

THE BUSINESS OF STARTUP LAW: ALTERNATIVE FEE ARRANGEMENTS AND AGENCY COSTS IN ENTREPRENEURIAL LAW

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I. INTRODUCTION

Due in part to a downturn in the economy and developments in both legal technology and clients' access to information, many areas of the legal landscape are changing. In response, one current trend is fee arrangements alternative to the billable hour, also known as value billing. Law firms throughout the United States are experimenting with and implementing alternative fee arrangements for particular clients and specific legal tasks throughout diverse practice areas.¹ This Note explores the use of alternative fee arrangements specifically as they relate to firms that practice entrepreneurial law.

Alternative fee arrangements are growing in the practice area of entrepreneurial law in part because liquidity is often a concern for

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1. See, e.g., Catherine Ho, *Is Time Running Out on the Billable Hour?*, WASHINGTON POST (Jan. 15, 2012), http://www.washingtonpost.com/business/capitalbusiness/is-time-running-out-on-the-billable-hour/2012/01/10/gIQAKUSU1P_story.html?tid=pm_business_pop.

entrepreneurial clients. Entrepreneurial clients often request detailed budgets for legal expenses or must wait to pay legal fees until after financing events occur, so lawyers must adjust their fee arrangements accordingly through flat fees, variations on the billable hour, or deferred fees. Many routine tasks in entrepreneurial law, such as entity formation and standard contracts, lend themselves to alternative fee arrangements like fixed fees. Additionally, entrepreneurial clients rarely have budgets for in-house legal counsel at the formation of the company, but they need legal counsel for tasks such as entity formation, employment agreements, financing, and intellectual property protection. Without in-house counsel to screen prospective law firms, there is greater potential for law firms to over-charge entrepreneurial clients. This Note examines some of the ways that alternative fee arrangements can mitigate risks of unfair fees to entrepreneurial clients.

The remainder of Section I discusses the history of and trend away from the billable hour; Section II introduces agency costs related to various fee arrangements; Section III provides taxonomies and examples of alternative fee arrangements; Section IV profiles the fee arrangements used by a variety of entrepreneurial law firms in the Boulder/Denver metropolitan area; and Section V concludes with a look at where the value billing trend is going and how firms can employ alternative fee arrangements to minimize agency costs.

A. *The billable hour*

Billing methods for legal work have changed over time. The billable hour as we know it today was not always the standard billing practice. In the early twentieth century, lawyers used a variety of billing methods, including flat fees, success fees, rough budgets, and monthly retainers,² which are now coming back into vogue. In the 1940s, state bars began requiring minimum fees lawyers had to charge clients, in part to raise the status of the profession as a higher-earning trade.³ This requirement reduced the use of billing methods like success fees.⁴ In the late 1950s, the ABA circulated a pamphlet emphasizing that lawyers were being out-earned by other business people, and its suggested remedy was to keep better track of time and work performed—hence, hourly billing.⁵ By the

2. Niki Kuckes, *The Hours: The Short, Unhappy History of How Lawyers Bill Their Clients*, LEGAL AFFAIRS (Sept./Oct., 2002), http://www.legalaffairs.org/issues/September-October-2002/review_kuckes_sepoct2002.msp.

3. *Id.*

4. *Id.*

5. Ronda Muir, *A Short History of the Billable Hour and the Consequences of Its Tyranny*, LAW PEOPLE BLOG (June 18, 2007), <http://www.lawpeopleblog.com/2007/06/articles/profitability/a-short-history-of-the-billable->

late 1970s, hourly billing became the standard billing method with the partial justification that hourly billing provided clients with greater certainty regarding fees through a more businesslike approach.⁶ There has been tension over time between charging clients a large amount to keep up the status of the profession and charging a fair amount that is more agreeable and transparent to clients.

From the 1970s until recently, the billable hour seemed to resolve this tension. Hourly billing improved clients' understanding of the legal fees charged more than just a "for services rendered" bill with no explanation of the work involved.⁷ Billing by the hour seemed not only to provide clients with more certainty regarding legal fees but also to provide a better ability for firms to match an individual lawyer's productivity with revenues.⁸ Hours billed became the chief, if not only, way to measure performance internally at firms; it became nearly the exclusive way clients were billed, and many firms started comparing their overall performance based on average profits per partner.⁹

As billable hours became more prevalent across law firms, firms expected lawyers to work more hours in order to bring in greater revenue and compete with other firms. In the 1950s, the ABA claimed that there were "1,300 fee-earning hours [available] per year," but today many firms expect lawyers to bill upwards of 2,000 hours per year.¹⁰ While a 2,000-hour requirement may seem achievable from a practical standpoint, (there are approximately 8,765 hours in a year, after all), lawyers who are focused on meeting billable hour quotas often face enormous pressure in downturn economies, when work is scarce, but the quota remains. Billable hours theoretically create perverse incentives for lawyers to inefficiently use time and technological resources to meet their billable hour quotas. Billable hours requirements may also cut into a lawyer's ability to pursue client development opportunities, do pro bono work, and mentor younger lawyers, which can disturb both the sustainability of the firm and the mental health of its lawyers.¹¹

Billable hours can have negative effects on clients as well. Even when lawyers discuss a billable rate upfront, clients may not be able to predict costs if they do not know how many hours a project will take.¹²

hour-and-the-consequences-of-its-tyranny/.

6. *Id.*

7. Larry E. Ribstein, *The Death of Big Law*, 19 (2010), <http://works.bepress.com/ribstein/22>.

8. *See id.*

9. *See* Michael Roster, *The Reckoning*, CALIFORNIA LAWYER, Apr. 2009, at 21, 22..

10. Kuckes, *supra* note 2.

11. JEFFREY F. LISS & ANASTASIA D. KELLY, ET AL., ABA COMMISSION ON BILLABLE HOURS REPORT 2001-2002, 5 (2002), *available at* <http://www.judicialaccountability.org/articles/ABABillableHours2002.pdf>.

12. *See* Ribstein, *supra* note 7, at 18.

Additionally, clients may avoid communicating with lawyers about serious issues in order to save money, knowing that even a quick phone call may cost \$300.¹³ Finally, the billable hour may not reflect the real value clients expect from legal transactions.¹⁴ Clients prefer lawyers to research and provide an optimal amount of information where the client “pays for the lawyer’s marginal effort and receives the marginal benefit,” but under the billable hour method lawyers have incentive to do extra research and provide information about additional risks both to protect their reputations and to maximize revenue.¹⁵

Although alternative fee arrangements existed before the billable hour became the primary player, firms have been reconsidering alternative fee arrangements increasingly in the past five years to combat these negative effects on both lawyers and clients.¹⁶ Alternative fee arrangements may lead lawyers to reduce inefficiencies, embrace technology that can improve the way legal services are produced and delivered, and focus on results that add value for clients.¹⁷ Benefits to clients billed using an alternative fee structure include an improved ability to predict costs, fifteen to thirty percent savings on legal fees and reduced administrative costs, and better-aligned incentives in the attorney-client relationship.¹⁸ The next section discusses some additional drivers of the trend away from the billable hour and toward alternative fee arrangements.

