



Panel: Alternative Fee Arrangements

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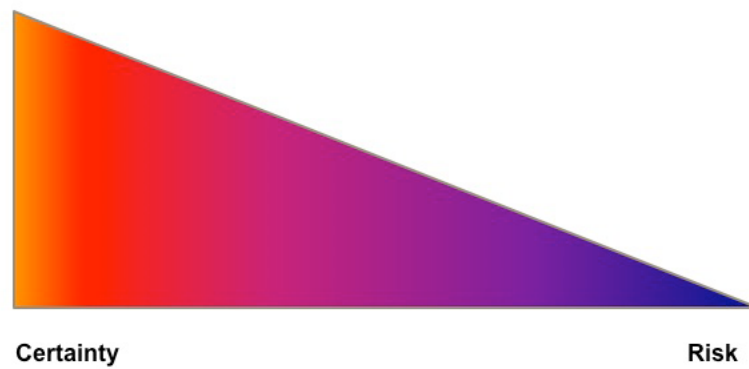
Types of AFA's

- Contingency Fee
- Flat/Fixed Fee
- Capped Fee
- Holdback/Success Fee
- Blended Fee
- Shadow Billing
- Other

Pros/Cons

- Risk
- Certainty
- Trust

Certainty vs. Risk



Win-Win Alternative Fee Arrangements

By Colin Cameron

American Bar Association, Volume 38 Number 4

Law firms have been providing AFAs for commodity personal legal services, such as residential conveyances and wills, for years. But that's not the case for most business law and litigation work. Clients are asking for AFAs in these areas, but law firms aren't rushing to offer them. This drives clients to look for options, and forward-thinking small firms are increasingly using AFAs to steal large clients away from big law firms.

In a climate where major clients are pushing for—and getting—discounts of 20 percent or more, the legal industry needs to adjust to current trends if it wants to survive and thrive. A New York State Bar Association report issued in April 2011 states that alternative billing will be the legal industry's dominant form of billing in the future. It's time to get on board with this concept.

GETTING STARTED

To succeed using AFAs, you need to present a unique value proposition. Unless you offer your clients something your competitors don't, you'll soon find yourself in a price war. That's just a race to the bottom, as there's always someone willing to charge less.

Start by asking your clients what they value most. Many law firms are afraid to ask this question, as they feel the value of their services is worth less than the price they're charging. But asking about what they value most, as well as their strategic goals, adds value to your services by showing the client that you really want to be a strategic partner. Once you know your client's goals, you can organize your legal services to best meet his or her long-term needs.

Another important way to add value is to put the client's profits ahead of your own. Most law firms start their strategic planning by setting their own profit targets, instead of thinking how they can help their clients increase their profits. When you help your clients achieve their profit targets, they are happier and more likely to give you more work—which means your profits increase as well.

The Association of Corporate Counsel (ACC) offers some great tips for adding more value for clients in the document "51 Practical Ways for Law Firms to Add Value," available on its website.

Ron Baker, a CPA who has written several books on the concept of value pricing and has thousands of loyal followers, has been using this concept in the accounting industry since the early 1980s. His ideas apply directly to the legal industry as well.

Baker proposes the formula "value = customer profit - price." In other words, value is defined as the impact your legal work has on a client's profit, less the price you charge for your services.

In his book *Implementing Value Pricing*, Baker propounds an eight-step plan for pricing a fixed-fee job up front. Baker's concept of value pricing is very different from the value-billing concept most lawyers have understood for decades. For example, lawyers working on an hourly basis often try to charge a premium at the end of the file, based on extra "value" as they themselves perceive it. On a \$30,000 file, if the lawyer recovers a significantly higher amount for the client than expected, he or she might try to charge a premium of 20 percent, or \$6,000. The client might respond, "Why are you charging me a premium? Didn't we have a contract for an hourly fee?" The lawyer then points out that the fine print of the engagement letter allows him or her to charge a premium on top of the hourly rate—a premium set at the lawyer's discretion rather than the client's perception of added value. At this point, the client often just says no, decides to use a different lawyer next time, or both.

Under Baker's value-pricing system, you calculate the value and price up front, not at the end of the file, as is done under hourly billing. Discussing the premium parameters before you start work on the file ensures that there are no surprises for the client. Rather paradoxically, the client is often willing to pay a premium for certainty about the premium, thus boosting your returns on these AFA files.

Through similar means, pricing up front can also garner you a larger retainer. If you have scoped out the work properly and can give the client a solid idea of what the total legal fees will be, he or she will probably be much more willing to give you a retainer for at least half of the fixed fee up front. Under hourly billing, the client is more hesitant to pay a retainer up front, due to uncertainty. In short, you stand to get both a larger premium and a larger retainer simply by setting clear parameters.

