A monthly online survey and commentary presented by The Managing Partner Forum

April 2014

A Slow-Motion Riot:
The Use of Alternative Fee Arrangements Creeps Forward...Ever So Slowly
by John Sterling and John Remsen, Jr.

In April 2014, The Managing Partner Forum, in partnership with Sterling Strategies, LLC and TheRemsenGroup, surveyed managing partners regarding alternative fee arrangements. Fifty-two managing partners participated.

The questions were straightforward and focused. Specifically, we asked managing partners to share their current experience with alternative fee arrangements (AFAs). We asked three very direct questions:

▪ In your own firm, do you see the percentage of fees earned by your firm via alternative fee arrangements (i.e., something other than straight time and materials billing) growing, declining or leveling off?

▪ Roughly what percentage of your firm's revenue comes from alternative fee arrangements?

▪ What alternative fee arrangements you have used in your own firm over the past year (a check all that apply question)?

We also gathered open-ended insights from managing partners regarding AFAs – those insights may be the most valuable result emerging from this month’s survey.

MOST FIRMS DERIVE LESS THAN 10% OF REVENUE THROUGH AFAs

Roughly half of the managing partners responding to the survey reported that 10% or less of their fee revenues in 2013 were attributable to AFAs. Slightly more than a quarter of firms reported that AFAs were between 10-20% of total revenues. No one reported that they had no revenues from AFAs.
GROWTH AND USE OF AFA’S PLODS AHEAD

Despite all the fuss, managing partners report (on balance) that AFAs continue to grow as a percentage of their revenues. But the growth is very slow. So slow, in fact, that Susan Hackett, former General Counsel of the Association of Corporate Counsel, describes it as a “slow-motion riot.”

Over half of all respondents report AFA use is still growing, with 21% reporting that AFAs are growing at an accelerating pace and over a third reporting that AFAs are leveling off. 10% of managing partners reported that AFAs are declining modestly – and no one reported that they are declining quickly.
FIXED FEE ARRANGEMENTS DOMINATE THE LANDSCAPE

Fixed fee arrangements are far and away the most prevalent form of AFA in use – almost 90% of all firms report using fixed fees in some settings. Other approaches in use by more than half the firms responding to the survey included:

- Blended rates for defined matters;
- Contingent fee arrangements (plaintiff’s work);
- Volume discounts/discounts once a volume threshold is reached;
- Fixed cap arrangements.

Types of AFAs in Use (Percentage In Use)

<table>
<thead>
<tr>
<th>Type of AFA</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Fixed fee arrangements on matters</td>
<td>88.5%</td>
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<tr>
<td>Blended rates for defined types of matters</td>
<td>73.1%</td>
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<tr>
<td>Contingent fee arrangements - plaintiff’s work</td>
<td>61.5%</td>
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<tr>
<td>Volume discounts/discounts upon reaching a threshold level of hours/dollars</td>
<td>57.7%</td>
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<tr>
<td>Fixed cap arrangements on matters</td>
<td>53.8%</td>
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<tr>
<td>Agreed upon discounts or write-offs for cratered deals/transactions that did not close</td>
<td>28.8%</td>
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<tr>
<td>Retainer based discounts - discounted billing against a prepaid retainer</td>
<td>21.2%</td>
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<tr>
<td>Hold backs on some percentage of standard rates - with full rates awarded for success</td>
<td>19.2%</td>
</tr>
<tr>
<td>Hold backs on some percentage of standard rates - with premium rates awarded for success</td>
<td>17.3%</td>
</tr>
<tr>
<td>Contingent fee arrangements - defense work</td>
<td>11.5%</td>
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FIRM SIZE

Our survey sample slanted toward firms with fewer than 50 lawyers – so in many respects this survey provides a particularly useful window into the prevalence of AFAs in small to mid-sized firms.
INSIGHTS FROM MANAGING PARTNERS

As noted above, some of the most valuable information gained from this month’s survey came in the form of managing partners’ responses to an open-ended question asking them to “share any unique strategic insights you have gained from the deployment of alternative fee arrangements.”

