Case Study:
The Use of KM in Establishing Fixed Fee Pricing

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The Challenge: *Client requested a fixed fee for a multijurisdictional product liability case.*

Proposed Solution: *Utilize billing history as a foundation for developing a budget to establish the fixed fee.*

The History

Common Knowledge Management (KM) wisdom holds that analyzing past billings is a constructive effort for building new budgets to use in establishing fixed fees and other alternative fee pricing. Past matter billings can tell you how much time, the level of time keepers used and how to budget for specific types of matters including phases and hopefully tasks. This wisdom points to KM as a necessary tool/approach for accessing and analyzing this information.

In order to understand and appreciate the outcomes of this case study, we will explore the underlying assumptions about KM's role in addressing Alternative Fee Arrangement (AFA) challenges. KM is an obvious partner or driver of effective AFA management. The industry needs KM to develop effective pricing knowledge. So how and where will KM bring the highest value to understanding and driving successful AFAs?

The first step is to understand pricing; which includes budgets and fees. Beyond that, KM can serve as the knowledge driver, moving firms from a cost-plus business model to a profit margin model. Using the traditional hourly model, profit is built into the hourly price, requiring only a basic level of KM to sustain a profitable venture. However in a profit margin model, the role of KM will become mission critical. A law firm's ability to deliver cost effective services at acceptable profit margins will be driven in large part by the firm's ability to effectively and efficiently access and utilize its knowledge base.

This case study reveals a microcosm of that challenge. It also highlights some inherent weaknesses in the existing knowledge base and legal KM methodology and suggests one area where KM can play a vital role going forward.

For our AFA in question, we started out following the common KM wisdom noted above. Reviews of past billings were conducted to help establish a viable budget for setting the fee. Two findings immediately discovered in the process were:

Point 1 – Past billings appear to have a low value for pricing future work.
Point 2 – KM is necessary going forward.

Point 1

Reviewing and analyzing past billings for numerous matter types has produced very little value. Few patterns have been discovered in the billings and no real cost per matter type or task has emerged. In fact the opposite was found. Findings include:

A) Going back more than two or three years on billing history is problematic since practice approaches have changed dramatically and continue to change. The days of employing large numbers of associate hours at-will are gone and past billings tend to reflect that approach.

B) From analysis of past billings for similar matter types, there does not appear to be easily definable budgets or even strong trends within the data. The specific circumstances of each matter have a strong influence on the overall billings per matter and the timing of the fees.

In retrospect this is not surprising since time keeping practices have not taken such needs into account. Time entries have been all about the narrative a client will accept and not about the phase, task or type of work. Therefore, the information is not structured such to enable useful billing analysis.

To highlight these findings, presented below are two examples from efforts made leading up to the AFA in this case study.

<u>Example One</u>:
Matter type: Simple type of common litigation.
Conducted review of fees for 30 plus of matters. The matters were hand selected by the partners involved to insure consistency in the type. Fees were evaluated for overall amount and on a month-by-month basis. Variations in fees from smallest to largest: 255%. Follow-up calls with partners involved lead to discovery of reasons for variance. These included; early settlement, plaintiff died, bad jurisdiction, good jurisdiction, key individual, key case, went through trial, etc.

<u>Example Two</u>:
Matter type: moderately complex, but common litigation.
Conducted review of fees for 50 plus matters from the same client. In this scenario we hoped to isolate variations by limiting the research to a similar matter type for the same client. Again, matters were hand-selected by partners to insure consistency. Variations in fees from smallest to largest: 300%. Follow-up calls revealed the same reasons as noted in Example One.

Conclusion: Spending significant KM resources to mine past billings is a poor use of KM resources.

Point 2

We need and want this fee knowledge and KM will be the best tool for obtaining it.

Starting today, law firms can begin to capture this fee information, especially on AFA-type engagements. All of the information noted above that firms have never tracked or cared about will require new processes and systems. This level of change will not come easy to a law firm. Strong leadership buy-in and support will be necessary for any success in this goal.

Firms can look to specific practices or clients to start this effort. Practices like IP are already inclined to capture more detailed and better information. Clients who require e-billing (and the use of phase and task codes) would be good candidates to start with as well.

Ultimately firms should build better knowledge about the costs they have for different matters, phases and tasks. This knowledge would allow a firm to understand its cost of delivery for various types of matters and various segments of that work. This is the real goal. If a firm knows its costs for the investigation phase (a.k.a. the L100 codes) for a given type of case, they can price such a phase at a much higher level of certainty.

<u>WARNING</u>: Your lawyers want these numbers for the wrong reason.

Most lawyers will do anything to avoid talking with clients about fees. If they have a fee amount and type for a given matter type, they will starting e-mailing it out to clients instead of talking with them about their needs and concerns related to fees. The e-mail effort will not work. So be careful about having your KM / AFA wish come true.