So you need to negotiate both the value and the price of the legal work at the outset in a conversation with

the client. Ask the client what he or she values most, and let the client's perception of value—not yours—determine the price you charge for your legal services.

DETERMINING COST

Once you've set the price for your fixed-fee service, you need to determine the cost to do the job. You'll need to budget costs to arrive at your desired profit margin. If you can't keep your costs below your offered price, you should simply decide not to take the job right now.

Baker's value pricing approach suggests that you should do your time sheets up front, not as you are doing the work. It's true that this lets you determine your costs for pricing purposes in order to achieve your desired profit margin. However, I recommend that you still track time to understand the costs and profitability of previous files. Your time sheets provide important guidelines for costing out future jobs and thus ensuring that you price for optimal profitability.

Clients often try to use AFAs to get a discount on fees. Offering discounts, though, can oblige you to get pretty creative to compensate for the loss in profit. For

The pros and cons of 5 popular alternative fee arrangements

AFAs are an extension of the partnership between in-house and outside counsel

By David Liston, Alex Patchen, James Delaney
Inside Counsel - August 10, 2012

When most in-house counsel describe their job, the description usually includes language to the effect of: "No two days are alike and I never know the next surprise that will come across my desk." There are, of course, nice surprises and unpleasant surprises. Of the unpleasant surprises, perhaps none is more unwelcome than a larger-than-expected legal bill. To minimize these surprises, corporate legal departments are increasingly using alternative fee arrangements (AFA).

The ABCs of AFAs

AFAs generally fall into one of five basic categories: contingency, flat fees, capped fees, blended fees and holdback.

1. Contingency. This is the oldest and most well-known

instance, if you provide the client with a 10-percent price discount and your profit margin is 40 percent, you're looking at a 25-percent cut in profit. A better alternative is to focus on building your value proposition to attract more premium work.

To keep overall costs to a minimum under alternative billing, you need to use leverage to your advantage by moving the work down to the lowest possible level of staffing. Smart firms are implementing project management techniques to increase effectiveness and efficiency.

Using AFAs may also oblige you to improve your fee-budgeting skills. Most lawyers aren't very good at budgeting, as they've never had to do this under hourly billing. You should be prepared to do more work on this up front to meet your profit margin targets.

Clients want the AFA issue addressed now. So get ahead of the curve: Partner with them, instead of resisting them, and prepare for alternative billing. By providing more value to clients and increasing efficiency, you can offer a better service while increasing profitability. That is the ultimate goal.

form of AFA. In a "pure" contingency fee arrangement the client only pays the law firm if it obtains the agreed-upon result. While contingency usually occurs in the context of representing a plaintiff, it can also be useful in defendant cases or for determining fees in transactional matters. When used with a defendant, the company and law firm agree upon an expected damages amount. If the damages are equal to or lower than that amount, then the firm receives a fee, which grows in proportion to the extent that the damages are under budget. In the transactional context, the firm's fee, which is generally a percentage of the size of the transaction, is dependent on completing the transaction. This arrangement usually includes a "broken deal" fee that provides some protection for the law firm.

2. Flat fees. This is the most common AFA. In a flat fee arrangement, the firm agrees to represent the company in exchange for a specified fee, regardless of the number of billable hours. While this provides cost certainty for the company, if the firm quickly resolves a matter, the company may end up paying a higher fee than if it paid an hourly rate. The AFA can be structured so that the law firm earns a flat fee on a task-by-task or stage-by-stage basis within a single matter, or in a

broader approach, for all of the company's legal needs across the board or in a given practice area. A flat fee, of whatever sort, is usually most appropriate for repeat or repetitive engagements where both the company and law firm have a similar understanding of the necessary work and the amount it should cost.

3. Capped fees. Under a capped fee agreement, the company pays on an hourly basis, but the law firm agrees that the total bill will not exceed the capped amount. A cap is often accompanied by a minimum fee, which together are sometimes referred to as a "collared fee" agreement. A capped fee provides the company with cost certainty, but, particularly for the law firm, may not be appropriate for cases in which the scope of the engagement is unpredictable. The parties can agree to use a "soft cap" in these more amorphous representations. With a soft cap, the parties agree on a maximum fee based on specific agreed-upon assumptions. If the assumptions turn out to be wrong, resulting in a cap that is substantially less than what the work would otherwise cost, the law firm and the company agree to adjust the fees accordingly.

