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Marketing Alternative Fee Arrangements

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Lawyers are an interesting group of people. We are often smart but can also be aggressive and strong willed—"sometimes in error but never in doubt"—and are trained to look backward—"precedent is king." So when something new comes along, the first inclination is for lawyers to say no, and then someone has to convince smart, aggressive, argumentative people to change their minds. And because many of us have grown up with billing by the hour, to ask us to change to an alternative method and market it to our clients can be a doubly threatening task—there is little precedent for that! But why are alternative fees being discussed so intensely now anyway? With the dip in the economy over the past two years, business clients are demanding it.

In a recent Altman Weil survey of large and midsize law firms, 81 percent of the large firms reported an increase in alternative fee arrangements (AFAs) over the prior year. AFAs are used by 95 percent of all firms surveyed. However, while two-thirds of the firms reported their use of such fees is primarily reactive in response to client requests, the remaining one-third reported being proactive as a means of creating a competitive advantage. Moreover, the report found: "Firms that are proactive in their pursuit of non-hourly business were more than twice as likely to report higher profitability on nonhourly projects compared to firms that are reactive." (The full report, *2011 Law Firms in Transition*, can be found at www.altmanweil.com/LFiT2011.)

The fact is, business clients are more and more demanding that their law firms look at alternatives to hourly billing as a way of translating the value of legal services as the client sees it—not as

COMMON TYPES OF AFAs

■ **Contingent or Success Fee.** Based on the results achieved, this fee requires a clear agreement as to what the desired results will be and what will not be covered under the fee arrangement. A common example in litigation might be a personal injury case based on a recovery. A common example in transactional work might be a success fee upon the closing of an offering or the funding of a loan.

■ **Fixed or Flat Fee.** This means charging for a defined service at a fixed or flat rate. It may be the total fee for the engagement or it may be for a portion of the services. An example might be a fixed fee for organizing a business or doing an estate plan.

■ **Task or Unit-Based Billing.** In this arrangement, identified tasks or components of the transaction are used to measure the fee. This arrangement may also be used in complex litigation or transactional matters where budgeting is required by the client.

the law firm sees it. The survey clearly points out that firms that are marketing and being proactive in suggesting alternatives to clients are more profitable in their use of AFAs than firms simply reacting to client demands.

The Key to Alternative Fees

AFAs are not about charging more than what an hourly rate might be—they are about charging an appropriate fee based on what value the client receives *and* how that client perceives value. Alternative billing should be based on what is fair and reasonable both to the client and the lawyer. Keeping track of time should be the lawyer's measure of cost, not necessarily a measure of the value he or she is providing the clients in their legal needs.

Clients, of course, perceive value in a variety of ways. When spending money adds to the value of what a person has, the money spent is an investment and not an expense. A developer client, for example, invests in raw land hoping to have it become a residential subdivision. The developer pays for planning and engineering services to lay out the tracts and for lawyers to provide expertise in the rezoning and the documents required for the subdivision. Each of these investments adds value to the developer's land. They are clear, and in a sense tangible. In litigation, in comparison, the client wants to achieve a certain result or preserve existing assets. The client will measure the value the attorney has provided based on the results achieved. Other values the client receives from an attorney might be (1) avoiding exposure to risk, (2) solutions to a problem, (3) preparing documentation that requires legal expertise, (4) wisdom and counsel, (5) specialized expertise—and the list goes on.

For the lawyer, keeping track of one's time is critical in determining what the costs of legal services are. In many instances, the time it takes a lawyer to perform a task has little to do with the value of the service to the client. But AFAs must provide value to the client while being able to measure costs for the lawyer so he or she can pay for the beer and the beans.

The more-common AFAs are listed in the sidebar in this issue. Note that in almost every instance, the fee is centered on defining not only the scope of the work but also the value to the client—and *that* is the key to marketing AFAs.

Framing the Marketing Message

The marketing tools you will use for AFAs aren't any different than those you should already be using in your practice. It is the message you are delivering, not the method that matters. So let's frame the message first—it's about fee options that provide value to the client.

When exploring alternative fees you must first identify what works for you and your practice. Can projects or cases in your practice be broken down into distinct parts that systems can be developed

■ **Percentage Fee.** Unlike a contingency fee, a percentage fee is based on a schedule of fees related to the amount involved in the matter being handled. The amount may be predetermined, such as a percentage of a loan amount being negotiated or the value of real estate being purchased, or it may be based on the amount of a bond issue. The percentage rate may be consistent or graduated.

■ **Retrospective Fee Based on Value.** This is different from most AFAs in that the exact amount of the fee is not known to either the lawyer or the client until the matter is concluded. The fee agreement should set forth the factors that would be considered in setting the final fee and in some instances a minimum or a maximum fee may be outlined in the engagement agreement.

■ **Statutory or Other Scheduled Fee Systems.** In some instances, the amount to be paid for legal services is spelled out in some statutory enactments, scheduled for prepaid legal service plans or by purchasers of legal services on a volume basis. Sometimes these are imposed, sometimes they are negotiated. Some reflect government-imposed social policies. Examples are social security cases, prepaid legal, insurance subrogation and uncontested foreclosures.

Hybrid Fee Arrangements

around? Are documents or pleadings standard or capable of being customized through document assembly or a manual system of options? When there have been dramatic differences in fees for roughly the same type of work, what are the reasons for such variances? Are these types of projects or cases frequent or rare and how do your competitors charge for similar services?

