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Speaking Different Languages: **Alternative Fee Arrangements for Law Firms and Legal Departments**

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Written by

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INTRODUCTION

This report, sponsored by LexisNexis and conducted by ALM Legal Intelligence, provides an overview of the alternative fee arrangements used by large law firms and corporate legal departments.

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PREFACE

Speaking Different Languages: Alternative Fee Arrangements for Law Firms and Legal Departments is an ALM Legal Intelligence white paper sponsored by LexisNexis. ALM Legal Intelligence gathered data, conducted interviews, and administered the online survey. Erik Sherman wrote the report and Jennifer Tonti conducted the survey and was the report editor. We would like to thank all those who participated in the survey and agreed to be interviewed for this report.

- APRIL 2012

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EXECUTIVE SUMMARY

FOR YEARS, THERE WAS ALWAYS A LOT OF TALK ABOUT ALTERNATIVE FEE arrangements—approaches to billing that are not based on traditional hourly rates—but very little action. Then came the economic collapse of 2008 to 2010. Corporations needed to cut expenses, and nothing was left off the table, including outside legal costs. Alternative fee arrangements (or AFAs) obtained a new urgency, as research and a survey of law firms by ALM Legal Intelligence suggested.*

But a study focusing on the momentum of AFAs among law firms misses half the story. That is why ALM Legal Intelligence took another look at the issue, this time surveying both large law firms and corporate legal departments. Although the results support some prior conclusions, they also show new complexities of how legal departments and law firms both view and use AFAs and where things may go from here.

The main findings of our research into AFAs include the following:

1 (ALMOST) EVERYBODY'S DOING IT. Of the 218 law firm respondents, only one reported that their firm does not employ alternatives to the hourly billing rate model other than discounting. On the legal department side, 18% of the 206 corporate respondents reported that they do not employ AFA billing.

2 AFAS START TO PICK UP STEAM... One issue law firms and legal departments agree on is the rate to which AFAs have increased since 2010. About 62 percent of firms saw an increase in AFA billing, with only 2 percent citing a decrease, and the remainder seeing no change. One in two legal departments saw an increase, and the other half say that the degree of AFA billing has essentially remained the same. Looking forward to 2016, about three-quarters of legal departments (76 percent) and law firms (74 percent) alike predict AFA billing will increase in the next five years.

3 ...BUT NO OVERWHELMING AFA CHAMPIONS. Only 6 percent of law firm respondents said that more than half of their outside corporate legal work was billed using an alternative fee arrangement, whereas the majority (67 percent) used AFAs for less than a quarter of their work. Legal departments are less bearish, with 12 percent reporting use of AFAs for more than half of their legal work. Even more telling is that 6 percent of legal departments and 17 percent of law firms did not know what percentage of their legal work was billed not using the standard hourly rate model.

4 THOUGH INCREASINGLY PERVASIVE, FEW ARE TRULY HAPPY WITH AFAS. On the whole, legal departments are more satisfied about using AFAs than law firms, with about 84 percent of legal departments responding that they are "somewhat" or "very satisfied" with AFAs. Comparatively, 72 percent of law firms gave AFAs the same satisfaction rating. The difference was even sharper when looking at only those that were "very satisfied": 26 percent of legal departments vs. 11 percent of law firms. This suggests that full acceptance of and satisfaction with AFAs still has a ways to go.

5 DIFFERENT MOTIVATIONS. Although law firms and legal departments understandably must cooperate when establishing and billing alternative fee arrangements, they have largely different reasons for instituting AFAs. Firms want to attract clients (91 percent), simplify billing and operations (50 percent), increase billing realization (43 percent), and predict costs (37 percent). Legal departments share an interest in cost predictability (at 87 percent, the biggest driver), but also look for cost savings (68 percent), increased efficiency (44 percent), and risk-sharing (35 percent).

6 THE BILLABLE HOUR STILL DRIVES THE BOAT. Law firms and companies' opinions differ as to who they think is responsible for the lag in AFA adoption, with either side pointing the finger at the other. According to law firms, the top obstacles to increased use of AFA billing focus on either side feeling more comfortable with hourly billing in general. Legal departments agree that law firms are more comfortable with billable hours, but they go on to find lack of experience in defining and managing work and billing matters on a basis other than hourly as big a stumbling block.

7 FAVORITE AFA MODELS ARE THE SAME FOR LEGAL DEPARTMENTS AND LAW FIRMS ALIKE. The top three choices for types of alternative fee arrangements were shared by both firms and departments: flat fee (89 percent of legal departments, 93 percent of firms); blended rate (47 percent of legal departments, 89 percent of firms); and capped fee (57 percent of legal departments, 83 percent of firms).

8 COMPETITIVE BIDDING HITS THE LEGAL SECTOR. In most areas of business, seeking bids on work is common. And although bidding is not the norm in legal work, it has become an increasingly popular way for legal departments to request outside counsel legal work. One-fifth of legal departments said that they had instituted a "reverse auction" or competitive bidding on high-volume and repetitive work. Just over a third of the firms said that they had participated in such a bidding process.

9 A GENERATION GAP MAY EXIST. Although not quantitatively indicated, some in-depth interviews suggest that both law firms and legal departments face a generational challenge. We hear that younger attorneys at law firms and legal departments are more willing to employ AFAs than their older peers. Smart management at both these institutions will have such people spearhead alternative fee arrangements efforts in their organizations going forward.