B. Drivers of the trend toward alternative fee arrangements

Some firms may provide alternative fee arrangements to maintain a low-cost competitive advantage compared to other firms. However, the primary driver of alternative fee arrangements is client demand. Clients want more predictable fees and for lawyers to share in the risk. Although information is imperfect, with today’s technology, entrepreneurial clients can access information about fees, can see reviews of lawyers and law firms on-line, and can sometimes perform legal tasks on their own, all of which allow clients to be extremely selective when choosing legal

13. *See id.*

14. *See id.*

15. Donald C. Langevoort & Robert K. Rasmussen, *Skewing the Results: The Role of Lawyers in Transmitting Legal Rules*, 5 S. CAL. INTERDISC. L.J. 375, 383 (1997).

16. Thomas S. Clay, *Uncertain Transition: Anticipating the Pace of Change*, ALTMAN WEIL (2010), http://www.altmanweil.com/index.cfm/fa/r_resource_detail/oid/66283b79-eb54-4594-a68a-f263d9eb6ec4/resources/Uncertain_Transition_Anticipating_the_Pace_of_Change.cfm.

17. *See* Kaleb A. Sieh, *Law 2.0: Intelligent Architecture for Transactional Law*, Report No. 9 at 14, *The Silicon Flatirons Roundtable Series on Entrepreneurship, Innovation, and Public Policy* (Aug. 13, 2010), <http://www.silicon-flatirons.org/documents/publications/report/SIEHLaw2.0.pdf>.

18. *Id.* at 13.

counsel. This, in turn, requires law firms to be more creative in how they market themselves and how they bill their clients.

In addition to entrepreneurial clients who can research fees and demand alternatives, general counsel at larger companies are demanding alternative fees such as fixed fees for projects like mergers and acquisitions and discounts and success fees for litigation.¹⁹ In-house counsel desire these alternative fees as a way to better predict and value legal services. They know that they must be flexible on fixed fees if complexities arise, but in-house counsel have the option to hire other law firms if demands for alternative fee arrangements are not met.²⁰ Because entrepreneurial clients typically do not have their own in-house counsel to review an outside firm's billing practices, transparency in fees for entrepreneurial clients is essential. Also, now that many law firms are working to meet the demands of in-house counsel, entrepreneurial clients can request and receive the same billing features that many in-house counsel are demanding of outside counsel, like creating budgets upfront and seeking ways to reduce costs.²¹

One example of a firm that switched to an alternative fee arrangement system based on client demand is the litigation firm Shook Hardy & Bacon, which implemented a value-billing model in response to the request of its large client, Tyco.²² The keys to Shook Hardy & Bacon's successful alternative fee arrangement model, which now accounts for thirty percent of its revenue, were focusing on strategic objectives rather than billable hours, effectively staffing deals, and utilizing case-management techniques to match clients' budgets and shareholders' interests.²³ More examples of firms that have successfully employed alternative fee arrangements are discussed below in Section IV.

A spring 2010 survey of law firms (not exclusive to entrepreneurial law firms) by the legal consulting firm, Altman Weil, showed that 94.5% of firms currently use non-hourly based billing in some aspects of their

19. Mark Chandler, Senior Vice President, General Counsel, & Secretary, Cisco, *Leveraging Technology for Efficiency and Productivity* presentation at the Colorado Law In House Counsel Series: The Changing Dynamics of Technology and Outsourcing (Feb. 13, 2012).

20. *See id.*

21. Roster, *supra* note 9, at 22.

22. *See* Rachel M. Zahorsky, *Facing the Alternative: How Does a Flat Fee System Really Work?*, ABA JOURNAL (Mar. 1, 2012, 6:10 AM), http://www.abajournal.com/magazine/article/facing_the_alternative_how_does_a_flat_fee_system_really_work/.

23. *Id.* *See also* Stephanie Francis Ward & Rachel M. Zahorsky, *Alt. Billing is Part of Fundamental Shift in Buying Trends, Corp. Counsel and Partners Say*, ABA JOURNAL (Apr. 5, 2010, 3:09 PM), http://www.abajournal.com/news/article/alternative_billing_whos_actually_doing_it/.

practices.²⁴ All firms surveyed with more than 250 lawyers used some form of alternative fees, but according to the survey, smaller firms were less likely to use alternative fees.²⁵ In Section IV below, interviews with Boulder and Denver entrepreneurial law firms show that firms of all sizes use alternative fee arrangements to some degree, but larger firms such as Cooley tend to be more comfortable with certain kinds of fee arrangements like equity that smaller firms do not use. However, these findings are debatable because small firms may have more agility to personalize fee arrangements for their clients. Large firms, on the other hand, may be slower to change due to large infrastructures that evaluate individual lawyers and the firm as a whole based on common metrics revolving around billable hours. As more firms start to utilize alternative fee arrangements, it will be interesting to track whether small or large firms are switching more quickly.

Based on economic circumstances in 2009, firms overwhelmingly stated in the Altman-Weil survey that they thought non-hourly billing was more than a temporary trend and would be adopted as a standard by most firms going forward.²⁶ Moving on from this examination of the billable hour and the trend toward alternative fee arrangements, the next section will introduce some of the agency costs associated with different fee arrangements.

II. AGENCY COSTS

An agency relationship is a “contract under which . . . the principal(s) engage . . . the agent to perform some service on their behalf which involves delegating some decision making authority to the agent.”²⁷ The agent may not act in the best interests of the principal because the agent has “the power to control the principal’s affairs but does not fully bear the risks and rewards associated with this control.”²⁸ This problem of misaligned incentives between the principal and the agent is often referred to as agency costs.

To mitigate agency costs, the principal can monitor the agent and establish incentives for the agent to limit perverse behavior. However,

24. 2010 LAW FIRMS IN TRANSITION, AN ALTMAN WEIL FLASH SURVEY, <http://www.altmanweil.com/LFiT2010> (last visited Jan. 13, 2013) (including responses from 218/787 firms with more than fifty lawyers).

25. *Id.*

26. *Id.*

27. Michael C. Jensen and William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure* 5, in *A THEORY OF THE FIRM: GOVERNANCE, RESIDUAL CLAIMS, AND ORGANIZATIONAL FORMS*, (Harvard Univ. Press Dec. 2000), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=94043.