The Exception: Our Case Study Example

Using the subject of this case study, we were able to determine costs based on segments, only not the segments we predicted. As in the examples noted above, we were hoping for some phase or task based patterns to show up since this example took things one step farther, in that the matter types were essentially identical (same product liability claims) and they were all for the same client in the same timeframe. Again we were disappointed in attempting to isolate case segment billing patterns.

However, in this circumstance past billings had a high value. We identified a past product liability case, with an MDL[1] in place and began analyzing the fees. Instead of the overall fee or fee per phase numbers we initially sought, what ended up being valuable was the fee per case numbers and how they evolved over time.

First, there was a relatively small number of cases that had very high fees. Logically, these were initial key cases where the science was established, discovery was conducted, and cases were worked up for trial or even tried. These are the cases

[1] MDL: Multidistrict litigation (MDL) refers to a special federal legal procedure designed to speed the process of handling complex cases such as complex product liability suits, by combining all cases involved.

where precedence was set, even by jurisdiction, for the remainder of the cases. It should be noted that some early cases did not fit this profile and may have been in the lowest cost category once the entire set of cases was resolved. However, it was clear that the high-fee cases were definitely early stage filings.

Following the small group of very high fee cases, were groupings of cases that fell into stages of lowering fee per case groups. So the analysis shifted to finding out where the drops in fees per case occurred along this spectrum, what caused the drops and then how this analysis applied to the new set of cases and budget.

Here are the primary factors found for different fees per case:

1) Highest fee cases – worked up for trial or go to trial, typically very early stage, but not always. There were a group on the federal level, spread out nationally, but then there were also specific cases indentified in key jurisdictions.

2) Jurisdictions: In MDL federal court prevails, except in states where the defendant has a physical presence, in other specific states, or in states with very aggressive plaintiff's lawyers.

3) Sympathetic Plaintiffs: Certain plaintiffs based on their situation, can drive higher fees in a single matter. Example: young mother with two small children, versus 80 year old man who smoked his entire adult life.

4) Aggressive plaintiff's counsel: Usually in certain southern, plaintiff friendly jurisdictions, but not always.

5) At certain stages, large drops in fees per case occur: some initial drops were based on resolution of the first stage, high-fee cases. These drops also occurred when certain science experts had weighed in and courts had accepted their opinions.

6) Volume counts: at a certain point, cases enter into a settlement processing phase. Here fees per case are quite low, leverage is very high and the fee number flattens out.

THE BIG LESSON: The shape of the curve. When does the fee per matter drop and how fast does it drop? Next, at what level does it settle in to settlement processing fees?

By understanding the shape of the curve, we could apply the same thinking to the new case, adjusting for fee levels for the first group and then grouping other cases at different levels based on their jurisdiction, etc. The result was a solid fixed fee proposal for a 12 month period that accounted for the various groupings of cases as they were expected to come in and evolve over the 1 year period. With this approach you could also group cases and give either a fee per group or even a fee per case within the group, spreading some fee risk across the cases in that group. Of course, spreading risk across matters becomes much easier as volume rises. This is even the case in the fee per year approach noted above - volume matters.

Conclusions of Case Study

There is a well-defined need for law firms to better understand the costs of their services and to understand these costs at greater levels of detail going forward. Without this knowledge, setting profitable pricing will continue to be problematic. Experience has shown that using existing historical billings in this effort has not proven valuable, except for the specific exception in this case study. Although law firms own significant amounts of knowledge related to this issue, it was not captured with this need in mind and can be federated across multiple systems. In the past, no one ever even wondered about the cost of a deposition or due diligence, so time entries didn't note this type of detail. Only recently has this need been fully realized.

This case study demonstrates that KM can play a critical role in making sense of law firm billing knowledge. However, going forward, different processes and systems need to be implemented.

The case study also demonstrated the inadequacy of existing KM resources for this task. Accessing and analyzing the past billing information and understanding case fee differences was a highly manual process. Numerous systems were used along with highly complex spreadsheets. It is clear that new KM systems are needed and will ultimately have high value. This level of manual effort could not be sustained over even a moderate volume of matters and AFAs.

The case study reveals the value of understanding your costs at the right level. In this scenario we discovered patterns that we had not originally searched for and these patterns become critical to the success of the new budget and fee.

KM is the best option for addressing the issue of understanding our fee and pricing knowledge going forward. Our case study demonstrates that where structured information exists, even at modest levels of detail, value is derived. KM projects will want to directly address this need going forward, developing tools for ascertaining costs at the right level of detail. It is past time to institute the right KM processes and system for meeting this critical need.