10 SOFTWARE IS ONE WAY TO FACILITATE ALTERNATIVE FEES BUT IT IS NOT SUFFICIENT. A majority of legal departments are now using ebilling software to plan, manage and track alternative fees. This is more effective than matter management and accounting software but does not facilitate the use of alternative fees in every case. Law firms are primarily using their accounting software for the management of alternative fees. These systems built for billing and timekeeping do not fully support AFAs, but there are some emerging financial planning software products that work with these systems and have functionality for evaluating and managing alternative fees, better meeting the need. However, software by itself is not enough. Both law departments and law firms talk of a need for culture change, collaboration and the establishment of trust to have alternative fee arrangements work effectively.

About the Survey

This report, sponsored by LexisNexis and conducted by ALM Legal Intelligence, provides an overview of the alternative fee arrangements used by law firms and legal departments. The data was collected via e-mail invitations to a Web-based survey conducted between March 6, 2012, and April 6, 2012. The survey sought to document how frequently the parties use such arrangements; how they manage and monitor the arrangements; the forms of AFAs employed; and the perceptions of both sides toward AFAs and each other.

Invitations were sent to senior management (General Counsel, Deputy GC, Corporate Counsel) in corporate legal departments for one survey. Among the responding law departments, 206 opted into the survey and 141 were qualified to respond (the law department uses AFA billing methods). Law department respondents came from a combination of small companies (100-499 employees, 22 percent), midsize companies (500-4,999 employees, 25 percent), large companies (5,000-9,999 employees, 15 percent), and very large companies (10,000+ employees, 37 percent).

Invitations for a separate but similar survey were sent to partners at Am Law 200 and NLJ 250-size (large) law firms. 218 firms opted in and 194 qualified to respond (the law firm uses AFA billing methods).

PART I: THE BILLABLE HOUR MAKES WAY FOR THE AFA

ALTERNATIVE FEE ARRANGEMENTS ARE OF GROWING IMPORTANCE TO both law firms and legal departments because they currently represent one of the periodic shifts in how legal business is conducted. “What does alternative fee mean?” asks David Susler, associate general counsel of Elk Grove Village, Illinois-based National Material L.P. “It depends on the context. The hourly billing became king in this country only within the last 25 or 30 years. There are countries where billable hours are unheard of.” In the context of the last few decades, alternative has come to mean some approach other than straight hourly billing. (See *Types of Alternative Fee Arrangements sidebar*.)

The concept of the AFA, however, is not new. “We’ve had alternative fee arrangements going back to the early to mid-1990s,” says King & Spalding partner Dwight Davis. Hourly billing is still widely used, but there is a change in the unquestioned primacy of the billable hour, as both legal departments and law firms have increased their AFA activity since the economic recession of the late 2000’s. Half of the legal department respondents had seen an increase in the volume of AFAs between 2010 and 2011, and the average increase was almost 30 percent. The change for law firms was even more dramatic, as 62 percent of respondents saw an increase in AFA matters between those two years.

Projections about the strong future of AFAs is underscored by respondents’ answer to a question asking whether AFAs would become more important in their legal work from 2011 to 2012. Fifty-five percent of legal departments expect the use of AFAs to increase, while only 7 percent say they would decrease. On the law firm side, 74 percent of law firms believe AFA use will increase, while 2 percent expect a decrease.

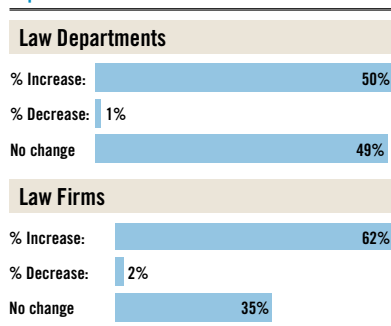
Looking further down the road to 2016, 76 percent of legal departments expect an expansion of AFA use, while 4 percent foresee a decrease. Just over one-quarter believed the level will remain the same. On the law firm side, 82 percent of law firms foresee an increase, 3 percent expect a decrease, and just 15 percent said that AFA use will be static.

Part of the belief in the future of AFAs may have to do with a corporate financial reality check. “Hopefully the economy goes back up, and the GC goes to the company and says to the CFO, ‘The company is doing better and I want to restore my budget,’ “ says Gary Hoffman, partner at Dickstein Shapiro. “[The CFO would say], ‘The sky didn’t fall.’ You’re going to have to learn to live with [a reduced budget] for years to come.”

We’ve had alternative fee arrangements going back to the early to mid-1990s.”

Dwight Davis, King & Spalding partner.

Between 2010 and 2011, what change did your law department/ law firm see in the volume of AFAs?



TYPES OF ALTERNATIVE FEE ARRANGEMENTS

“Alternative fee arrangement” refers to a mutual agreement between a law firm and corporate legal department for billing and payment of outside legal services that does not rely on straight hourly billing by the firm. Below are nine types of AFAs that our survey tracked, a description of each, and the Association of Corporate Counsel’s assessment of the most appropriate circumstances for each:”

BLENDED RATE—Sets an agreed-upon hourly rate that applies to all lawyers working on a matter, regardless of their seniority. Encourages firms to staff matters efficiently.

CAPPED FEE—Limits the total cost of an agreed-upon amount of work. It is often used in conjunction with an hourly rate arrangement. Provides a degree of predictability to clients who are otherwise comfortable with hourly billing.

