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Alternative Fee Arrangements: The Time Finally Has Come

By Thomas S. Clay and Daniel J. DiLucchio

Introduction

Seismic shift! Transformational change! The end of lawyers! Death of the billable hour! Power to the clients!

With all of the changes in the legal profession today, perhaps more than any other issue, the current conversation revolves around the use of alternative fee arrangements (AFAs). Are we truly on the brink of a tsunami about to break over the legal profession — bringing irrevocable changes? Or are we at the leading edge of a developing dynamic in the legal profession whose resulting change is unclear?

What is clear, even to the casual observer, is the rapidly burgeoning interest in alternative fee arrangements among clients and in particular general counsel. We see a growing, probably permanent, change to the value proposition between clients and firms. Its magnitude and pace will be determined by competitive pressures from clients as well as competitive responses by law firms.

New law firms are springing up, founded on the premise of alternative fee arrangements and a new and different value proposition. The degree to which these “disrupters” will hasten change may be very high. As clients become accustomed to new, value-driven fee arrangements, they will see greater and greater benefits, including cost management and predictability. Once AFAs are in place, we see no obvious reason or rationale for a return to the billable hour.



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Our experience suggests that every practice area, or at least some portions of all practices, in every law firm, has the potential to offer alternative fee arrangements. There is a presumption among some lawyers, and it seems especially prevalent among litigators, that because their practices are so complex or unpredictable, alternative fee arrangements will not work. If this is true, how then can other (fast-growing) law firms that deal with the same variables offer alternative fee arrangements? Alternative fee arrangements are being used in *all* areas, and firms must learn how to use them effectively.

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While we do not anticipate the seismic shift some are predicting, we do believe that all lawyers in all law firms of any size need to take note and start making some decisions about how to proceed. The response should be thoughtful, but swift enough to be useful and relevant.

Strategic Necessity or Competitive Opportunity

It concerns us that too many lawyers either are not paying attention to what's going on in the marketplace or, through complacency or arrogance, are ignoring the evidence. Some are comfortable in a fur-lined rut. One of the biggest threats law firms face is attaining a competitively viable strategic position *too late*. Once other firms have developed, refined and begun to use AFAs competitively, it will be very difficult for followers with minimal experience or knowledge to compete. If an RFP asks for an AFA proposal, a firm must be able to respond intelligently. If a client says "Another group has offered an alternative fee, what can your law firm offer?", the response cannot be "What would you like?" or "I'll get back to you."

It is imperative that law firms, regardless of their current thinking and experience with alternative fee arrangements, adopt one of two strategic positions: reactive or proactive. Doing nothing, waiting to see how other firms handle alternative fee arrangements, or waiting to see what clients ultimately decide once they have greater experience with this tool, are not viable options for a successful law firm.

As one general counsel said, "If a lawyer cannot offer me an alternative fee, I will find an alternative lawyer."

Strategic Necessity

Considering the development of AFAs as a strategic necessity is the bare minimum that a firm must do to stay

AFAs Defined

Let's be clear. AFAs are defined as a fee arrangement that is not based on hours multiplied by rates. Therefore, an AFA might include flat fee or fixed fee arrangements. AFAs are not discounts on hourly rates, blended rates or progressive discounts. In addition, AFAs should not be confused with alternative billing arrangements, which might include such techniques as retainers, quarterly payments, discounts for prompt payments or other methods of billing.

in the game going forward. (Ideally, over time, firms will build to the second, more sophisticated stance.) In this baseline posture, firms will acknowledge that it is very likely clients will ask for proposals which include alternative fee arrangements, and that most RFPs will include similar requests — and they will be prepared with specific AFA responses. A firm that waits for an RFP to arrive before beginning work on AFAs is already behind the curve.

To be ready, firms must do the work necessary to determine what sort of alternative fee arrangements they can offer, articulate how the AFAs will benefit the client and understand the internal implications to the firm's processes and profitability. Although in this posture firms may not be able to aggressively market alternative fee arrangements, they at least will be well prepared to respond quickly and clearly to RFPs, and will be able to demonstrate that their proposal is reflective of clients' needs.

