

Are Alternative Fee Arrangements (AFAs) the New Standard for Law Firms?

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The Supreme Court of the United States answered this question when they released the opinion for *Perdue v. Kenny A.* In this case, the Supreme Court rejected the statement "departures from the hourly billing are becoming more common." In addition, the court noted "if hourly billing becomes unusual, an alternative to the lodestar method [hours worked times billing rate] may have to be found. However, neither the respondents nor their amici contend that that day has arrived."

Are AFAs new?

Although the U.S. Supreme Court stated hourly billing is the usual practice, alternative fee arrangements remain a growing trend in law firms. From 2008-2010 law firms have seen an increase in AFAs from 4-16% (Source: CounselLink). However, the question remains are AFAs new or are they a natural evolution?

Alternative fee arrangements have existed for decades in many law firms. Examples include blended rates, contingency fees, fixed fees, capped fees, collared arrangements, etc. Although the concept of AFAs is not new, the push to offer more alternative arrangements has never been more prevalent in law firms as it is today. Key drivers of this shift are the economy, the ACC Value Challenge and the clients demand of more risk sharing and consistent, transparent, value-based project pricing.

The ACC's Value Challenge is based on the concept that law firms can improve the value of delivering legal services without increasing the cost. For law firms, this concept alters and increases the focus on efficiency in the delivery of those legal services. This new focus on efficiency creates a demand to price legal services, manage the legal work process, manage the right talent and form a strategic alliance with clients to improve the service delivery. Clients are now looking for transparency and true cost control. AFAs are the new way of delivering on these demands.

Ultimately, alternative fee arrangements are about risk sharing. With the economic and global shift, clients and companies are now in the driver's seat. They are attempting to shift more risk of legal service delivery to law firms. However, law firms are only agreeing to this risk transfer as long as the arrangements are still profitable.

What do law firms do now?

As AFAs become more common, how can a law firm compete in this area? Law firms must understand the different sides to alternative fees - estimation and management – and align their firm strategies to these areas.

First, firms need to learn to estimate the cost of legal services. Estimates and budgets must now be based on cost rather than billable rates. Firms are beginning down this path of price estimation with many different budget and estimation tools that are new to the market. A standard starting point is data mining previous matters of similar nature of suit. This process provides an accurate view of prior costs for a type of service. However, using historical data can also show the inefficiencies in those former processes. Finally, the data mining of former data can be incredibly difficult if law firms have not previously used phase and task billing codes in their time entry system.

Next, firms must learn to manage the alternative fee arrangements effectively in order to remain profitable. Budgeting tools, case management tools/ strategies and process analysis are key pieces to this phase. As stated above, there are many new budgeting tools to the market that now help law firms manage budgets and control expenses. However, most tools rely on the use of phase and task billing. In addition, law firms are now considering strategies to aid their attorneys and staff in the understanding of legal project management. This is a difficult task to accomplish because lawyers are not project managers by nature and the norm is not to look at legal work in phases or tasks. Finally, firms are looking at any and all tools that exist within their firm or outside their firm that can aid in efficiency. Things such as document assembly, form production, expertise databases, case/deal management software and extranet collaboration with clients are just a few tools that firms are considering. When an alternative fee arrangement is used, without management of the budget, deal/case and processes, the risk of profitability loss now falls to the law firm instead of the client.

What will change?

The largest change seen by law firms is that billable rates are no longer the driver of profitability. Firms have previously been raising rates at a 6-8% increase with each passing year. With the economy, the practice of raising rates had to change. We now live in a buyers-market for legal services. Clients no longer stand for the standard rate increases but instead now look for a strategic partner. Additionally, the entire law firm model on compensation and partner track are called into question with the change from billable hour and rates. Firms that move to alternative fee arrangements need to look to alternative metrics and measures for compensation, partner track, staffing and bonuses. Some firms are turning to metrics such as overall performance, expense management, practice management, client development, and leadership skills instead of the maximum billable hours.

Conclusion

In conclusion, alternative fee arrangements are not the new standard for law firms in 2010. Currently, AFAs only make up 10-16% of business. However, just as we saw this percentage increase from 2008 to 2010, we expect a further increase over the coming years. In order to stay competitive, law firms must determine their stance and strategy with AFAs and learn to remain profitable in this changing time.

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