28. Larry E. Ribstein, *Symposium: Ethical Rules, Agency Costs, and Law Firm Structure*, 84 VA. L. REV. 1707, 1709 (1998).

because lawyers' work is specialized and often tailored to the client, monitoring costs may be high.²⁹ This agency problem affects both parties: if clients cannot easily evaluate potential agency costs in legal representation, they may distrust lawyers and opt to perform work on their own or through a less expensive, possibly lower-quality option, therefore lessening both lawyers' revenues and clients' potential gains from hiring lawyers.³⁰

From the vantage point of the client as principal and the attorney as agent, incentives may be misaligned based on the different types of fees that attorneys charge. If an attorney bills by the hour, he may shirk on efficiency; however, if an attorney charges a flat rate, he may shirk on quality.³¹ While hourly billing may seem to give clients assurance that an attorney has spent significant time on their issues, "the assurance is misleading if clients have no way of knowing how many hours were necessary to do the job well."³² A lawyer has an incentive to overstate the client's legal risks so that the client requests additional legal work, maximizing the lawyer's revenues.³³ With the billable hour, lawyers theoretically have incentive to work as many hours as possible, ignore tools and technologies that could increase efficiencies, and do more work than the client needs. Flat fees theoretically mitigate these perverse incentives to an extent, but with flat fees, attorneys may try to work as few hours as possible and do the bare minimum to satisfy the client. Because the lawyer may not be paid enough to motivate a sufficient effort with a flat fee and because it is difficult for a client to measure the lawyer's real contribution, the lawyer may shirk.³⁴

This Note explores whether and how alternative fees, or value billing, might help to mitigate agency costs to align the incentives of both lawyer and client. Attorneys' value to clients includes identifying and helping clients avoid risks; reducing uncertainty around regulations; leading deals; and helping clients understand issues and documents involved.³⁵ If an attorney shares some of the risk involved in the transaction, the client's goals and attorney's goals theoretically are better aligned. As discussed in more detail in Section III below, different fee arrangements allow attorneys to share different amounts of risk.

In many discussions in preparation for this note, I came across an

29. *Id.*

30. *Id.* at 1713.

31. Ribstein, *The Death of Big Law*, *supra* note 7, at 6.

32. *Id.* at 19.

33. Langevoort & Rasmussen, *supra* note 15, at 380 (discussing an economic analysis of the lawyer-client relationship).

34. Ribstein, *Symposium: Ethical Rules, Agency Costs, and Law Firm Structure*, *supra* note 28, at 1709-10.

35. *See* Sieh, *supra* note 17, at 24-25.

alternative theory to the agency cost theory as to why attorneys want to bill clients appropriately. Michael Roster, a co-chair of the Association of Corporate Counsel's Value Challenge, stated, "a lawyer is [better characterized as] a professional, not an agent for the principal."³⁶ Roster has a unique perspective as a past managing partner, general counsel, and corporate client,³⁷ and he explained that the reason lawyers want to provide value for clients and bill them appropriately turns on professionalism—high professional standards, expertise, reputation, and relationships.³⁸ An attorney wants to put forward an excellent work product and develop a strong relationship with the client, particularly if there is potential to do business with the client or similar clients in the future. Professionalism was a common theme in the interviews depicted in Section IV below. I argue that both theories of agency costs and professionalism are valid and interconnected. In fact, professionalism and preserving one's reputation is one way to reduce agency costs and constrain perverse behavior.³⁹ Alternative fee arrangements can be an additional way to align incentives that is motivated not only by professionalism but also by profitability. The next section classifies different types of alternative fee arrangements and briefly examines their associated agency costs.

III. TAXONOMIES OF ALTERNATIVE FEE ARRANGEMENTS

Fee arrangements come in several forms, and many firms employ a variety of alternative billing arrangements or hybrids of one or more alternatives. This section defines a cross section of the alternative fee arrangements in existence and discusses possible agency costs in employing each particular arrangement. The following chart introduces the four broad categories of fees as well as several subcategories, and the text below provides detail concerning each of these taxonomies.

36. Interview with Michael Roster, Co-chair of Association of Corporate Counsel's Value Challenge (Feb. 1, 2012).

37. Michael Roster served as Managing Partner at Morrison & Foerster's Los Angeles Office, General Counsel at Stanford, and Executive Vice President and General Counsel of Golden West Financial Corporation.

38. Roster, *supra* note 36.

39. Although, to protect reputation and avoid malpractice suits, lawyers may do more work than is necessary for a client, racking up fees under the billable hour system. *See* Ribstein, *supra* note 28, at 1710.

Category of Fee:	Sub-category:
Billable hour	<ul style="list-style-type: none"> • Blended rates • Early company discounts • Fee caps • General budget based on an hourly rate
Flat, or fixed, fees	<ul style="list-style-type: none"> • Risk collars • Subscriptions
Success fees	<ul style="list-style-type: none"> • Deferred fees to financing
Equity	

Billable Hour

The billable hour is still in effect in many firms, but firms bill by the hour in different ways. Generally speaking, with the billable hour system, attorneys have hourly rates based on a combination of attorney's experience, location of the practice, and specialization of the practice. Many firms today are preserving the billable hour but making modifications like blended rates, early company discounts, fee caps, and general budgets based on an hourly rate. Each of these modifications is discussed in more detail below.

Blended rate

A blended rate is a flat hourly fee for work, regardless of which attorney at a firm does the work.⁴⁰ This method is used more in litigation than in transactional work. It has many of the same issues as a billable hour, but it allows clients who complain of paying to train associates a flat rate whether a first year associate or partner works on the deal.

One potential perverse incentive regarding blended rate fee arrangements is that a firm could push work down to the lowest-billing attorney so the client pays more for less experienced work. This concern is mitigated by the fact that a firm wants to achieve positive outcomes for its clients, so experienced attorneys likely will remain involved so that the rate really is a blend of partner and junior associate work. This form of fee arrangement likely works best with team-based law firms, where a flat hourly rate would average out to be profitable for the firm. None of the firms profiled in Section IV below described using this type of fee

40. LISS & KELLY ET AL., *supra* note 11, at 17.

arrangement in their practice, but again, this practice is used more widely in litigation.

Early company discounts

Another fee arrangement unique to entrepreneurial law is early company discounts. This takes into account the fact that entrepreneurial clients may not have the funds to pay a law firm's typical hourly rate. The discounted fee could be based either on an hourly rate or on a flat rate. When based on an hourly rate, the discount is essentially the same as a billable hour model, but clients get the benefit of paying less per hour. Discounting a flat rate has the same effect. Moye White is one entrepreneurial law firm that offers early company discounts in some situations.⁴¹

If a particular client provides many referrals or is a long-term client, a discounted rate might be profitable for a law firm to employ.⁴² However, law firms must be judicious in offering discounts. With a discounted hourly rate, the same agency cost as a normal billable hour remains in effect; attorneys may spend more time on a project to recover more costs, making the discount ineffective. Additionally, if client A hears that another client B received a discount, then client A may demand a discount as well, which could set a precedent for lower rates all around. Further, if the entrepreneurial company grows more profitable over time and stays with the same law firm, it may be difficult for the law firm to raise rates on that client due to precedent of the initial rate, despite the client's ability to pay non-discounted rates in later stages of the business.