The *strategic necessity position* would include:

- **Education.** Law firms must develop initiatives and processes to educate their lawyers fully about alternative fee options and current market offerings. This should be discussed firm-wide and practice area by practice area as well.
- **Inventory.** Many lawyers cannot tell you what types of alternative fees their firm has offered in the past. Most firms don't have a centralized means by which to collect

data on what has been proposed or done, or what has been successful (or not). This information needs to be systematically inventoried and made available throughout the firm to improve the educational process.

- **Project Management.** It is impossible to propose alternative fees — and still be successful economically — without making changes to legal service production processes and improving internal project management skills. To try to invent a project management process *after* an alternative fee proposal has been tendered and accepted has proven disastrous in the past. Firms should immediately dedicate themselves to understanding the discipline of project management and begin to educate lawyers on its scope and scale.
- **Cost of Services Data.** Firms should begin to develop means by which they will evaluate the cost of services sold in order to determine how to price and evaluate alternative fee arrangements. Although it is difficult in most cases to get absolute precision, there must be a fundamental understanding of how to develop and use cost data effectively. Again, waiting until after alternative fee arrangements have been proposed to develop the data may lead to disastrous economic results.
- **Fee Approvals.** It should be made clear that centralized approval of alternative fees will be required, at least early on. There are too many

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instances in which partners have unilaterally proposed fees that were not appropriate or economically sound. Many firms are appointing committees or “fee czars” to review and approve alternative fee arrangements. All firms should do this.

If firms that are just beginning to deal with AFAs will commit to each of the above steps, they will be in a far better position to deal effectively with current clients who make AFA requests, and to respond to such RFPs. As they gain experience and knowledge and achieve some initial success, they should have the means to move to a more aggressive approach, if desired.

Competitive Opportunity

Approaching AFAs as a competitive opportunity takes a firm to the next level. Initiatives should be directed toward maintaining current clients and their work, as well as moving the firm forward in acquisition and growth of new client work by proactively demonstrating a willingness to engage in alternative fee arrangements. This is an aggressive position requiring rapid change and agility within the firm.

Achieving this position includes all of the elements of strategic necessity described above, plus:

- **Start with Current Clients.** We recommend that firms select a manageable number of current clients with the objective of determining whether or not each of those clients might benefit from alternative fee arrangements. Every client has different business, strategic and operational objectives, as well as legal objectives. In addition, larger clients have multiple objectives depending upon the different types of work they need. Therefore, each client has to be treated separately and independently in determining

whether or not they are logical AFA candidates. In the best of all worlds, the determination is reached collaboratively, with the client participating as an equal partner.

- **Marketing.** Although not all clients have decided AFAs are the route for them, many have. In response, many firms are now marketing their expertise with alternative fee arrangements. It is unlikely that widespread generic marketing will suffice. Instead, firms should focus their efforts by practice type, industry, etc. Firms will need to be careful about selecting areas of focus, as it is not likely that THEY can engage in all kinds of alternative fees for all clients at the same time.
- **Cultural and Operational Issues.** When firms begin to consider alternative fee arrangements, lawyers very quickly begin to spot potential challenges and conflicts. For example, how do you “credit” lawyers for fee revenues? If people have been paid based upon the number of billable hours recorded, what does this change mean? What if the alternative arrangement actually results in a less than profitable outcome? All of these questions are important and will need to be dealt with by firm leadership proactively in order for any firm to engage in the competitive opportunity position.

Getting Started

What should a law firm do to get started? Don’t be surprised when you search the literature surrounding AFAs and don’t find an easy answer. This will require work; there is no silver bullet or magic wand. We recommend that you take the steps outlined below. Some firms may have already started down this path, or jumped into the middle, but each step is an important facet of a full, effective AFA program.