Without attribution, managing partner advice regarding AFAs is summarized in the following points.

Some noted positive outcomes:

- If the client asks or you perceive that they may ask, go for it.
- On successful implementation, we become business partners instead of customer-vendor relationship.
- If we can get someone to pay us a reduced hourly with a contingency component, it’s a great arrangement for us because we more than cover overhead, plus we have the chance for substantial upside.

Many commented on the nature of fixed fee and fixed cap arrangements:

- AFA have been a hot topic for years, but mostly clients want clarity leading to caps, discounts and fixed fee arrangements.
Many firms elect to assign a younger associate to the fixed fee cases. We assign an experienced partner who pilots the case to an early resolution with the least wasted effort - more profitable for us, certainly pleasing for the carrier.

Most flat fee work has resulted in lost fees compared to straight hourly billing. Still very hard to intelligently set the flat fee.

Some noted how critical good data is to having successful outcomes vis-à-vis AFAs:

In order to utilize either fixed fee or contingent fee arrangements, a firm must have current and accurate records of the time required to accomplish tasks and time actually devoted to matters. The fee arrangements are fluid and firm must update the fixed fees based on actual historical results in cases.

You need the data from past experience to appropriately fix or cap fees. You cannot just fix the fee to get more revenue without knowing whether the work will be profitable. The discipline this process brings is valuable for lawyer and client.

Some lamented the downside(s) associated with the growing prevalence of AFAs:

Volume discounts to retain institutional clients are the norm now vice the exception only a few years ago.

Not enough consideration given to the economic impact upon the firm of receiving less than the true value of the legal services rendered. For smaller firms this impacts the amount the firms can pay their lawyers and such firms consistently lose well-trained lawyers to larger firms. This will ultimately reduce the options GCs have to send work to quality lawyers at smaller firms.

Part of the irony is that the smaller firms were most likely billing at reasonable rates in the first place.

Not enough consideration is given to the fact that when a matter costs more than anticipated, it often is due to facts embedded in defending the matter, which is something beyond the control of outside counsel. The client should pay for the cost of the difficult witness or difficult facts, not the lawyers.

I find that the same institutional clients who are concerned about their legal spend to be the least flexible when it comes to discussing AFAs - especially those who use electronic billing systems that are not set up to accept anything but hourly-rate bills.
Billing auditors, particularly as used by insurers to review their own attorneys' bills, are destroying the attorney-client relationship, and creating antagonism and distrust between insurance clients and attorneys.

Finally, at least one managing partner noted that AFAs are often a subject of discussion that never leads to action:

- Corporate in-house talk a big game about AFAs but in our experience, few have the fortitude to pull the trigger after we make a proposal (and we’re not losing the work on an hourly basis).

THE MPF PERSPECTIVE

This survey (along with data from PeerMonitor and other sources tracking larger firms) makes it clear that AFAs continue to grow - albeit slowly - and are here to stay. We strongly agree with those managing partners who underscore the importance and value of having good data inform your approach to crafting an alternative fee arrangement. In addition to that universal truism, we offer the following closing pieces of advice.

- Make a point of understanding the clients’ core motivations in seeking an AFA.
  - Are they looking for greater predictability? If so, a win-win fixed fee arrangement may be the solution.
  - Are they looking to save money? If so, volume discounts are an option, but deeper analysis may lead to process improvements that reduce fees and boost law firm profitability.
  - Are they interested in aligning incentives? If so, creative contingent arrangements and/or discounts coupled with success fees may be a great solution.

- Be as open and transparent as possible in discussing costs, fees and alternatives with clients – with rare exceptions the desire for an AFA is motivated by broader pressures, not a desire to cut into law firm margins. Collaboration and communication can lead to solutions that are a win for the firm and the client and can strengthen the relationship dramatically.

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ABOUT THE AUTHORS

John Sterling is the founding partner of Sterling Strategies, a firm focused on strategic planning, strategy development, and related implementation management. More information about John Sterling and Sterling Strategies is available at www.sterlingstrat.com.

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