

# Whatever Happened to the Alternative Fee Arrangement?

## Why We Can't Shake the Billable Hour

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*"Gunfighter's aren't paid by the bullet."*

– Anonymous Criminal Defense Attorney

*"Alternative fee arrangements are like teenage sex. There's a lot more people talking about it than actually doing it. And those that are doing it, don't really know what they are doing."*

– Legal Industry Observer

When you think about it, the billable hour doesn't make much sense. In almost every other profession, fees are based on the client's problem and the value that the client places on a solution to that problem.

This very notion of price based on the value to the consumer is at the heart of a free market society. The current disconnect between fees and value for legal services has been reported many times before and, with the recent recession, an even greater emphasis has been placed on Alternative Fee Arrangements (AFAs) as the solution to controlling legal costs.

So why are AFAs still considered "alternative?"

As always, the answer is more complex than it would seem on its face.

### Birth of the Billable Hour

For those of you who started practicing law after 1960 (which should be about everyone) you may be surprised to know that the billable hour has not always been the standard practice. Yes, prior to World War II, hourly billing was considered "alternative" and only used in rare instances. For most of history, lawyers worked independently and charged based on the value delivered to the client.

As clients grew larger and more sophisticated, the lawyers that serviced them began to group together to form larger and larger law firms with salaried attorney employees. These firms needed a simple way to track lawyer productivity and costs; hence the dreaded hourly time sheet was born.

Additionally, as companies grew, so did their consumption of legal services. Companies began to scrutinize legal bills more carefully and demanded an objective way to measure the services they received. At some point some attorneys showed one of these demanding clients his time-sheet and the billable hour was born.

Despite its many flaws, the billable hour offered many attractive benefits. Clients liked it because it offered an objective measurement (Number of Hours x Hourly Rate is a simple formula). Bills are detailed and straightforward.

Lawyer's liked the billable hour (at least initially) for many of the same reasons: It was easy to link costs with revenues; and, it provided an objective measure for employee productivity. Billing could be automated to a much higher degree, which reduced administrative costs. For a while the new system worked fine. The problem is that none of the perceived benefits

worked as well as everyone hoped.

Billing by the hour, while certainly objective, is not a very accurate way to measure value. Initial billing may be very simple, but negotiating bills after the work is complete can be extremely aggravating if the client's perceived value for such services differs significantly from the bill. Additionally, the value of an attorney employee began to be judged less by the quality of their work or their efficiency and more by the quantity of their hours billed.

Finally, rather than promoting efficiency, the billable hour encourages inefficiency by rewarding the attorney that takes longer to complete a task.

### The Alternative Fee Arrangement

For many years, a small but growing number of companies and law firms have been exploring AFAs that attempt to more closely align value with price. With the recent recession, interest in AFAs has grown even greater as companies try to reduce costs and create more predictability.

The various AFAs employed range from the very simple to the very complex. Unfortunately, no standard has arisen to wage an effective challenge to the billable hour as the dominant standard. The simplest AFAs, such as flat fees, create a risk on both sides. Conversely, the more complex AFAs require much more data and reporting that the billable hour system.

Additionally, the negotiation of an AFA is a much more challenging task for both clients and attorneys, especially on the front end. Attorneys and clients need the data necessary to determine the historical cost of certain matters and the value that an attorney can bring to a matter.

An AFA requires a degree of transparency that can push clients and attorneys out of each other's comfort zone. Needless to say, AFAs can be very difficult to negotiate unless there is a significant level of trust between the client and attorney.

Finally, attorneys tend to view AFAs as a zero sum game. If the client is saving money, naturally I will lose money. This perception is due in large part to the way clients approach AFAs. Many clients tend to view AFA as a tool for "cutting costs." This slash and burn approach immediately puts attorneys on the defensive and the negotiation is doomed before it ever gets started.