Once you have identified some areas that might be a fit for alternative fees, start with one or two potential types of work and begin gathering all the financial data for those types of projects or cases and analyze the profitability for each distinct piece of work. Data mine your files. Your closed files may well be your greatest resource in determining what might work for AFAs.

Start small and decide what type of fee arrangement works for that type of matter. Is a fixed fee appropriate or could a success or contingent fee apply for this type of work? Keep in mind that there may be more than one type of alternative fee depending on the facts and circumstances of each client's needs.

One example might be organization of a business entity. What is the actual time spent on each function over the last 5 or 10 incorporations? Who performed the work and can it be delegated or a document assembly system built around the function? What caused the big variables in fees? Length of meetings with clients? Changes to standard documents?

I've done hundreds of incorporations or organizing of limited liability companies over the years and our system using a fixed fee works for both the client and me. They know the exact cost before they retain us to do the work and we have a system in place that generates realization rates in excess of standard rates for nearly every engagement. The client determines the value for the services is acceptable and it is up to me to make certain that what we deliver meets that value expectation and is a fair fee for me.

Once a type of matter or case has been identified as suitable for an AFA, you can then use your normal marketing channels for spreading the word and having clients spread the word. Web-based as well as print-based mediums need to mention that AFAs are offered by the firm. Clients that have used you for projects with AFAs should be encouraged to refer others who have similar needs, too.

Part of any marketing plan for AFAs is to internally educate and market alternative fees to influencers in the firm as well. Sometimes the biggest impediment is a senior or managing partner who doesn't see the reason to change. It may be a problem with the compensation system that rewards hours and not collections.

Be aware, too, that any alternative fee program will require strong project management skills on the part of the attorney responsible for a matter using an AFA. Being able to demonstrate to both the

■ **Blended Hourly Rate.** In this hybrid of the hourly rate system, instead of specific hourly rates for individual fee chargers, one rate is applied to all hours billed on a matter regardless of whether it's for a partner, associate or paralegal. This is often used in larger firms, where it has been negotiated as a fee arrangement by a corporate client.

■ **Fee Collars.** This means hourly rates with maximum and minimum fees quoted.

■ **Fixed Fee Plus Hourly.** A portion of the matter may be charged on a fixed or flat-fee basis, and a portion charged on an hourly rate basis, because parts of the engagement cannot easily be defined. In an estate planning matter, for example, documentation may be based on a fixed fee, while client meetings are based on an hourly fee.

■ **Fixed Fee Plus Success Fee.** This hybrid is used when the firm has a good understanding of the services required and the client and the lawyer are willing to share in the risks associated with the matter. An example might be a securities offering where a fixed fee is charged for the documentation and a success fee is charged if the offering closes.

■ **Hourly Rate Plus Contingency.** By combining hourly billing and a contingency factor the client and lawyer are sharing risks. Since a portion of

client and the management committee that using an alternative fee works and can deliver the services promised with the resources that make it profitable for the firm requires project management skills that a lawyer needs to learn and develop if he or she expects to be successful in implementing alternative fees.

In that light, here are some real-life examples of success with AFAs should your management need precedents to rely on.

- Cisco Systems bundles certain routine matters and firms are invited to bid on those bundles on a flat fee basis. Complex or protracted matters are done on a flat monthly fee plus a bonus paid at the end of the matter for favorable results.
- For the past five years, Tyco's products liability work has been handled by one law firm in which an annual flat fee is negotiated prior to the beginning of each year. Lawyers still keep track of their time, and at the end of the year, the difference between the flat fee and the time charges is measured and is split between the company and the law firm.
- Levi's negotiated a fixed annual fee for worldwide representation in all matters with one law firm (except for the intellectual property work). If the law firm didn't have an office in a particular location requiring representation, it would be required to hire local counsel to handle it, which would come out of its fixed fee.
- Pfizer has selected a small group of law firms that are preferred providers for most matters requiring representation of the company. The providers operate on a fixed fee basis for most matters.
- One national firm's real estate practice uses "unit" fees based on the type of work being performed for its real estate clients. Office park developments might be charged on a per-square-foot basis while residential developments might be charged on a per-lot basis. The law firm has translated its fees into units used by a client to measure value rather than an hourly rate system.
- European-based law firm CMS Cameron McKenna last year sent out an offer to over 3,500 clients for them to consider different options under an alternative fee system. The firm had various alternative fee options, as well as a method for measuring the eligibility of clients to receive them. The firm's marketing piece, "Future of Fees: Your Route Map to Value," is available on its website.

The bottom line? The benefits of AFAs are numerous. They often result in closer relationships with the client, rewarding lawyers for expertise, efficiency and good results and can mean fewer fee disputes with clients. Marketing value through AFAs to the client should be pretty simple once you have identified what services you can offer under such arrangements.

the fee will be hourly (possibly at a reduced rate), the lawyer is guaranteed a minimum amount. An example might be a reduced hourly rate in litigation with a lower percentage contingency fee upon success

So, is the hourly billing rate dead? No, the majority of work has been and probably will continue to be based on the time it takes to handle a matter. But that percentage of hourly billing is shrinking and being replaced by fees better reflecting what value is both to the client and the law firm.