CONTINGENCY—Specifies that a firm will be paid only if it achieves a financial recovery or other agreed-upon result for the client. Typically, the firm receives a percentage of a total recovery. Provides protection from a bad result for clients who are willing to forgo a large portion of a positive result.

DEFENSE CONTINGENCY—Establishes an expected outcome for a defendant in a monetary claim and specifies that if the firm obtains a better-than-expected result, it will receive a portion of the savings. Encourages the firm to limit damages.

FLAT FEE—Sets an agreed-upon sum of money for a discrete amount of work. The firm, not the client, assumes the risk of cost overruns. Encourages firms to perform distinct pieces of work efficiently.

FLAT FEE WITH SHARED SAVINGS—Sets a flat fee for a matter while allowing the firm to track the work on an hourly basis. If, at the conclusion of the matter, the hourly fee is lower than the flat fee, the client and the firm share the difference. Provides a guarantee of a low cost to clients who are otherwise comfortable with hourly billing.

HOLDBACK—Specifies that the client will withhold an agreed-upon portion of the total fee unless the firm obtains a particular result. Encourages both the firm and the client to measure success quantifiably.

PARTIAL CONTINGENCY (OR SUCCESS FEE)—Sets a bonus that the firm receives in addition to its hourly, flat, or capped-fee arrangement if the result meets agreed-upon criteria. Encourages the firm to obtain a positive result for the client.

PHASED FEE—Sets agreed-upon fees, perhaps using differing structures, for discrete phases of a matter. Gives maximum flexibility to both the firm and the client.

Economic Imperative

For many in business, 2008 was clearly a watershed year whose ripple effects were felt in all parts of the organization, especially in the legal department. Suddenly, managing legal budgets—in particular outside counsel spend—took on a whole new level of importance and immediacy. “We probably started using [AFAs] heavily when the economy started to turn because it gave you a lot more certainty in terms of the legal spend,” says Verona Dorch, vice president, deputy general counsel, and assistant corporate secretary of Camp Hill, Pennsylvania–headquartered Harsco Corporation. “It became a way to start smoothing out the bumps.

Others point to a financial imperative. “A couple of years ago, we were bleeding money, subprime was killing everybody, and management said get costs [including legal] under control,” says the chief counsel of a large U.S. bank. “The target [to cut expenses] was 30 percent, and we ended up at 55 percent year over year.”

Apart from the pure economics of cost control, there is another reason why legal departments like to use AFAs: aligning business interests. From the perspective of many clients, hourly billing offers a conceptual problem. “It incentivizes inefficiency because lawyers get paid based on how much time they spend on a matter,” says Joshua Frank, general counsel and secretary for DHL Americas. In theory, hourly can drive a firm to inefficiency because spending more time on a matter than it deserves increases total billing.



[The billable hour] incentivizes inefficiency because lawyers get paid based on how much time they spend on a matter.”

Joshua Frank, general counsel and secretary for DHL Americas.

CASE STUDY: Medtronic (Legal Department)

I’d love to say that we got involved in alternative fee arrangements because of our farsightedness and the great vision we have,” says Medtronic general counsel and corporate secretary D. Cameron Findlay. “But we were driven to look at them because of the cost pressures that companies all over the country are facing.” That was three years ago, when e-discovery started to drive up the cost of litigation. “I looked at the bills coming in and they were 50 percent higher than they ought to be,” Findlay says.

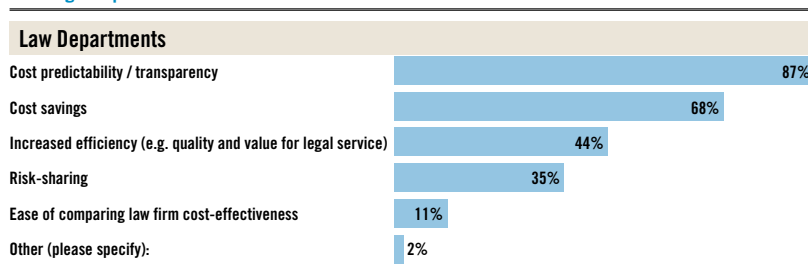
Findlay has tried a number of different AFA structures: monthly flat fees, contingencies as both plaintiff and defendant, blended rates, and combinations. “As each case comes in, we think about what sort of alternative fee arrangement do we use here?”

The company is currently using contingency on one case. “When we get to the end of the day, I have a feeling we will have paid the law firm more than we would on an hourly basis,” Findlay says. “But it gave the firm an enormous incentive to work hard to win the case and it relieved the business unit from the burden of having to fund the litigation, when there might not be a return on it.”

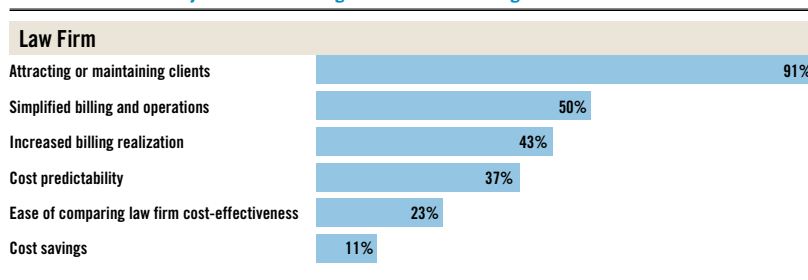
Medtronic will often propose a contingency arrangement to test a matter’s merits. “If [the law firm] won’t [take it], it tells us that they don’t think they will win,” Findlay says, “and we have to [re]consider whether we can.” But it’s never a negotiation tactic to get a concession. “I think you’d only get to do that once before someone wouldn’t do the work for you next time.”