Another alternative to a discount for early-stage companies based on the billable hour is a discount for early stage companies that pay on time or early. For example, law firm Stigler Wussow offers a five percent discount to clients that pay within ten days and reserves the right to charge interest if a client takes more than sixty days to pay.⁴³ With entrepreneurial clients, lawyers face an additional risk that the venture will not be successful and the lawyers may not be paid at all, regardless of the fee arrangement. This incentive to pay early or penalty to pay late attempts to reduce the risk for the lawyer and ensures better cash flow for the law firm while also providing incentive for the client to pay in advance if possible.

41. Interview with Trish Rogers, Partner, Moye White (Nov. 10, 2011).

42. LISS & KELLY ET AL., *supra* note 11, at 17.

43. Interview with Shawn Stigler, Named Partner, Stigler Wussow (Nov. 10, 2011).

Fee caps

With a fee cap, an hourly billing arrangement is used, but the cap creates a ceiling for the total amount of billings allowed.⁴⁴ This is often couched in a “not to exceed” provision, as is the case with Cooley.⁴⁵ If the firm’s billable hours exceed the cap, then the firm absorbs the cost for the extra work. Often, a fee cap arrangement also includes a “safety valve” provision where parties may renegotiate if the fees exceed the cap by a certain number of dollars or hours.

The benefit of fee caps is that both parties have a budget that still relates to an hourly rate. This increases the ability of both parties to predict cash flows. It also incentivizes law firms to stay within budget or incur transaction costs for going over budget. At the same time, if the transaction exceeds the estimated amount for a reason that could not be foreseen, the safety valve provision allows the parties to renegotiate the cap.

The risk with this approach, as with flat fees, is that not all projects can be estimated easily, and law firms risk absorbing costs if the transaction exceeds the budget and renegotiations do not go well. Although the safety valve provision mitigates this risk somewhat, renegotiating for additional fees adds transaction costs and can hurt an attorney-client relationship, especially if a client relies on a certain capped arrangement from the start.

General budget based on an hourly rate

This type of arrangement is also labeled in law firms as “dollars times hours with a general estimate” or “shadow billing.” It blurs the line between a fixed fee and a general budget based on an hourly rate. A law firm provides a planned budget based on an hourly rate and reports the hours actually spent alongside the proposed budget so clients can compare the two transparently.⁴⁶ Firms that are willing to risk potentially lower profits to seek new business using alternative fees use shadow budgets more than firms that are conservatively implementing alternative fee arrangements.⁴⁷

44. James A. Comodeca & Scott R. Everett, *Alternative Fee Arrangements: Risk Sharing Requires a Strong Partnership*, THE NATIONAL LAW REVIEW (May 3, 2010), <http://www.natlawreview.com/article/alternative-fee-arrangements-risk-sharing-requires-strong-partnership>.

45. Interview with Mike Platt, Partner, Cooley LLP (Jan. 9, 2012).

46. Jim Hassett, *The LegalBizDev Survey of Alternative Fees: A Research Report Based on In-Depth Interviews with Chairmen, Senior Partners, and C-Level Executives from 37 of the Largest Law Firms in the U.S.* (2009).

47. *See id.*

For firms that want to transition to a flat fee, this method is useful to gauge how much time transactions actually take in order to develop that alternative fee arrangement. This type of fee mitigates concerns that entrepreneurial clients might have about budgeting because the estimate provides a framework that the client can use to hold the lawyer accountable. At the same time, the hourly rate continues to apply. As with other fixed and capped fees discussed below, this type of fee has the potential to decrease profits for the lawyer if the work goes beyond the scope of the budget.

Flat, or Fixed, Fees

Flat fees are also referred to as fixed fees and seem to be the most commonly used alternative fee arrangement. Many firms are investing heavily in technology to make the switch to flat fee arrangements. For example, Patrick Daugherty, partner at Foley & Lardner, a firm with a leading IP practice, stated that his firm invested \$1 million in software and created a budget management tool in order to switch to a fixed fee system.⁴⁸ Daugherty stated that the down economy and a supply/demand imbalance for legal services drove the firm to switch.⁴⁹ In fact, all of the firms I spoke with incorporated flat fees into their alternative billing arrangements in some form. Most did so for automated tasks for which they could easily predict their costs like patents drafting and filing, motions, some aspects of mergers & acquisitions, and general administrative tasks like position statements.⁵⁰

Flat fees can be used for a single transaction or for a menu of services. Boulder law firms Stigler Wussow and Indigo Venture Law Offices provide a fixed fee menu to clients.⁵¹ In a flat fee arrangement, generally the attorney and client decide upon a set price for the agreed-upon scope of work. Typically, flat fee arrangements include a caveat or safety valve provision that the attorney reserves the right to renegotiate if the work goes beyond the agreed-upon scope, as discussed above in the fee caps section.

Flat fees can help to minimize agency costs and align incentives. A flat fee is a set, guaranteed revenue stream for the law firm that the firm can receive once the client and attorney sign the contract rather than collect after the work is done and the attorneys have tabulated hours. Having a flat fee upfront can help both clients and attorneys budget time and money on projects. If a firm can manage costs well, flat fees can be

48. Ward & Zahorsky, *supra* note 23.

49. *Id.*

50. *See id.*

51. Stigler, *supra* note 43; Interviews with Roger Glovsky and John Koenig, Managing Partners, Indigo Venture Law Offices (Nov. 11, 2011).

very profitable for law firms. Michael Roster stated that switching to flat fees can bring costs down twenty-five percent and also helps change the focus of law firms from selling hours to selling expertise.⁵² Additionally, flat fees may allow firms to develop new practice areas.⁵³ If a client retains a law firm on a flat fee for one issue, that client may see what the firm can do in a new area since they are already engaged with the firm, expanding the capabilities of the firm.

On the negative side, while clients may request flat fees, firms may find it difficult to project what the cost will be upfront and end up underestimating the fee and losing money on the deal. Also, there are potential behavioral issues with flat fees. There is a risk that clients may take advantage of lawyers, reasoning that a flat fee entitles the client to bring up any possible issue at any time.⁵⁴ Additionally, if a client expects a flat fee and the project goes beyond the scope of the agreed-upon fee, clients may be suspicious that attorneys are over-charging, so there may not be a trusting attorney-client relationship or repeat business. It is vital that attorneys clearly delineate the scope of the flat fee to manage flat fees appropriately.

Risk collars

Risk collars are related to both hourly billing arrangements and fee caps. A risk collar is built around an estimated budget based on an hourly rate for a project.⁵⁵ However, if the firm completes the work under budget, the client pays a bonus, and if the firm completes the work over budget, the client gets a discount.⁵⁶ Shook Hardy & Bacon uses risk collars, retaining a portion of estimated fees as a bonus when the deal comes in under budget, but remitting a portion of overages before a shared-cost safety valve kicks in.⁵⁷ Collars, like blended rates and success fees, are likely used more often in litigation. None of the firms interviewed for this Note explicitly mentioned using risk collars, but a description of this sub-category is informative to depict the full scope of alternative fee arrangements.

