

Embrace Alternative Fee Arrangements; Kill the Billable Hour

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The billable hour undermines professionalism. It incentivizes lawyer inefficiencies and undermines client confidence. Alternative fee arrangements align the incentives of lawyers and clients and should become the norm.

Despite Reports, the Billable Hour is Not Dead

When I started practicing, a story passed around by the senior partners at my firm was that of seeing a bill issued to a client by a big New York law firm that simply stated “For Services Rendered” and the then-colossal monthly amount of \$100,000. They seemed wistful that none of our clients would accept such a bill. Instead, our clients required bills that recorded a lawyer’s time spent on their matters broken down in quarter hour increments. Now of course, due to client demand for greater transparency, lawyers account for their time in tenth of an hour increments.

Reducing the increments of time lawyers must bill in does not necessarily raise transparency. Over the years, the number of yearly hours lawyers in law firms are expected to bill clients has risen. This simply means more tenth of an hour increments a lawyer must account for.

Lawyers who are judged by the number of hours billed are not rewarded for dealing with matters more efficiently or bringing special skills, or creative outcomes to the client’s matter. Especially as work becomes scarce, lawyers can feel pressure to bill more on the same client matters. They are implicitly encouraged to bill more on the file (how many associates have ever heard the expression “This file can handle more...?”) or even falsify the time spent.

This could be a contributing factor to the lousy public image lawyers have. In a 2013 [Pew Research Center Survey](#), only 18% of respondents responded positively to the statement that “lawyers contribute a lot to society”—down from 23% in 2009. In a 2016 [Gallup poll](#) only 18% of Americans rated the “honesty and ethical standards of lawyers” as high or very high. In weary contrast, year after year, during the [decade plus](#) that I have been working to promote professionalism, well over one-third of Gallup poll respondents (about 37%) characterize the honesty and ethics of lawyers as low or very low.

Billable hours provide a simple and familiar means of calculating fees, but ignore whether the lawyer’s work actually furthers the client’s interests. Many have written that the billable hour should be abandoned, [one of the notables](#) being Chicago BigLaw attorney and best-selling author Scott Turow. We have written previously about the importance of [delivering value to clients](#). How we price our services should reflect that value.

Types of Alternative Legal Fee Arrangements

Fee arrangements other than hourly billing have been around for a long time. The Association of Corporate Counsel identifies many common alternative fee arrangements in its [Guide to Value-Based Billing](#) and various other guides exist as well. A few of the most well-known are:

1. **Fixed Fees.** Fixed fees, as the name implies, are agreed to by the lawyer and client agree at the outset of the representation. This helps the client avoid the unpredictability of hourly billing and incentivizes the firm to avoid “over lawyering” the matter.

2. **Blended Rates.** A blended rate is a set hourly rate agreed to by the lawyer and a client regardless of the hourly rate that attorneys or timekeepers working on that matter may normally bill. From a client's perspective, blended rates may result in a reduction of the overall fees and provides more predictability than just straight hourly billing as there is less fluctuation between the hourly rates of those working on the file.
3. **Reverse Contingency.** A reverse contingency fee is based on a percentage much like traditional contingency fee representation, except the fee is based on a percentage of the amount that the firm saves for the client. This requires both the firm and the client to agree on the maximum exposure the client faces in the representation. Then the reverse contingency fee is calculated as a percentage of the difference between that maximum exposure and the ultimate resolution amount.
4. **Success Fees.** Success fees require the lawyer and the client to define what will be considered as successful, for example, an early resolution of the case or reaching settlement below a certain figure. If the firm is successful, it can realize higher returns and gain specific rewards for success. If unsuccessful, the firm shares the pain with the client.
5. **Capped fees.** Under a capped fee agreement, the client pays on an hourly basis but the law firm agrees that the total bill will not exceed a set amount. A cap is often accompanied by a minimum fee, which sometimes is referred to as a "collared" fee agreement.
6. **Holdbacks.** Holdbacks are not a standalone fee. Rather, they overlay another billing method and involve the client "holding back" a certain percentage of the fee to be paid upon the lawyer accomplishing certain agreed-upon performance metrics, possibly at various stages in the representation.

The fixed fee is the type of alternative fee agreement most embraced by corporate clients, according to BTI Consulting group. BTI Consulting Group surveyed general counsels and legal decision makers on their use of alternative fee arrangements. [BTI's 2016 survey](#) reports that 60% of corporate clients prefer fixed fees—three times more than the second runner up which was capped fees.

Are Alternative Fee Agreements Finally Gaining Traction?

The [2016 BTI State of Alternative Fee Arrangements](#) opens with this attention-getting statement:

Alternative Fee Arrangements (AFAs) now account for \$21.1 billion of outside counsel spending in 2015, and are the biggest growth market around. The jump in AFAs explains how clients have been able to keep their outside counsel spending flat while they experience growth in new, more complex matters. Alternative fee arrangements have finally become the cost control tool they were intended to be.

Outside counsel spending under AFAs surged to almost 36% of total spending in 2015, compared to close to 20% in 2012. Interestingly, the number of companies using alternative fee agreements has shrunk, as a smaller number of clients are spending substantially more on AFAs.

The reasons top legal decision-makers love AFAs? Improved focus, predictability in budgets, a more streamlined approach to the work and the savings. Clients using AFAs reported savings in 2015 of 13.9%, adding \$2.7 million to the average client's legal budget.