The survey finds that cost predictability, cost savings, and increased efficiency are the major benefits of instituting AFAs from the perspective of the legal department, with risk-sharing appearing in a strong fourth place. But while a number of law firm attorneys in interviews talked about aligning interests with and providing value for clients, their top reasons for using AFAs were different than their counterparts in legal departments, in that their focus is more on attracting or maintaining clients, simplified billing and operations, and increased billing realization.

What do you believe to be the THREE major benefits of using alternative fee arrangements for a legal department?



What are the THREE major benefits of using alternative fee arrangements for the law firm?



Each side has its reasons for and incentives to using alternative fee billing, and both expect AFAs to expand their presence in corporate law matters. However, if the billable hour is to go the way of the dinosaur, law firms and legal departments alike will have to overcome some significant challenges.

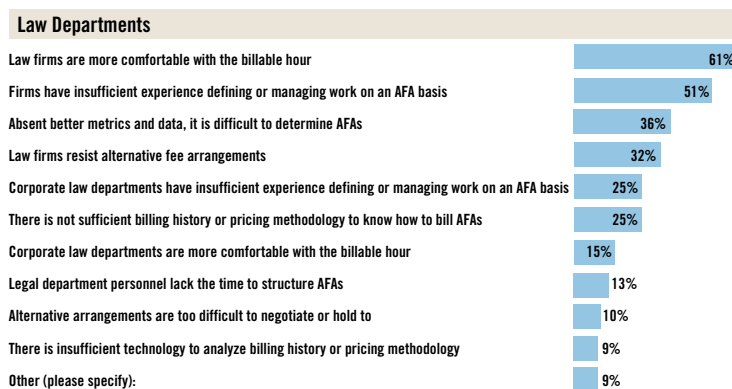
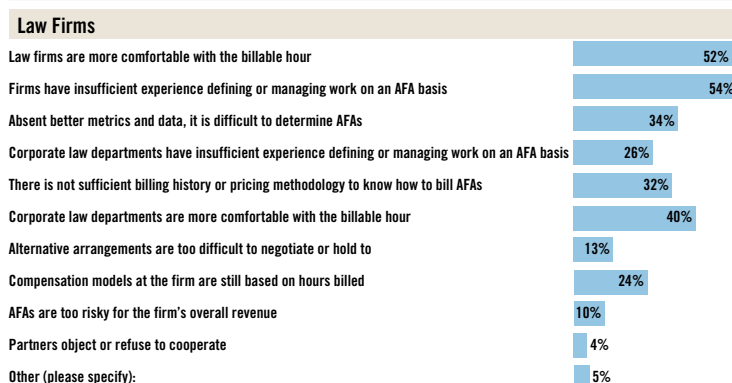
PART II: OBSTACLES TO GROWTH

ASK A LAW FIRM PARTNER LIKE KING & SPALDING'S DWIGHT DAVIS about why AFAs had not become a bigger deal sooner and the answer points to the client. "As a young partner, I used to make pitches like this all the time: 'Say, don't you think this makes more sense?'" he says. "After some futzing around, the client would come back and say, 'No. How about that 10 percent discount?'"

"I think, historically, it sounds like a great idea but is challenging for clients to get their arms around," says Pillsbury Winthrop Shaw Pittman partner Robert Wallan. "They get uncomfortable with the possibility of the law firm making a much higher fee than on an hourly basis."

And yet, the view from the other side of the department-firm debate is often at odds with what the law firms are reporting. According to Dorch, "At the beginning, our law firm partners weren't embracing [AFAs] with open arms."

What do you believe to be the THREE biggest obstacles to the growth of AFAs?



The Devil in the Details

Probe more, and you realize that both sides of the legal coin have major challenges in adopting alternative fee arrangements. One obstacle that is proving exceptionally difficult to overcome is the amount of work required in figuring out how to structure the alternative fee arrangement.

“The truth is, it’s been harder to change the mind-set of the inside counsel than the law firm,” says an inside counsel who wishes to remain anonymous. In many legal departments, lean staffing and demanding workloads make this extra work especially burdensome. Then there’s a lack of training in undertaking a business analysis to learn how to structure the fees.

“The attorneys here want to practice law, and the law schools don’t teach lawyers that it’s a business,” says the anonymous in-house lawyer. “They teach lawyers that it’s a noble pursuit and that nobody wants to dirty their hands with money. I have a hard time convincing the lawyers here, and it makes them angry and crazy when I say this, but at the end of the day ... we buy legal services the way some people buy copy paper.”

Additional work also means additional hours in a schedule that is already packed full. Convincing in-house counsel to devote time to fee structuring becomes even more difficult when they see that the money saved in one matter seems insignificant compared the size of the overall department budget, let alone overall corporate net profits or losses that are exponentially larger.

Not all in-house lawyers enjoy the process of structuring an AFA. “You have to have the right type of people negotiating this,” says Harsco’s Dorch. “I’m a deal lawyer, so I’m comfortable negotiating. Some aren’t,” even when they are lawyers.

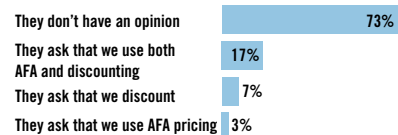
Legal departments also have a long-standing disincentive to structure AFAs: traditional discounts that have made them look like heroes to their organization. “[If an in-house counsel] accomplished getting a 10 percent discount on every legal dollar we spend, everyone would say, ‘You did a good job,’” says Goodwin Procter partner Laura Hodges Taylor. But that eventually becomes a dead end. “They can’t show that they’re doing better,” she says. “It’s oddly unsatisfactory after a time.”