Risk collars align the incentives of both parties; firms have skin in the game where they get a bonus for being efficient or pay for being inefficient.⁵⁸ At the same time, clients do not overpay for unnecessary

52. Roster, *supra* note 36.

53. David Boies, *Is the Billable Hour Past?* ABA NOW (Feb. 12, 2011), <http://www.abanow.org/2011/02/is-the-billable-hour-past/>.

54. See Langevoort & Rasmussen, *supra* note 15 at 384.

55. Hassett, *supra* note 46.

56. *Id.*

57. Zahorsky, *supra* note 22.

58. Jim Hassett, *Risk Collars: A Great Way to Start Offering Alternative Billing*,

work. Because a budget exists upfront, both parties can manage cash flow better. Risk collars also prevent attorneys from excessively billing clients and prevent clients from interfering with the attorneys' work and throwing additional issues into the mix. Firms that have not yet forayed into alternative fees may want to start by using this fee arrangement if flat fees sound daunting because risk collars actually limit risk. This type of fee arrangement is especially useful in scenarios where the attorney and client expect to have a long-term relationship related to a particular project.

On the other hand, risk collars are similar to hourly billing and still could create perverse incentives for attorneys to potentially cut corners. They also may prevent clients from disclosing issues to attorneys fully in order to stay under budget.

Subscription fees

A spin on the flat fee for services is a subscription fee or repetitive flat fee for a period of time. A subscription may also be referred to as a retainer. An example of a law firm that has switched from the billable hour completely to subscription billing is Smithline Jha, a San Francisco-based Internet and software law firm.⁵⁹ According to this firm, clients did not respond favorably initially to the subscription model because they felt they had lost the ability to compare rates across different firms since the fee structure was so different, but many clients ended up appreciating the model because they were better able to predict their costs on a monthly basis.⁶⁰

As a benefit to law firms, over time clients tend to pay more with subscriptions than with the billable hour method and revenue can be predicted each month.⁶¹ Clients can also predict legal expenses each month, which can be useful to smooth out expenses over time rather than having one large legal fee due at the beginning or end of a deal. Other benefits of the subscription model include encouraging clients to be more proactive in choosing and staying with a lawyer; encouraging lawyers to build efficiencies so that similar deals in the future are less expensive to the firm; and facilitating close relationships with extensive

LEGALBIZDEV BLOG (Mar. 3, 2010), http://adverselling.typepad.com/how_law_firms_sell/2010/03/risk-collars-a-great-way-to-start-offering-alternative-billing.html.

59. See Sieh, *supra* note 17, at 14; see also Petra Pasternak, *Small Law Firm Woos Clients With Monthly Subscription Fees*, THE RECORDER, Dec. 23, 2009, available at <http://www.law.com/jsp/article.jsp?id=1202437219609> (last visited Jan. 15, 2011).

60. See Sieh, *supra* note 17, at 14 n.25.

61. *Id.* at 15.

communication between attorneys and clients.⁶² Transaction costs are also lower with subscriptions than with a project-based flat fee because attorneys can negotiate the cost of the monthly subscription rather than negotiate the cost per project.

Although the firm knows what revenue will be coming in on a monthly basis, a downside to the subscription model is that the firm can only take on a limited number of clients because with the subscription the firm has to take on any legal issue the client faces in that month, and it can be difficult to predict what issues will arise.⁶³ It is also difficult for a firm to know all of its costs upfront.⁶⁴ Additionally, the model does not account for attorneys' relative experience levels as varying billable hour rates do.⁶⁵

None of the firms I spoke with had moved so radically into a full subscription fee model as Smithline Jha had, but both Stigler Wussow and Moye White offer a monthly retainer option that resembles the subscription option.⁶⁶ Boulder law firm Indigo Venture Law Offices is also utilizing a partial subscription model to clients through its thirty-day unmetered consultation offering.⁶⁷

Success Fees

Success fees, also known as contingency fees or holdbacks, are used more often in litigation practices but can sometimes be used in entrepreneurial law when executing merger and acquisition deals. Cooley was the only firm I spoke with that uses success fees, although Moye White uses a variation of success fees, deferred fees to financing.⁶⁸ With a success fee, there is often a set fee for the attorney to work on a particular project and an additional bonus if the attorney achieves the desired results.⁶⁹ Measures of success include closing by a certain date with specific terms, or resolution of an issue before costs reach a certain level.⁷⁰

Success fees align incentives between attorney and client to work toward a mutually set goal. Success fees:

ensure[] the firm will allocate sufficient resources to maximize profit margin while still providing flexibility to do the work as efficiently as

62. *Id.*

63. *Id.* at 16.

64. *Id.*

65. *See id.*

66. Stigler, *supra* note 43; Rogers, *supra* note 41.

67. Slovsky & Koenig, *supra* note 51.

68. Platt, *supra* note 45; Rogers, *supra* note 41.

69. Comodeca & Everett, *supra* note 44, at 1-2.

70. *Id.*

possible. Expectation setting at the outset benefits both parties because it aligns goals and requires clients to carefully consider the amount they are willing to spend in order to achieve the desired results.⁷¹

Success fees can benefit lawyers as a bonus structure as well as clients as a way to budget projects like litigation.⁷²

On the negative side, success fees can lead to cash flow issues for attorneys, who still have to work to prepare for a deal and rely on a steady revenue stream to pay for overhead, salaries, and other firm expenses. Additionally, as with flat fees, attorneys could achieve the desired outcome from a broad perspective but cut corners to achieve that outcome and not get the best deals for their clients.⁷³ Because success fees shift the risk to the lawyer, there are additional transaction costs of negotiation to make the switch and to ensure that all parties understand the risks and complexities of the project.⁷⁴ Although a fixed fee supplemented by a success fee may mitigate the risk of low cash flow or potential shirking, those risks remain.⁷⁵

Deferred fees to financing

One sub-category of success fees specific to entrepreneurial law is deferred fees to financing. Entrepreneurial clients often do not have funds to pay legal fees initially, so firms will work with the expectation that once entrepreneurial clients achieve a specific amount of financing, they will be able to pay those fees. Both Moye White and Cooley sometimes employ this alternative fee arrangement.⁷⁶

Deferring fees is useful for entrepreneurial clients who show promise but are bootstrapping the company until a financing event. If reputable law firms were not able to defer fees, clients might either try to handle the legal work themselves or hire subpar, inexpensive law firms that might hurt the business's future. To balance the risk of accepting deferred fees, law firms may be able to charge a premium or interest for deferring fees. Additionally, sometimes fees are deferred for a particular time period rather than a specific financing event to mitigate the risk of non-payment for a long period of time. Sometimes the premium for deferring fees is the opportunity to invest in the stock of the startup,

71. *Id.*

72. Chandler, *supra* note 19.

73. See Kevin Miller, *Lawyers as Venture Capitalists: An Economic Analysis of Law Firms That Invest in Their Clients*, 13 HARV. J.L. & TECH. 435, 452 (2000).

