



Law Department Management

Matching Work To Bonuses

Techniques to help overcome the complications.

BY REES MORRISON

In a world that favors pay-for-performance, bonuses dangled by law departments for firms that achieve an especially desirable outcome are in vogue. The seeming simplicity of promising a cash sweetener if your law firm succeeds as agreed, however, glosses over several concerns. After a quick overview of bonuses, this article discusses several of those concerns and then offers some curative techniques to put into practice.

In a Nutshell

A bonus can attach to a single matter, such as the outcome of a major acquisition or lawsuit, or to a group of matters, such as all lease negotiations for a 12-month period.

Bestowal of a bonus can be subjective (“if we think you deserve it”); objective (“a 30 percent reduction in the number of lawsuits against us next year”); or a mixture (“We will top off your fees by up to 15 percent if we get regulatory approval for our application within six months.”)

A bonus can come on top of standard fees charged or be the restoration of some or all of the fees held back during the matter. For example, a law firm might agree to discount its hourly rate in return for a bonus if a good verdict or settlement is reached.

Some of the Tensions

The following section describes some of the difficulties that bonus arrangements create.

- Time constraints at the start may make it difficult to figure out an effective bonus.

It takes time to figure out arrangements such as bonuses or holdbacks. Even when both sides are amenable to a novel payment

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structure, time passes while the concepts are articulated, hashed out, reviewed, and refined. In the meantime, a complaint may be served, and the clock starts ticking. That clock may constrain the ability of a law department to negotiate a bonus arrangement with its litigation firm. After all, there have to be appearances made and answers filed. Plaintiffs often grant extensions, but one never knows.

Another factor is that law firm partners can try to game the arrangement; for example, if settlement dollars are not included in the equation, they will push for the company to pay to resolve cases. This can create constant tension.

- Bonuses often do not take into account the likelihood of events that trigger them.

Alternative fees ought to target desired outcomes, and be sized in proportion to the odds. If you agree to an extra fee for some result that is virtually a given, such as settlement of a typical lawsuit, you will pay more but get the predictable result. The longer the odds of success, the larger should be the bonus.

It sounds straightforward, but to figure out the odds of some event happening in the swirl of many scenarios and then to attach a dollar figure to that event is quite challenging. Worse, I am quite sure, partners may view the odds quite differently than the responsible in-house lawyers.

- Inducements may not materially change the quality of a law firm’s effort.

Competent lawyers at good firms work hard and try mightily to succeed, so you have to wonder whether a cash bonus months or years away actually heightens their resolve and effort to any measurable degree. Many associates might not even know that a bonus lies out there to be won.

True, even if day-to-day effort may not change, the strategic focus of the engagement partner might change: “Our client wants this resolved in nine months or less, so I will concentrate on achieving that goal.” But then the question arises whether that person can make much of a difference. It seems odd to reward a law firm when

there are many other participants in a successful outcome. The financial group, strategic planning, the other side, judges and competitors, business executives all pitch into the outcome.

Hard to get around is the concern that law firms lack leverage either way. In the words of one general counsel, "When a project goes wrong, it is rarely the lawyer's fault, so I wouldn't expect them to share the pain with us [a holdback on their fees]. When a project goes right, why would I want to share the upside with them [a performance bonus]?" This same view ought to prevail for litigation.

- Bonuses do not fit as well with hourly engagements as with fixed-fee engagements.

If a law firm works on a cost-plus basis—being paid for each hour its timekeepers log—there is less justification for a law department to top off that amount with a premium. The firm has fully factored in its profit levels to its fee structure. And, nearly all law firms bill most of their matters on the basis of hours worked multiplied by rate charged.

By contrast, if a firm takes on a matter or a set of tasks for a fixed amount, then if it completes its work very successfully, a bonus might be more instrumental. The firm has taken some risk by agreeing to a set fee so a bonus opportunity provides some offset.

- Bonuses may present difficult decisions to corporate counsel at the end of the matter.

Those who manage outside counsel have some concerns about success-based billing arrangements because they will have to make what might be a difficult decision at the end of the matter: What value do I put on the performance of the firm in relation to the outcome? The problem, sometimes, is that we cannot describe in advance what we mean by value.

It may not be clear, for instance, how to define a "successful" outcome of a complicated lawsuit or whether there was a benefit to the company.

Perhaps the unease of the responsible in-house counsel arises because the decision

of what to award must be comparative, and usually the arrangements are negotiated for unusual, important matters as to which the lawyer has had little experience.

In addition, perhaps the lawyer anticipates that the law firm is likely to be disappointed at the amount awarded. These psychological drawbacks deter lawyers in companies from agreeing to success-based bonus arrangements.

- Strategies of the company may change and undermine the bonus deal.

The company may change its mind as to the desired process or result. It may no longer want to buy the other company, or proceed with the massive re-zoning request, or pursue its rights through arbitration. If a bonus hinges on some action of the company that it no longer seeks, the law firm that depended on the discarded strategy comes away with nothing.

Techniques to Follow

Life in bonus land is not all bleak; in fact, law departments and law firms should move away from hourly billing and embrace more bonuses, but bonuses that minimize the risks and concerns described above. Several techniques are available.

- Enlist the law firm in the determination. When a firm might be eligible for a bonus, ask the partner to state the firm's case for why it should deserve a bonus and in what amount. Then the law firm has to introspect and pick out what aspects of its services were above and beyond, or what results were significantly better, than might have reasonably been expected. The law firm's response will be self-serving and well-spun, but it will push the law firm to assess its performance somewhat realistically. The firm's observations will complement the assessment done by the law department's managers. They will help the law department come to a conclusion about the appropriateness of a bonus payment.

- Match likelihood to amount of bonus such as during the competitive bidding

process. Bonuses to law firms ought to correspond to the likeliness of the outcome and the value to the client of that outcome. Since many bonus arrangements develop after a competitive bid process with several law firms, to try to bring into alignment the incentive and its likelihood, ask the law firms that are competing for the business to estimate the likelihood of various scenarios.

While far from irrefutable, at least if several experienced firms weigh in on the probabilities of a scenario, such as prevailing on a motion for summary judgment within 12 months, a law department can more rationally match incentives to the probabilities of their achievement. Over time, too, the law department will develop a better sense of these probabilities.

- Cast the bonus as a holdback restored.

One effective tool is to agree to a holdback, such as 15 percent of the fees incurred. If the firm performs exceptionally, it gets back the funds in the pool. If not, the firm absorbs the loss. Large firms can better absorb the cash flow crimp of a holdback, and their cost structure may be higher, but still the technique is widely available. Moreover, some people believe that mid-tier law firms and specialized boutiques are more willing to put some skin in the game. They may feel they need to do that in order to break into the major leagues of legal services or because they know the particular services very well.

Conclusion

In summary, bonuses raise concerns but there are countervailing techniques available. Forward-thinking law departments should work bonuses that are usefully constructed into their arsenal of management techniques.