Law firms also have their issues with AFAs, particularly in terms of workloads. “It’s the same for the lawyers,” Taylor says. “The amount of time it takes to analyze 30 transactions of a particular type, figure out where the variations were, interview the lawyers that did each one before you make your own budget that allows you to figure out how and whether the fee arrangement would be profitable [is] enormous.”

According to one major firm partner who asked not to be identified, even getting lawyers to track their time in the ways necessary to obtain the data to analyze is challenging. “Not only do I have to write down my fricking billable time for every matter, but I have to code it,” says the partner. “And we already don’t like keeping track by the six minutes. Imagine if in every six minutes you had to track by task and phase. It’s the old geezers like me that really can’t stand the thought.”

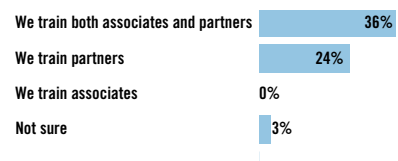
If your company puts pressure on the law department to demonstrate value, do they request that the law department use AFAs, discounting, both or do they even have a preference?

Law Departments



Is there an effort underway at your firm to train associates and/or partners in implementing AFAs?

Law Firms



It Still Comes Down to the Billable Hour

Firms have an additional problem with the increase of AFAs in that their compensation models focus on individual billable hours and realized rates. “Even when we talk about billable hours and alternative fee arrangements, if your internal structure doesn’t change, in the long run it’s doomed to failure,” says the chief counsel of outside counsel relations at a major banking institution. “You’re still converting the value of your work to billable hours. I don’t think it’s appropriate to compensate an associate who bills 3,000 hours more than an associate who provides higher-quality work and more efficiently but who only bills 2,000 hours. Unfortunately, the way law firm compensation is structured, that’s what happens.”



“The attorneys here want to practice law, and the law schools don’t teach lawyers that it’s a business.”

Anonymous in-house lawyer

Compensation commonly presents a challenge to companies when strategy asks for one behavior but promotes another, as employees will do what they are paid for, not what they are told. In this case, law firms run into the classic business problem of sub-optimization: when one part of a system improves its production of a given criterion but the larger whole is hurt as a result.

A law firm presumably wants to maximize total profit for billable time, so maintaining target hourly rates would seem desirable. However, there is an underlying assumption that the number of billing hours does not change. That is not necessarily correct. There are a number of ways in which an alternative fee arrangement could increase the total number of billing hours:

- Firms could attract a greater portion of business from their clients.
- AFAs could make the firms more competitive in gaining new work.
- By locking down blocks of work, firms would open the marketing time that would have been necessary to win it for other billable use.

A simple example shows the issue. Law Firm A has ten hours available for billing. Because it focuses on maintaining a \$500 an hour rate, it books five of those hours, for a total of \$2,500. Law Firm B uses an AFA with a client that calls for a blended rate of \$400 per hour, but it books eight hours of work, for a total of \$3,200, or revenue that is 28 percent higher than Law Firm A.

Although the reality of law firm billing is far more complex, the principles are the same. An AFA might mean (though not always) charging effectively less per hour than standard firm rates. But drive up billable time enough, and income and profit increase for the same matters. Structured correctly, AFAs will help a firm mitigate its risk of not being able to profitably use the time of its partners and associates. Given that many major firms continue to expand their use of AFAs, and assuming that the partners are no less interested in making money than others, one might conclude that using AFAs in a growing portion of their work actually delivered more financial value to the firms than straight hourly billing would have.

Software Not Sufficient

One of the most challenging aspects of using AFAs for either department or firm is collecting, managing, and analyzing data. “In the last six to nine months, we’ve seen an accelerated interest in [AFAs], but it coincided with more tools in the firm and knowledge about it,” says Miles Stockbridge chairman John Frisch.

A majority of legal departments are now using ebilling software to plan, manage and track alternative fees. They are finding this to be more effective than matter management and accounting software, however, it does not facilitate the use of alternative fees in every case. Law firms are primarily using their accounting software for the management of alternative fees. These billing and timekeeping systems do not fully support AFAs, but there are some emerging financial planning software products that work with these systems and include functionality for evaluating and managing alternative fees, better meeting the need. Quality data for structuring more effective AFAs requires better software. Some firms, like Goodwin Procter, develop their own, but that has its own difficulties in attracting enough talent with the necessary expertise in analyzing large amounts of data. However, software by itself is not enough. Both law departments and law firms talk of a need for culture change, collaboration and the establishment of trust to have alternative fee arrangements work effectively.

“Even when we talk about billable hours and alternative fee arrangements, if your internal structure doesn’t change, in the long run it’s doomed to failure.”

Chief Counsel of outside counsel relations at a major banking institution

CASE STUDY: Goodwin Procter (law firm)

Goodwin Procter has used AFAs periodically for at least 20 years. But four or five years ago, some partners decided to examine what exactly made the agreements work. “One of the most important elements ... would be to understand what it actually takes to do the things we do,” says partner Laura Hodges Taylor. “How much does it cost us in terms of hours to do a motion to dismiss, to take a deposition?”