74. *Id.* at 459.

75. LISS & KELLY, *supra* note 11, at 18.

76. Platt & Rogers, *supra* note 68.

discussed more in the equity sub-section below.⁷⁷

However, deferring fees is risky for law firms, which are generally risk-averse entities. If the law firm bets on the wrong entrepreneur and the client's company fails, the law firm must either write off the fees or go through an uncomfortable collections process.

Equity

In some cases, entrepreneurial law firms, like Cooley, take equity in a startup company as an alternative to or in addition to other fees.⁷⁸ There are a few different types of equity interest arrangements. First, in a straight investment model, a law firm purchases stock in clients like any other investor, and the firm does not adjust fees or billing schedule.⁷⁹ Second, in a stock-as-fees model, a firm receives stock or stock options of a client's company instead of cash compensation or in addition to lower fees earlier in the representation.⁸⁰

An entrepreneurial client may grant equity to a law firm because it plans to have a long-term relationship with the firm, and a firm may accept equity knowing that it can monitor the entrepreneurial client and exert some control over the direction of the venture.⁸¹ Generally speaking, equity can be an incentive for an attorney to work harder for an entrepreneurial client to achieve financing. Up-side profit potential compensates the firm for its assumption of risk that the client may not ever obtain financing.⁸² On the other hand, if payment comes in the form of stock rather than an immediate payout, there is potentially an incentive to spend less time on the client's deal.

Equity stake in a company may lead to conflicts of interest. Conflicts may arise because the firm may consider not only its lawyer-client relationship but also its relationship to the client as an investor. If a lawyer continues working with an entrepreneurial client through the exit event, there is an incentive for the attorney to take the deal no matter what the terms are so that the lawyer can get some return. There is much written about potential conflicts of interest related to a law firm accepting equity,⁸³ but details on that particular issue go beyond the scope of this Note. Some law firms have determined ways to take equity in a client company while avoiding conflicts of interest, but not every

77. See Miller, *supra* note 73, at 437.

78. Platt, *supra* note 45.

79. See Miller, *supra* note 73, at 444.

80. *Id.* at 445.

81. *Id.* at 449.

82. *Id.* at 439.

83. See, e.g., *id.* at 453-58 (discussing conflicts of interest and ethical rules regarding law firms accepting equity).

law firm is ready to do so or wants to take on those risks of conflict.

IV. FIRM PROFILES

As outlined above there are several methods that firms could use to charge clients in addition to or as an alternative to the billable hour. But what is actually being done? To determine what firms are currently utilizing in terms of alternative fee arrangements, this section analyzes some empirical, qualitative research from a sample of firms in the Denver/Boulder metropolitan area that practice entrepreneurial law. The sample includes only firms with entrepreneurial law practices and presence in the Denver/Boulder area so that the clientele and relative cost of living is the same, but the firms differ in size. The Denver/Boulder area is a center for entrepreneurship, with many startup companies, venture capital presence, a large research institution, and a new startup initiative, Startup Colorado. The following profiles are organized from the smallest to the largest firm in terms of attorneys at the time of writing: Campbell Law Group, Indigo Venture Law Offices, Stigler Wussow, Moye White, and Cooley.

Campbell Law Group

Campbell Law Group (“CLG”) is a small law firm in Boulder, Colorado that works with entrepreneurs and small businesses, including many social ventures.⁸⁴ The firm uses a variety of fee arrangements, including hourly billing, flat fees, and monthly subscriptions.⁸⁵ Because entrepreneurs use legal services differently than corporate clients and are often more price-sensitive, fee arrangements for entrepreneurial clients differ from other practice areas.⁸⁶ While companies appreciate having a line item legal fee in the budget, it can be difficult to estimate exact fees because each matter is unique.⁸⁷ CLG reserves flat fees for tasks that can be estimated easily, like corporate formation tasks, single-member LLCs, and stock agreements on a flat rate. Jochem Tans, an attorney at CLG, noted that even some tasks that may seem fungible require more customization than initially planned, so it can be difficult to use a flat fee.⁸⁸

In some circumstances, typically ongoing corporate tasks excluding financing deals, the firm has tried monthly subscriptions.⁸⁹ However,

84. CAMPBELL LAW GROUP, <http://campbelllawgroup.com/overview> (last visited Jan. 15, 2012).

85. Interview with Jochem Tans, Associate, Campbell Law Group (Nov. 10, 2011).

86. *Id.*

87. *Id.*

88. *Id.*

89. *Id.*

with subscription-based fee arrangements, a firm has to lock in the subscription at a premium, which is often difficult to do with price-sensitive entrepreneurial clients. In some situations, the firm defers fees to financing events. Ideally, the firm would charge a premium for the risk involved in fee deferral. In the future, CLG hopes to have a menu of pricing or potentially use a subscription model.⁹⁰

Indigo Venture Law Offices

Indigo Venture Law Offices (“Indigo”) is a five-attorney entrepreneurial law firm, which provides services to entrepreneurial companies in both Colorado and Massachusetts on a fixed fee basis.⁹¹ Although Indigo continues to offer billable hours to some clients who are more comfortable with that billing method, it is currently in the process of a business model innovation to build in more efficiency and value for clients. An interview with the managing partners revealed that the drivers of this change include both client demand and a downturn economy.⁹² After 2008, they realized that entrepreneurial clients are different from corporate clients and that legal services were becoming unaffordable for small businesses, so they came up with a new model focused on solutions rather than time.⁹³ They believe that as a profession, lawyers have to figure out how to add value and have structured their own value-billing model.⁹⁴

The first aspect of Indigo’s business model is fixed fees. The partners compare their fixed fee structure to the structure used by car mechanics, who offer a set menu of items they can work on and let the client/customer choose.⁹⁵ The partners stated that the fixed fee structure provides an incentive to get a deal done quickly, but they take care not to shirk on quality.⁹⁶ The firm chose a fixed fee arrangement over other alternative billing arrangements because other alternatives seemed too close to the billable hour for them, and they wanted a more collaborative approach.

The second aspect of Indigo’s business model is unmetered consultation. This is similar to a thirty-day subscription to the firm’s services. It encourages clients to ask questions rather than remain silent to avoid additional fees and facilitates the attorney client relationship.