1. **Ensure leadership support.** This is fundamental. Experience proves that a guiding coalition dedicated to development of resources, methodologies and processes will ensure real accomplishments. Such a coalition might work across various practice groups, assisting in evaluation of opportunities, establishing methodologies, and defining acceptable alternative fee arrangements.
2. **Proceed with specific practice groups or specific lawyers first.** Often there will be practice groups that seem to lend themselves to AFAs (e.g., labor and employment, intellectual property) or there may be lawyers who understand the need for AFAs and are enthusiastic about the opportunity. It is always better to begin with a high degree of enthusiasm.
3. **Develop an “inventory” of firm experiences with AFAs.** We have found that many firms are not aware of other fee arrangements that have already been negotiated. This is an opportunity to evaluate experiences, successes and failures – and then build upon them.
4. **Set measurable objectives at the firm, practice area, or client level.** For example, set a goal that 20% of the firm’s fee arrangements will be AFAs within 12 months. A measurable goal will ensure progress. Without it you will not progress very quickly.
5. **Break down projects, matters and litigation into component parts.** This will provide a much more manageable way to evaluate costs, processes, staffing, technology and other efforts required to produce the work. Many firms struggle with alternative fees because they are trying to create AFAs on a firm-wide or practice-wide basis. This is usually too broad a basis to be effective.

6. **Collect cost data about past matters, transactions, and projects.** It is important to dig deeply and understand what it costs the firm in terms of time and effort to produce work. This, however, is only a first step. The time and effort spent on prior matters is good to know, but don't assume that the firm was performing at peak efficiency on those matters. This is where project management and reengineering come into play.
7. **Reengineer work to achieve a reduction in time, effort and overall costs.** Rethink staffing choices to be sure that the right people (lawyers, paralegals, staff) are performing the right level of work. Be sure to evaluate the need for additional or new resources such as systems analysts, program managers, and IT people. The importance of effective management, including delegation, staffing, and the use of technology cannot be overstated.
8. **Start potential initiatives with current clients.** AFAs work best when a relationship of trust already exists.
9. **Review the results, learn and adjust.** There is risk and potential failure. Don't let this reality deter efforts. As some would say, if you aren't ever failing, you aren't trying hard enough.

Leading Change

Make no mistake, this is all about change — and potentially rapid and extensive change. To be effective in implementation of alternative fee arrangements on any broad scale, it is critical that firm leaders get change management right. By far the best resource, in our opinion, is the change management principles set forth by John Kotter in his book *Leading Change*. Rigor in following these principles will greatly enhance the potential for a successful outcome.

Kotter suggests:

- **Establish a sense of urgency.** Kotter believes that at least 75% of key individuals need to share urgency in order to succeed. He also suggests that in the absence of this sense of urgency, complacency will overtake any initiative.
- **Form a powerful guiding coalition.** Many firms have developed task forces to study or evaluate AFAs. This is not enough. Your leadership group must have the mission and authority to begin implementation throughout the firm.
- **Create a vision and communicate it effectively.** The vision should be relatively simple, specific and provide guidance to senior leadership. An objective such as "25% of our fee revenue will come from AFAs by 2012" is clear and compelling.
- **Empower people to act.** We recommend that practice group leaders not only be empowered, but encouraged to act as they lead the efforts of their constituencies.
- **Consolidate improvements and produce more change.** Evaluate where you are effective, but also where you have not been effective, in winning business and being profitable with AFAs. Sharing this knowledge across the organization is absolutely required for the best progress to be made. Digital dashboards and other technologies facilitate this.

Finally, as a corollary to Kotter's principles, we believe that it is imperative to ensure alignment of internal law firm policies, systems and procedures that are affected by your new initiative. As we stated previously, you will need to make changes in fee structures and work process, and there will be other areas that will be impacted and require your attention, including:

- Alignment of compensation systems with new strategic objectives (behaviors you want to reinforce) and metrics. Current alignment in law firms evolves around personal fee receipts, billable hours and origination. This is insufficient for the new model and potentially counter-productive.
- Alignment of professional development training to ensure building requisite skills such as project management skills.
- Alignment of marketing and business development activities to ensure that they support the vision.
- Realignment of client relationship strategies and tactics at a fundamental level to ensure collaborative implementation and ongoing assessment of AFAs.
- Increased engagement by leaders at the firm, practice and office levels who inspire and encourage people to achieve alternative fee objectives and take necessary risks.

Summary

Close observers of the legal profession believe strongly that the use of alternative fees will increase, but there is no agreement as to how fast the change will occur. We think it is abundantly clear that firms that want to maintain a competitive stance must at least adopt the first position set forth above, while those that want to set the pace for their competitors will act aggressively to seize this critical opportunity in the new legal market. ♦

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