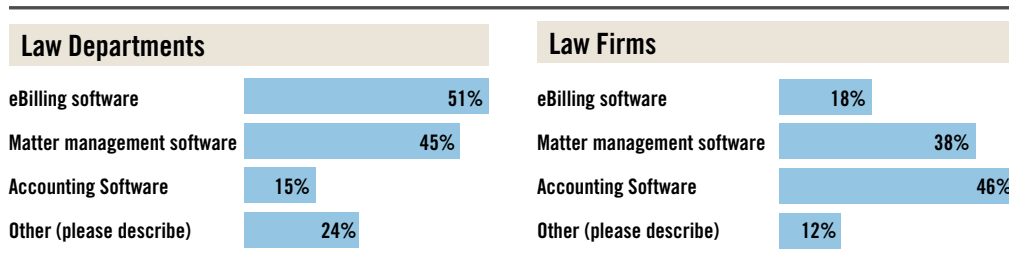
The firm started tracking matters at a deeper level by developing custom software that works with its billing and time entry systems. “If everyone enters their time properly ... then you can match it against budget and identify the minute things go out of whack,” she says. “We’d ultimately be able to look and say, ‘Is the right person doing this job? Could it be done just as well

and cheaper by a paralegal? Would it be better done by someone senior?’”

The best approach for Goodwin is to rely on data mining tools that analyzes information the firm currently has instead of pushing for real-time data collection by attorneys as they bill time on matters.

The data should help with proper budgeting and staffing, but the worry is always that the firm will find that it has no place to go but down. “There’s a lot of inertia that pushes against any really meaningful use of alternative fees, other than discounts,” Taylor says. “[Clients] don’t want to do fixed fees. They assume we’ll set the price above what the cost would be so we make money.”

Do you use software to plan, manage and track AFAs? If so, which? Check all that apply.



Has the use of any of these software systems actually helped facilitate the use of AFAs with your law firms / clients? (Scale: Always=1, Often=2, Sometimes=3, Never=4)

Law Departments			Law Firms		
	Mean	Responses		Mean	Responses
Matter management software	3.3	58	Matter management software	2.7	77
Accounting Software	3.5	46	Accounting Software	2.7	77
eBilling software	2.9	61	eBilling software	3.1	55
Other	3.2	22	Other	3.0	18

PART III: AFAS ARE HERE TO STAY (SO WHAT TO DO?)

AS THE SURVEY SHOWS, FOR ALL THE RESISTANCE AND INHERENT difficulties, AFAs are not just here to stay, but they will likely be active in an increasing amount of legal business.

To that end, both departments and firms need practical ways to make AFAs work. One is to alternately take on the role of student and teacher, says D. Cameron Findlay, senior vice president, general counsel, and corporate secretary of Minneapolis-based Medtronic, Inc. “We have learned a lot from a couple of our law firms who have suggested innovative alternative fee arrangements,

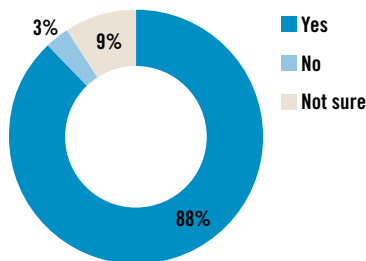
and in that sense, they were far ahead of us,” Findlay says. For firms that haven’t been as advanced, “we’ve been the teacher instead of the student.”

“One of our partners for internal purposes did a chart talking about alternative fees,” says Gary Hoffman, partner at Dickstein Shapiro. “Even with doing this at a somewhat high level, I think he had about 30 different combinations of things. When people ask what [AFAs are] limited to, it’s creativity and what makes economic sense both for the law firm and the client. If it’s one-sided, someone might do it, but they won’t do it again.”

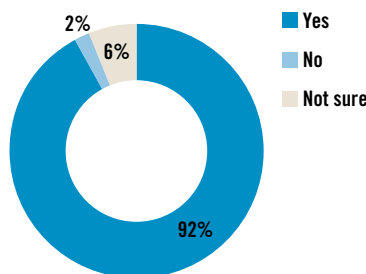
With the growing importance and pervasiveness of alternative fee arrangements, legal department and law firm respondents alike speak of the need for partnership and cooperation when structuring AFAs. Good intentions, however, are not enough. To what extent can firms and clients make that a reality when each side is looking to its own interests? An inherent symbiosis exists to the degree that neither side can ultimately recognize its goals without enabling the other.

Do you think AFAs will remain a permanent part of legal matter billing?

Law Departments



Law Firms



As for entrenched resistance, Matthew Wagman, a Miles Stockbridge partner in the product liability department, remembers an AFA conference he attended. “[Someone asked], ‘How do you get a lawyer in your firm who has practiced for 30 years billing hourly to use alternative fee arrangements?’ The leader said, ‘You don’t. Your clients will.’”

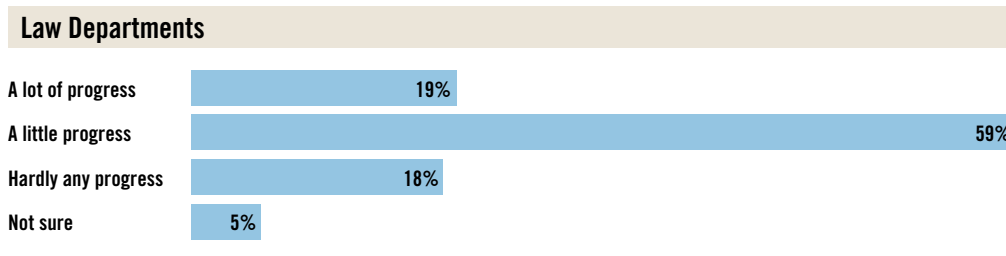
Or they might just do a worse job than you’d like. “Make sure you don’t disincentivize outside counsel from doing the right thing,” says David Shofi, chief intellectual property counsel of Danbury, Conn.-based ATMI. “If they feel as though they’re being asked to accomplish a task and they’ll lose money on the case in terms of their time spent, they’re just not going to spend the time that they should.”