The truth is AFAs, when done correctly,

provide many other benefits to both the client and the attorney. For clients, a good AFA can provide predictability, control and value assurance. For attorneys, AFAs can result in deeper client relationships, predictable income, greater efficiencies and higher employee morale.

### Flat Fee Structures

AFAs come in all flavors. Unlike the billable hours model, one size does not fit all. An effective AFA will take into account the types of services that the client needs. If these matters are routine with little variance, a flat fee may be appropriate. For example, if a company routinely deals with very similar litigation matters involving similar fact patterns and legal issues, the attorney should be able to handle such matters with greater efficiency each time.

Over time the attorney's cost should go down, but the value to the client would remain the same. Therefore a basic flat fee would keep costs predictable to the client, while offering the attorney incentive and opportunity to maximize efficiency.

More complex matters may require a task-based fee structure, which breaks a matter into a series of tasks and fixed fees for each task. For example, if a company routinely acquires investment property, but the property varies in size, fees for such a matter could be broken down into the discrete tasks that each deal requires such as, document drafting, due diligence review, closing services, etc. The more complex the deal, the more each deal would need to be broken down into its component parts.

Survey reviews could be based on the size and type of property and lease reviews could be based on the use and square footage. While the calculation of these task-based fees may be complicated, once established, a client would be able to accurately predict its legal costs for any future deal. The task-based fee concept allows the scaling up of the flat fee to increasingly complex matters.

Attorneys will quickly point out that neither of these flat fee structures is perfect. Often, matters that appear routine can become protracted through no fault of the attorney, resulting in a massive outlay of time and cost that can never be recouped if the flat fee does not account for such contingencies. For this reason, attorneys may want to include certain flexibility to permit some time-based billing if certain predetermined thresholds are exceeded.

However, some clients will argue that flat fees by nature require clients and attorneys to share the risk of legal services. Some matters are straightforward and the attorney makes a bigger profit; some matters are more complex and the attorney makes a smaller profit.

In order to be of any value to the client, flat fees should remain flat and the fee should account for reasonable fluctuations in cost.

### Results-Based Structures

While a flat fee system may work for some matters, in other matters the real value to the client comes from the result achieved rather than in the process. Specifically, for certain litigation matters involving high value and high risk, the true value to the client is in meeting certain goals in terms of money recovered or retained. In these instances a contingency fee may be the best value for the client. Clients pay based on the result. In these instances, the attorney bears all the costs and may take a severe hit if the matter is unsuccessful. However, the attorney will also stand to gain if the matter reaches a successful conclusion quickly.

Other results-based fees may involve withholding of a certain percentage of fees into an account or "bucket" until the conclusion of the matter. The attorney will receive anywhere from 0-200 percent of the fees held in the bucket at the conclusion of the matter.

If the matter is successful and is concluded quickly, the attorney may receive a "success bonus" of some amount over that held in the bucket. If the matter is unsuccessful, the attorney may receive none or a reduced portion of the bucket amount. The key to this kind of fee structure is clearly defining the meaning of "success" and agreeing on the percentage amounts awarded given certain results.

If done right, this type of results-based system acts as an incentive for attorneys to provide the best service in the most cost-effective manner.

### Conclusion

AFAs can be as complicated or as simple as attorneys and clients want to make them. The key to an AFAs success or failure is in balancing the needs of clients for costs that are lower, more predictable and value driven while at the same time rewarding attorneys for efficiency, quality and successful results.

Taking the long view, AFAs can be of great benefit to both clients and attorneys, but they do require some initial time and investment. This is probably the single greatest challenge to AFAs going mainstream: inertia.

As with all things, change requires effort and the willingness to stray into the unknown. But, with courage, trust and good data both clients and attorneys can find the right fee structure that accurately reflects the value of legal services, rewards attorney efficiency and ultimately results in an improved relationship between both parties.

As more and more attorneys and clients dip their toes into the water of AFAs, maybe someday we will finally be able to refer to the hourly method as the "alternative" way of billing.

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