# The Ethics of Alternative Billing

## Do AFAs Create Conflicts Between Clients and Attorneys?

By Jeff Vanderpool and Daniel P. Costello

There are those who find problems, and those who find solutions. Lawyers by nature are very good at identifying potential problems for clients. However, what the legal industry has often failed to do is to take risks to solve problems. Law students and young lawyers are taught to avert risk at all costs and to let the client decide. Insurance companies by nature are in the risk business, and theoretically need to take calculated risks to derive profits. What happens when the need for calculated risk, meets the ethical guidelines that attorneys need to live by in their profession? With the legal market changing significantly, both clients and attorneys have had to change their business model, including the use of Alternative Fee Agreements (AFAs). But does the use of alternative fees create potential ethical dilemmas for attorneys? More importantly in the insurance tri-partite scenario do alternative fees create ethical issues and potential bad faith exposures for insurance carriers?

### Playing by The Rules

What do the model rules on ethics truly tell us about using AFAs? Skeptics argue that alternative fees only encourage bad faith suits as they curtail necessary work and set more cases for trial. But is there any evidence that this is true?

Often cited as an ethical issue is the primary rule for attorney billing arrangements, ABA Model Rule 1.5, which provides in part that:

> "A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses."

Under Rule 1.5, it is clear that a lawyer's fee must be reasonable and that the lawyer must fully communicate with the client about the fee in advance. What it takes to make sure that the fee is reasonable in the context of alternative fees is not defined, but commonsense applies.

In almost all instances when talking about ethics and alternative billing arrangements, the biggest concern or question centers around a lawyer's duties and abilities to provide independent advice and competent legal services. Naysayers hold out rule 1.5 (and the corresponding comments) for the proposition that AFAs limit representation, and provide incentives for the lawyer to spend as little time as possible thereby opening themselves up for ethical problems.

Those who are problem solvers view this differently. Namely, that the rules are the best champion of AFAs, since the client and the attorney agree on outcome-based risk that is shared by both parties. This is the definition of reasonable, and helps to eliminate situations where there are disagreements over what are reasonable fees. In nearly all AFA agreements the cost is known well in advance of a traditional hourly bill, which is fraught with potential for disagreement.

In addition, Comment 10 to Model Rule 1.7 states that "[t]he lawyer's own interests should not be permitted to have an adverse effect on representation of a client." These rules prohibit lawyers from allowing their financial interests to interfere with or supersede their obligations to their clients. This has implications for AFAs, but again back to commonsense, these rules apply to any attorney handling any matter for compensation. If the goals of counsel and the client are aligned, then for counsel this potential pitfall is eliminated. Communication is key, and this includes putting the fees in writing, up front, and then having a discussion about any potential areas of concern. With informed consent in writing both parties are protected.

## Aligning Goals

In dealing with a tri-partite relationship there are ethical issues lurking around every corner. Courts have held that when an insurer undertakes the defense of its insured they have a duty to employ competent counsel and that defense requires the incurring of reasonable and necessary costs to that end. Do alternative fees prevent either of those obligations to the insured?

Since the early 1990s, the insurance industry has introduced technology, business process and standardization in an attempt to improve claims handling, legal focus and provide benefit to its insureds. These improvements have included the introduction of litigation guidelines, bill review programs and counsel guidelines. Most of the challenges to these programs as bad faith have fallen to the wayside and they are now embraced as best practice in the industry.

Similarly, AFAs should be embraced by the community as they do not interfere with the selection of competent counsel or reasonable costs of defense. If fees are structured properly and counsel has the potential for making a profit, then there are no financial considerations that prohibit sound representation of the client. Additionally, in the insurance context, quick resolution of a claim is often in the business interests of the client.

In reality, the use of AFAs only enhances the working relationship with retained counsel by eliminating the number one cause of friction between insurance carriers and counsel — that of the billable hour and fee reductions. With the right AFA in place, counsel is able to focus exclusively on the process and strategy of litigation without consideration of whether the bill will be too high or deemed unreasonable. The goal is to provide current and potential clients with a well-reasoned, experience-based, value pricing model that is in their best interests. Does hourly rate reflect value? If indeed AFAs were a sign of bad faith, wouldn't the same be true for negotiated rate discounts on an hourly basis?

Those critical of any shift away from the billable hour often overlook the importance of predictable costs. However, the problem fixed by AFAs is not one of trust, but of accuracy. Regardless of the billing practice used, no client would engage any counsel that abused their billing practices or produced ineffective results. Rather, the AFA is simply an alternative billing type that shares the risk of litigation costs and creates a strategic partnership. Clients like it because it is predictable. Attorneys like it because it is profitable and truly sets apart their value.

## AFAs Reward Results

AFAs reward early case resolution, winning a matter on a dispositive motion, and early issue identification — essentially all goals of their clients. This is quite the contrast to being rewarded by the time spent billing on a matter. Clients are perfectly happy to trade incentives for reworking the current legal model, which may unwittingly reward longer rather than shorter resolution time. By thinking about the cases differently, attorneys resolve them differently with aggressive, tailored approaches to meet their clients' goals. It's problem solving at its best. LM

*Jeff Vanderpool is the Senior Vice President and Chief Claims Officer with Sunshine State Insurance Company. Daniel P. Costello is Managing Partner with Daniel P. Costello & Associates, LLC.*