Another way is to focus on legal areas or matters where structuring AFAs can be easiest—the proverbial low-hanging fruit—then advancing from there. “In immigration law, it is not uncommon to bill primarily task-based,” says Nancy-Jo Merritt, a director at Fennemore Craig. But the firm steers clear of AFAs in litigation matters. “If we did a lot of it, maybe some of it we could routinize, because of course clients love to know exactly how much things are going to cost,” she says.

Pillsbury Winthrop’s Wallan put it succinctly. “They shouldn’t think of ‘how can I screw my lawyer to get lower costs’, but ‘how can we work together better to work more efficiently,’” he says. There is responsibility on the part of the law firm, as well: “You don’t need to gold-plate everything. You need to put the amount of resources that are appropriate to the case on the case.”

Both sides must work to learn more and consider the wide range of AFA structures that have proven themselves in such areas as litigation, patent prosecution, and mergers and acquisitions. Whether a structure such as partial contingency, monthly fixed fee, or caps on phases of litigation, the key to successful use of alternative fee arrangements is finding one that best fits the circumstances and the intent of the department and firm. Is cost containment of central importance to a client? Does risk sharing give the firm part of the reward in litigation?

Relative to two years ago, do you think that law firms are making progress understanding and implementing AFAs in general?



CONCLUSION

IF LAW FIRMS AND LEGAL DEPARTMENTS CONTINUE MIGRATING AWAY FROM the billable hour model, both sides will need to embrace profound structural changes, such as training legal staff to manage matters within a budget while keeping an eye on profits. To do so effectively, they will need to develop or invest in pricing databases and other software that monitors the structure and profitability of AFAs. But the larger effort should always focus on the client-law firm relationship, the foundation of which is built on cooperation, honest communication, mutual flexibility, and openness to making tangible changes that ultimately will be to the advantage of both parties.

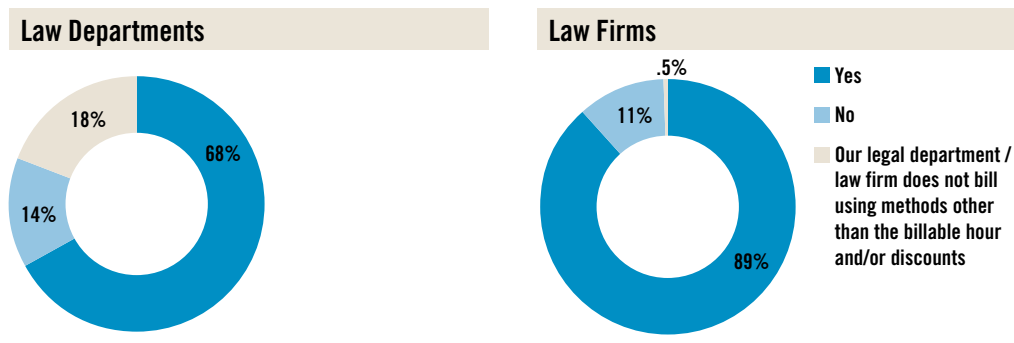
ENDNOTES

* “Allies or Adversaries: Law Firms and Alternative Fee Arrangements”; ALM Legal Intelligence; April 2011

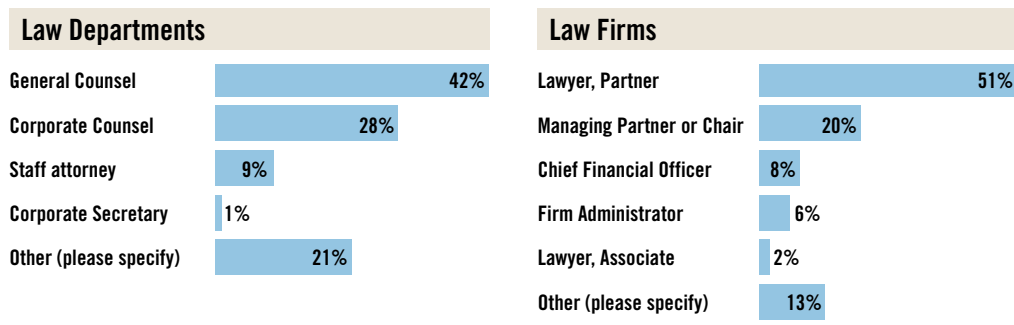
** “ACC Value-Based Fee Primer,” Association of Corporate Counsel, July 2010. Retrieved at acc.com on February 7, 2011.

APPENDIX: SURVEY RESULTS

Do you negotiate, initiate or approve alternative fee arrangements in your legal department or law firm?