90. *Id.*

91. INDIGO VENTURE LAW OFFICES, <http://www.indigoventure.com/index> (last visited Jan. 15, 2012).

92. Glovsky & Koenig, *supra* note 51.

93. *Id.*

94. *Id.*

95. *Id.*

96. *Id.*

The attorneys designed the unmetered consultations at thirty days based on their experience that most small entrepreneurial tasks could be accomplished within that time frame. If the client needs help for longer than thirty days, the firm can offer unmetered consultation for another thirty days or pro-rate the charge. Especially with entrepreneurs facing many new issues and not having strong cash flow, this service provides reasonable access to an experienced attorney. Other large law firms like Drinker Biddle also use unmetered consultation successfully.⁹⁷

Stigler Wussow

Stigler Wussow (“SW”) is a small Boulder law firm that primarily focuses on transactional entrepreneurial law with some litigation related to its entrepreneurial clients.⁹⁸ The firm works with a variety of clients in industries ranging from restaurants, renewable energy, organic and natural products, and manufacturing. The majority of its clients are privately held companies.⁹⁹ At the start of a client relationship, SW meets with the client then puts together a menu based on the client’s needs.¹⁰⁰ For some tasks like filing incorporation documents, the firm assigns a flat fee to the tasks but reserves the right to re-negotiate that flat fee if the direction of the project changes. For other tasks that might involve working with another side’s counsel, the firm tends to quote a number of hours because a flat fee is more difficult to predict.¹⁰¹

The firm also has some subscription-like fees. For instance, clients can opt to pay an annual charge for trademark maintenance. SW also has a retainer-like fee, ranging from \$500 to \$1,000, after the client signs an initial engagement letter. The firm does not charge for initial consultations and does not back-charge if the client later signs.¹⁰²

SW also adds in some modern technology for actually getting bills and documents to clients, like using EchoSign for contract signatures and using PayPal for invoicing.¹⁰³ Although the firm is small, it has better collection rates than big firms in part because the clients know what the bill will be upfront, so there are not disputes over the bill that delay payment. As mentioned in the early company discount subcategory of Section III above, the firm also offers a five percent discount to clients

97. Roster, *supra* note 36.

98. STIGLER WUSSOW, LTD., http://sw-ltd.com/a_bit_about_us/shawn_stigler.html (last visited Nov. 7, 2012).

99. Stigler, *supra* note 43.

100. *Id.*

101. *Id.*

102. *Id.*

103. *Id.*

that pay within ten days and reserves the right to charge interest if it takes more than sixty days to pay.¹⁰⁴

SW believes that a pure billable hour system does not work with entrepreneurial clients. As far as agency costs, named partner Shawn Stigler pointed out that law firms that can produce quality work tend to have happy clients and stay in business.¹⁰⁵ With flat fees, a lawyer may spend less time on a project than he would with a billable hour rate, but the lawyer must still produce a good work product and meet the client's needs. The goal of alternative billing is to improve the firm's systems and overall efficiency.

Moye White

Moye White is a Denver-based, fifty-attorney firm that practices both transactional and trial law.¹⁰⁶ Its entrepreneurial law practice makes up about ten percent of the firm's practice.¹⁰⁷ For the most part, Moye White bills early stage entrepreneurs by the hour, but Moye White offers alternative fee arrangements as needed, especially since many early stage companies are unable to initially pay legal fees.¹⁰⁸ As with many areas of transactional work, companies are asking for alternative fee arrangements, so Moye White is calculating budgets for projects to the extent it can.

In terms of alternative fees, Moye White offers discounts, deferred fees to financing, occasionally flat fees or fee caps, and retainers. Moye White is more likely to offer discounted billing rates if the client guarantees a certain amount of business.¹⁰⁹ Moye White also offers deferred fees to financing for startups, and these fees are typically stepped based on closing. Sometimes Moye White will offer flat fees or fee caps on transactions if there is enough volume and the task is a regular activity, like asset-based lending deals with no real estate involved, NDAs, assignment of works agreements, incorporation or LLC formation, and other standard form documents.¹¹⁰ The firm provides caveats on flat fees that the scope of the arrangement is contingent on reasonable and customary services. Moye White also offers a subscription-like monthly retainer, where clients agree to pay for a certain number of months. Although there is potential for the client to

104. *Id.*

105. *Id.*

106. MOYE WHITE, <http://www.moyewhite.com/about/about.aspx> (last visited Nov. 7, 2012).

107. Rogers, *supra* note 41.

108. *Id.*

109. *Id.*

110. *Id.*

overuse access to an attorney with a retainer, partner Trish Rogers mentioned that most of the time there is a good balance in terms of client communication.¹¹¹

In addition to alternative fees described above, Rogers suggested in a July 2010 Silicon Flatirons roundtable that lawyers can perform less complicated work, like providing a simple contract, for free at the outset of an attorney-client relationship. In this way, a firm can build goodwill so a client returns to the firm and pays for more complex legal work.¹¹² Although free work is not specifically outlined in the taxonomy section above, this can be analogized to an early company discount, where payment happens later once the client has some revenue and can return to the firm.

As far as risks in terms of agency costs, Rogers noted that no matter what the billing arrangement, attorneys should not shirk on efficiency and quality in part because of the risks of malpractice and harm to reputation. An attorney's job is to do well for clients and work product is important for an attorney and a firm to build a strong reputation and continuously manage relationships. Even with an alternative billing arrangement where the firm may lose money, the firm still wants to do a good job.

Additionally, Moya White tries with early stage companies to keep all work with one attorney, unless the project gets into a specialty area.¹¹³ Recognizing that young attorneys still need work and mentorship, the firm believes that with budget-constrained entrepreneurial clients, not pushing work down to lower-level associates cuts down on the time and cost to the client.¹¹⁴

Cooley LLP

Cooley is an international law firm with approximately 650 attorneys throughout the United States in ten offices, including an office in Broomfield, Colorado, with about forty-five attorneys.¹¹⁵ Mike Platt, a partner in the Broomfield office of Cooley, described a wide range of fee arrangements depending on needs, experiences, and the attorney's personal interest in that particular project.¹¹⁶ The impetus to change some fee arrangements from the billable hour occurred with the change in how software companies were funded with more angel investor deals. To get

111. *Id.*

112. *See* STEH, *supra* note 17, at 25.

113. Rogers, *supra* note 41.

114. *Id.*

115. COOLEY LLP, <http://www.cooley.com/broomfield> (last visited Nov. 8, 2012).

116. Platt, *supra* note 45.

involved in the best deals, Cooley had to figure out standardized approaches to incorporation and formation to avoid more comprehensive, nuanced deal structures and more expensive legal fees. Almost all clients want to imagine that they have a standard deal that will not take much time or energy, but rarely is that the case. Therefore, the firm transitioned fees to capped and deferred arrangements where they could.