The survey also contains a leaderboard of 22 law firms named by corporate counsel as best at developing and delivering alternative fee arrangements. The six reasons these law firms stand out:

1. Partners have authority to enter into an AFA quickly.
2. The firm is enthusiastic and committed to AFAs.
3. The firm is flexible about changing the approach as the objectives evolve and are agreed upon.
4. The firm is willing to take some risk; they have skin in the game.
5. The best firms are focused and efficient about reaching the client's goal.
6. The best firms stick with the agreement and don't try to change it when things don't go well.

I am pleased to see that several Chicago law firms are on the list—including Seyfarth Shaw and Valorem Law Group. Representatives from each of those firms are going to be speaking at the Commission's [The Future is Now: Legal Services 2.017](#) conference coming up on May 18, 2017.

Embracing Alternative Fee Arrangements is a Profitable Strategy

Successfully entering into AFAs with clients means that lawyers have to thoroughly understand their costs of services sold and understand the client's needs. Firms that have a handle on this and that take a proactive approach to developing alternative fee arrangements with clients are achieving financial success.

The 2016 Altman Weil Law Firms in Transition [Report](#) shows that relatively few firms (28%) proactively initiate alternative fee arrangements. In contrast, the vast majority (72%) take a reactive approach in response to clients' requests.

When asked to compare the profitability of non-hourly and hourly work, 84% of the proactive law firms report that AFA projects are "as profitable" or "more profitable" than hourly-billed projects. In contrast, the reactive firms report that only 51% of their AFA projects are as profitable or more profitable than the hourly-billed projects. It appears that those firms that make a rigorous effort to understand and manage this relatively new market tactic are enjoying benefits.

So why aren't firms more proactive? It makes no sense in light of the fact that a significant majority of those who responded to the Altman Weil survey believe that the future will bring more price competition and more billing methods alternative to hourly.

We need to embrace alternative billing for good. The "\$100,000 bill anything" days are gone and will never return. We live in a world of dramatically increased transparency where our personal and professional lives are open to public view. Clients expect the same transparency in their work. Law firms that proactively offer alternative fee arrangements will benefit from the process. So will clients, and our profession as a whole

Jayne Reardon

Executive Director at [Illinois Supreme Court Commission on Professionalism](#)

As a prior trial lawyer, Jayne leads lawyers to embrace the transformative possibilities of future law practice. As a prior disciplinary counsel, Jayne is passionate about promoting the core values of the legal profession. She is a graduate of the University of Michigan Law School and the University of Notre Dame. Jayne lives in Park Ridge, Illinois with her husband and those of her four children who are not otherwise living in college towns and beyond.

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One thought on "Embrace Alternative Fee Arrangements; Kill the Billable Hour"

1. [Paul Bernstein](#) says:

May 11, 2017 at 8:20 pm

Do we assume that all potential clients are totally honest, make full disclosure of a matter and that a "fixed fee" will be fair and reasonable to the lawyer? Do we assume that most lawyers will not be honorable and do their best without acting in a fashion that will have the ARDC in Illinois on your "you know what" in an instant?

Why do we think the worst of lawyers? Why? And, if it a litigation matter and if after a month of trial on that one matter and we KNOW, we are absolutely certain that the LAW and the facts that came out at trial warrant a finding by the Court in our favor, but the Judge rules in our favor and on our motion might even grant a new trial and so we start over again, how can one figure that in? And, is this now a question of BIDDING and competing for a potential new client's business? when I got started as a lawyer in 1959, I thought thinking like a business person and BIDDING for work was unethical, like paying a referral fee to a non-attorney who sent you a PI case!

"The billable hour undermines professionalism. It incentivizes lawyer inefficiencies and undermines client confidence. Alternative fee arrangements align the incentives of lawyers and clients and should become the norm." I strongly dissent! Lawyers do not try to be inefficient, but how many bar associations have, over the years and even now, how many of them do what needs to be done, like having super – techy staff either on the payroll or

available at VERY reasonable rates, to serve as the technologists for law firms to rely on and assist in finding other capable technical individuals to become employees of the firm. Those of us who have been fighting the great fight of resistance to technology in law firms for decades know that what now seems a convenient time to blame some "bad lawyers" is to miss the point entirely. Bad lawyers should go do something else, but most lawyers are GREAT in their love for the law and because we can and do help people and we can and as often as not, are problem solvers.

"or even falsify the time spent." FALSIFY time spent?! Why even address this topic!? And, frankly, I resent such a statement. Do I think NONE of that goes on? Of course a bit of that goes on, but not by GREAT lawyers, not by lawyers who love the law, not by lawyers who see the LegalZOOMS of the world trying to take over and prefer to ignore that the more time in the practice the more valuable you are.

"ignore whether the lawyer's work actually furthers the client's interests." I am sorry to argue with such astute and well known writers/authors, but I find this totally offensive.

"The firm is willing to take some risk; they have skin in the game." AND, the goal of many business people is to shift the balance of risk to the law firm. I've seen situations where the client uses such tactics and statements to milk the law firm really big time and you know what, such clients go from one law firm to another to another, and sometimes with malice aforethought! By definition, in competitive industries, winners win big and losers go broke and lots of good business people just love to bury their lawyers and squeeze the life out of them. Just look at our problems with alcohol and suicide.

The real questions are much simpler:

What programs should lawyers use?
How do they make choices?
How do they get trained?
How do they know whether the product and company selected will survive?
Do we really think that all of us will be superstars in technology?
Or, will our law firm, our team, be a team with lots of various talents and wins?

NO, I am afraid that the when we dig deeper and deeper into the LegalZOOMS of the world we will find that we lawyers have made some awful mistakes by letting them get away with this wrong and dangerous thinking.

Paul Bernstein, Esq.