4. Holdback. Under a holdback arrangement, the company agrees to pay the firm a specified percentage of the firm's standard hourly rate. Based on agreed-upon criteria, at the end of the matter, the firm is entitled to receive anywhere from \$0 to an amount exceeding the amount of the holdback. The basis for determining the additional fee can be subjective or objective. This approach links the law firm's fee to the client's satisfaction with the representation.

5. Blended fees. Under a blended fee arrangement, the company pays the law firm a specified hourly rate, regardless of the individual lawyer's hourly rate. This incentivizes the firm to appropriately delegate to less expensive attorneys rather than have its more expensive attorneys working at substantially reduced rates.

In addition to the categories above, in-house and outside counsel often work together to develop a hybrid fee arrangement that tweaks and combines elements from several types of AFAs to create a bespoke solution that meets their mutual concerns and interests for that particular engagement.

AFAs, friend or foe?

Are AFAs good or bad? More and more lawyers on both sides are recognizing that AFAs are not entirely boon or bane. Many factors go into determining whether or which AFAs are appropriate and the circumstances in which they are most likely to create a "win-win" situation. Echoing the views of several in-house counsel interviewed in connection with this article, Tara Martin, deputy general counsel for Travelex The Americas Inc., an advocate of AFAs, stated that she firmly believes that AFAs will only succeed "when you have a true partnership between the company and the law firm." When the company and firm do not communicate with each other, at least one of the parties is dissatisfied with the AFA, according to Martin. She has found that "fee agreements do not work where one party is trying to get a 'deal.' In a successful fee arrangement, both the company and the law firm are satisfied with the overall bill."

If a law firm is not responsive to a company's business objectives, it may raise a red flag as to the nature of the relationship. Instead, the law firm should seek to create a symbiotic relationship, working to understand the company's concerns and designing, in a collaborative manner, the appropriate fee arrangement that is consistent with the law firm's goals, while also providing in-house counsel with the assurance they need in an already volatile business environment.

James Delaney, a specialist in litigation funding brokers and director at TheJudge, provides a broker perspective.

As described in my earlier article for Inside Counsel, the external litigation funding market is adapting to the needs of larger corporate enterprises. Where funding is secured, it will often be in tandem with one of the AFAs described above. Approached properly, a funding package can create a symbiotic relationship between client, law firm and funder, each with risk alignment to the other. The level of risk/reward is a matter for open and transparent negotiation, since there ought not to be competing or conflicting interests. The multitude of available AFAs and tailored litigation funding/insurance products provide enormous flexibility to in-house counsel in their bid to achieve cost certainty and avoid unwelcome legal bill surprises.

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Lewis Wiener, an experienced trial attorney with more than 25 years of trial and counseling experience, brings creativity and energy to his representation of corporate entities and individuals in state and federal court litigation throughout the United States. Lew heads Sutherland's Financial Services Litigation Team, is co-chair of the firm's TCPA defense practice, and is a member of the firm's executive committee. His extensive civil litigation and trial experience includes serving as class action defense counsel and as arbitration counsel, conducting large internal investigations, handling complex litigation matters, and defending entities in connection with investigations and enforcement actions brought by government agencies. Lew also represents clients in eminent domain/inverse condemnation, environmental and land-use litigation before state and federal trial and appellate courts.

A former trial lawyer with the U.S. Department of Justice, Lew draws on his experience representing executive branch agencies to represent clients in court and to advise clients on regulatory, compliance and enforcement matters at the federal and state level. While at the Department of Justice, Lew was twice recognized by the Attorney General for special achievement in the handling of significant litigation matters on behalf of the United States, and he was lead government counsel in the largest class action ever filed against the United States. Lew also serves as pro bono partner for Sutherland's Washington, D.C. office.

Lew holds prominent leadership positions in national and local organizations including serving as co-chair of the Washington Lawyers' Committee for Civil Rights and Urban Affairs, as president of the United States Court of Federal Claims Bar Association, and as a member of the Board of Trustees of the State University of New York at Albany. Lew also chairs the investment committee at Norwood School and is a member of the Norwood School Board of Trustees and the Board of Directors of Washington Hebrew Congregation.

Practices / Industries

- Litigation
- Class Action Defense
- Financial Services Litigation
- Complex Business Litigation
- U.S. Court of Federal Claims
- Appellate
- White Collar Defense
- Environmental
- Natural Resources
- Construction
- Director & Officer Liability
- Insurance
- Consumer Financial Services
- Crisis Management
- Telephone Consumer Protection Act (TCPA)
- Privacy & Data Security

Education

- J.D., American University Washington College of Law, Managing Editor, American University Journal of International Law and Policy
- B.A., cum laude, State University of New York at Albany