.

Traditionally, law firms bill their clients based on the number of hours they have spent working, a system that remains an imperfect measurement of value. The hourly billing model creates a clear divergence of interest between client and law firm (lawyers want more hours, clients want less) but also puts all of the risk of the case with the client. While the lawyer focuses on activity, the client only cares about the outcome. Plus, it places an artificial ceiling on a firm's income; there are only so many hours in a day, after all.

So what are the alternatives? Fixed or capped fees have grown in popularity over the past few years and, for clients concerned about rising and unpredictable costs, they provide budget certainty. There is certainly some comfort in the fixed fee model. But they can be a challenge for law firms, requiring discipline and careful planning, as well as effective cost budgeting. Each case can represent a learning curve for any law firm.

As another alternative, contingency fees for litigation are gaining ground. Under these types of agreement, the law firm and client agree to share the risk inherent in litigation, potentially enabling a client to pursue good claims and facilitate access to justice. By offering a contingent fee arrangement, clients can access both their law firm of choice and the courts, without the barrier of financial impediments preventing them from pursuing meritorious claims. Even for those clients who have the capital available to pursue a claim, many would rather invest it in other business ventures and so look to their law firm for more innovative means of funding their case.

How do contingency fees work? The most popular arrangement is the Conditional Fee Agreement (CFA), popularly known as 'no win, no fee'. If a case is lost, the law firm does not receive any fee. However, if a case is won, the law firm receives a success fee, which is payable on top of its usual fee. In commercial litigation, this success fee, which is essentially an uplift on the lawyers ordinary fee, cannot be more than 100% of the ordinary fee and can be likened to a bonus payment, with the final fee taken from the client's damages award. The amount is based upon the firm's assessment of the level of risk, considering all relevant factors, including the merits and value of the claim, the likelihood of settlement and the level of costs likely to be incurred. This is not a straightforward assessment, especially where the case is dependent upon uncertain expert evidence. Also, the law firm's success fee (or indeed any costs associated with insurance premium) is not recoverable from the losing defendant.

Another option is the Damages Based Agreement (DBA), introduced into English law in 2013 by Lord Justice Jackson, as part of his sweeping reform of legal costs in civil litigation. Despite being almost a decade old, their use remains uncommon in the UK. Under a DBA, the law firm receives a percentage of the damages awarded to their client if the case is successful, enabling the law firm and client to share in the risk of litigation. A CFA differs from a DBA because the success fee cannot be a percentage of the level of damages awarded or agreed by the client. For example, in commercial litigation cases this percentage cannot be more than 50%. The indemnity principle also applies in relation to DBAs, which means that a law firm cannot claim more costs from the client's opponent than have agreed to be charged to the client.

DBAs are unpopular in the UK due to the uncertainty about the terms and effects of the Damages Based Agreement Regulations 2013, in particular, whether a lawyer could recover anything in the event that a DBA was terminated early, and whether a hybrid arrangement which provided for payment of the lawyer's regular fees, in addition to a percentage of recoveries on success, would render the arrangement unenforceable.

It is understandable that uptake of both DBAs and CFAs is still low given that any contingency fee arrangement places the majority of risk on the law firm. So, on a practical level, how can law firms feasibly take on this kind of risk? In the majority of cases, law firms transfer the risk they assume under a contingency agreement using third party funding. The funder ‘invests’ in the case by paying all the fees and expenses of the case on a non-recourse basis, taking a slice of the damages upon success. Many funders can now also look at the funding of a portfolio of cases and the work-in-progress (WIP) of a particular law firm. Portfolio funding is often cheaper given that the risk is diversified across a number of cases and therefore, reduced, compared to the financing of a single case where the risk is invariably binary.

Funding not only transfers the risk assumed by the law firm to the funder, but also provides the law firm with cash-flow whilst one or more cases are ongoing, and allowing for an increase in the number of cases that can be taken on contingency. With the right strategy, litigation funding can also fuel business growth giving the law firm an opportunity to pitch for work, yet at the same time offer a funding (and risk transfer) solution to the inherent risk in litigation.

One of the most important tasks before approaching a litigation funder with a full or partial CFA is that the case budget is accurate. Litigation funders need confidence that the law firm is financially incentivised to take on a case and see it through to its conclusion. Therefore, it is important to align the numbers to the risk correctly, so if the case has to go to trial, the figures still stack up.

How do we help at Exton? By modelling different scenarios that help firms identify potential outcomes. We help assess whether a case is suitable for investment and how it can meet the relevant criteria. We are then best placed to examine the structure of the DBA/CFA. There are often solutions that allow the building of a portfolio of cases on contingency over a period time, too.

In Part 2 of this series, we will dig into some of these financing options that start to bring some of these fee structures to life.

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