Cooley utilizes fixed fees and fee caps. With a small startup trying to bootstrap, Cooley typically charges fixed fees for tasks like forming the company, issuing founder stock, assuring good employment practices are in place through documents and contracts like employee letters, proprietary rights, and occasionally drafting an option plan. Cooley uses fixed fees in situations like this so clients without financial support have assurances of costs.¹¹⁷ Some fees are set up with a “not to exceed,” cautionary provision, and sometimes the cap is based on how long the deal takes with a provision against unanticipated due diligence.¹¹⁸ With Series A or Series B financing, the use of a “not to exceed” provision depends on the investors’ reputation. If the investors are experienced with a strong reputation, then it is easy for Cooley to utilize a fixed fee; but if there are multiple angel investors or less experienced investors, then the firm is less likely to do a fixed fee.¹¹⁹

In complicated transactions, Cooley mitigates misaligned incentives involving fixed fee arrangements by not providing a cap. As a transaction becomes more complicated, the firm is likely to exclude a “not to exceed” number because with caps the client may rely on the lawyer to perform tasks that the client could do herself.¹²⁰

With prior knowledge of the entrepreneur or a trusted referral source for the client, Cooley is also willing on occasion to defer fees.¹²¹ Typically, fees are deferred for a period of time like six months or a year rather than deferred to a financing event. The payment usually occurs at financing, but it costs extra time and energy to craft the fee arrangement in that way.¹²² With fee deferrals, the deferred amount may be the whole amount or may be just a percentage. If the startup fails, the firm may write off the fee or develop a long-term payment schedule. If called due, clients typically pay.¹²³

Cooley has also determined a way to take small amounts of equity without conflicts of interest. Cooley may defer fees for a small portion,

117. *Id.*

118. *Id.*

119. *Id.*

120. *Id.*

121. *Id.*

122. *Id.*

123. *Id.*

less than two percent of pre-dilution founder's equity.¹²⁴ The lawyer does not have a greater percentage of equity than the founder, so it is not a true conflict of interest.¹²⁵ If the startup later seeks an exit, the firm has motivation to get the deal done well as a beneficiary of proceeds of the transaction. There is potential for conflict when equity is first negotiated, and there can be conflicts of interest when the transaction becomes complex like when adding performance terms, asking for too high a percentage, or asking for increased percentage over time. Cooley works to avoid these conflicts.

Most deals that occur at later stages in the entrepreneurial life cycle are based on a billable hour model because of lack of predictability of costs. Even if a lawyer could estimate the cost to draft a contract, it becomes more difficult for either the firm or client to control the deal because of the different financing sources and third parties involved. Some clients ask about fixed fee arrangements, but when these arrangements are utilized, the firm implements strict parameters.¹²⁶

When entrepreneurial clients stay with Cooley through the life of their company, Platt thinks this is based more on value added than fee arrangements employed.¹²⁷ In a July 2010 Silicon Flatirons roundtable, Platt stated, "the lawyer's value is not in document drafting but in reducing 'misalignment' between the various parties to a transaction."¹²⁸ He says a good outcome for the client and a fee consistent with value is the best way to grow a practice.

Summary of Firm Profiles

Many entrepreneurial law firms have determined alternative billing arrangements that suit their clients' needs and their own budgets and risk tolerances. Firms that often have negotiations or factors outside of their control may rely on the billable hour but provide a blended rate, early company discount, general budget, or a cap to give the client some assurance that fees will not be unreasonable. Firms that can routinize or automate certain tasks may find that flat fees are the answer to billing. Firms that desire steady revenue streams may switch to a subscription model. Firms that have steady revenue already may convey confidence to clients through offering success fees like deferred fees to financing or by offering to take equity instead of cash. Based on this sample of interviews, success fees and equity are less widely used than other

124. *Id.*

125. *Id.*

126. *Id.*

127. *Id.*

128. See SIEH, *supra* note 17, at 8.

arrangements but remain an option for firms as the trend toward alternative fee arrangements grows.

V. CONCLUSION: FUTURE OF VALUE BILLING TREND AND SUGGESTIONS FOR IMPLEMENTATION

The question remains: where is this trend going? Signs point to a lasting shift in the legal services industry. Consumers are buying legal services in a new way; both in-house counsel and entrepreneurial clients without in-house counsel can demand alternative fees; the technological revolution is changing the way people access and use information not only to find attorneys but to find template documents and contracts online; and there is an opportunity for law firms to respond to budget pressures of startup companies and to guarantee their own cash flows using alternative fees.¹²⁹

Which alternative fees are the best to reduce agency costs depends on the client, the transaction, and perhaps the size of the firm and ability to defer or reduce fees. There is not one billing arrangement that will work for all firms or all clients, but it seems that relying solely on the billable hour is not working well for law firms or clients anymore. And within the realm of entrepreneurial law, certain alternative billing arrangements may be more efficacious than others. As documents become increasingly standardized, fee arrangements are moving toward more fixed than negotiated fees. If firms continue needing to keep legal fees low, they will need to continue developing a more standardized approach to transactions and knowledge management within firms.

Across the board, law firms recognize that their primary goal is to add value to their clients' companies. Alternative fee arrangements are a part of that goal of adding value. The late legal scholar Larry Ribstein wrote, "Clients buy solutions to legal problems. Time spent usually is not even a rough proxy for the value of this product."¹³⁰ The optimal way to minimize agency costs and align interests is to bill not solely based on time but based on the value of the services to the client. According to an American Bar Association podcast, value billing benefits three relationships.¹³¹ First, relationships between the firm and the client improve because the suspicion that lawyers are billing unnecessary hours diminishes.¹³² Second, internal relationships at the firm improve because staffing decisions become more flexible with flat fees or blended rates.¹³³

129. Ward & Zahorsky, *supra* note 23.

130. Ribstein, *supra* note 7, at 18.

131. Ward & Zahorsky, *supra* note 23.

132. *See id.*

133. *See id.*

Third, relationships between general counsel in-house and the finance department improve due to the certainty associated with value billing.¹³⁴

But with any kind of billing arrangement, there are potentially misaligned incentives between an attorney's functions and a client's needs. Communication upfront regarding expectations and billing methods helps improve the lawyer-client relationship and minimizes potential agency costs. The lawyer-client relationship depends on trust, and a firm's over-reliance on any particular fee arrangement can prevent that trust and hurt relationships.¹³⁵ Firms without alternative fee arrangements should talk with clients to gauge interest in alternative fees and develop a strategy to implement alternative fee arrangements. But firms also must realize the different issues that arise from switching to alternative fees, including agency costs and the effect on efficiency of service delivery and cost control.

In conclusion, as firms consider what alternative fee arrangements to introduce, they should consider the following suggestions from the co-authors of *Winning Alternatives to the Billable Hour: Strategies That Work*.¹³⁶ First, do not try to shift all deals over to a new system at once. It is better to see what tasks the firm can automate and switch those to a fixed fee before adding alternative fees. Second, make sure that with any billing arrangement you include a written agreement so clients know what to expect up front. Third, consider what is valuable to the client; what are the client's goals? Fourth, see where the firm can cut costs in other areas in order to be more profitable. Finally, review the alternative fee arrangements over time and continue improving the process to make sure the firm is both profitable and adding value to clients' deals.

134. *See id.*

135. Boies, *supra* note 53.

136. Jim Calloway & Mark Robertson, *Alternatives to the Billable Hour*, ATTICUS, http://www.atticusonline.com/graduates/graduate_main/alternatives_to_the_billable_hour/ (last visited Nov. 8, 2012).