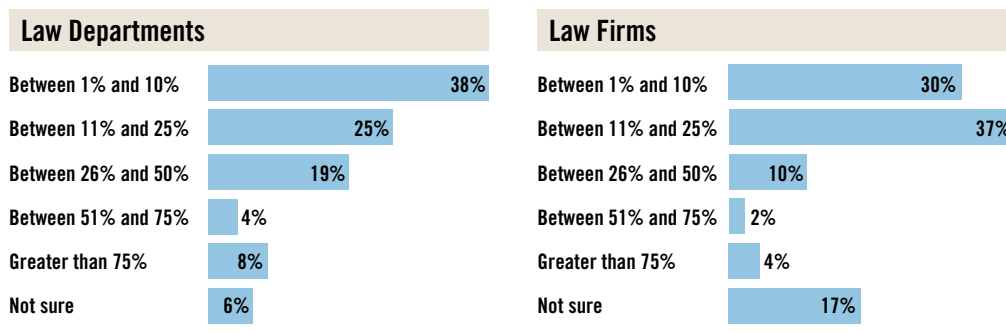


Which of the following describes your job responsibility or title?

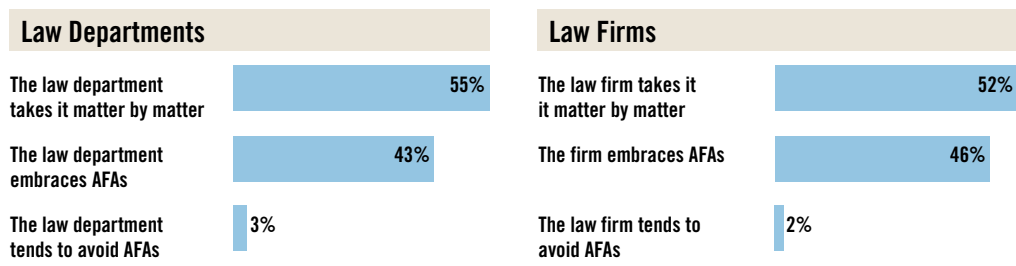


APPENDIX: SURVEY RESULTS

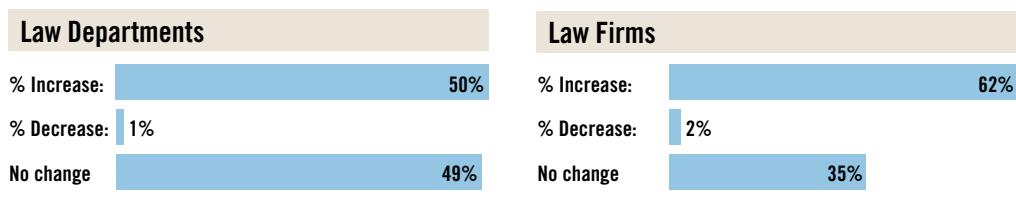
In 2011, approximately what percentage of your legal work was valued through an arrangement that is not based solely on hourly rates?



In general, what is your law department / law firm's philosophy when it comes to AFAs?

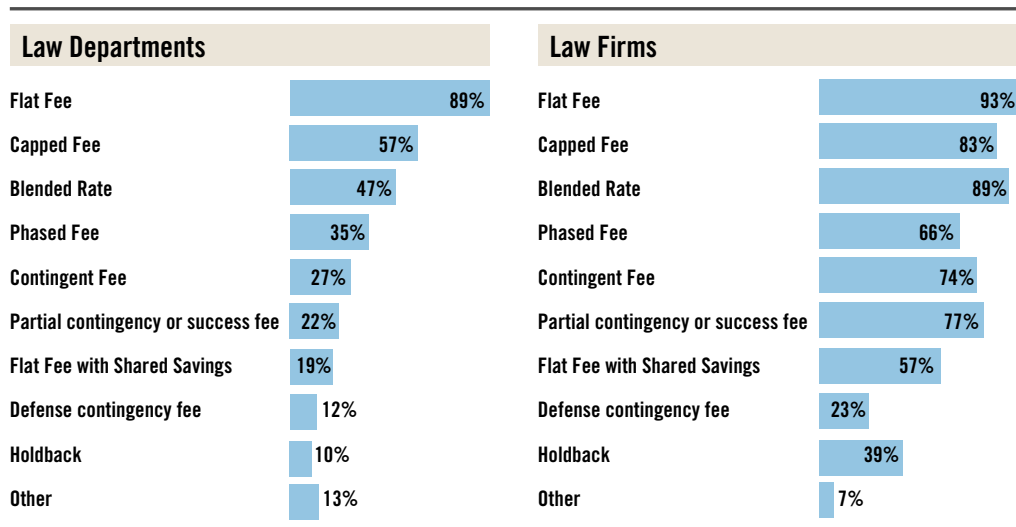


Between 2010 and 2011, what change did your law department/law firm see in the volume of AFAs?



APPENDIX: SURVEY RESULTS

Of the alternative fee arrangements employed in 2011, which of the following does/ did your law department / law firm use? (check All that apply)



Flat Fee: Client pays an agreed upon sum of money for an agreed-upon amount of work. Unlike hourly fee arrangements, flat-fee arrangements have the law firm assume the risk of cost overruns and the client assumes the risk of a bad result.

Capped Fee: Client pays up to an agreed upon sum for an agreed-upon amount of work or for an engagement. Capped fees often are used in conjunction with an hourly rate agreement, but the total amount charged by the hour cannot exceed the cap.

Blended Rate: A blended rate is an agreed-upon hourly rate that applies to all lawyers working on a matter. Some firms consider discounts to the hourly rate a form of AFA.

Phased Fee: Law firm and the client agree upon fees for discreet phases of the work. Different phases might utilize different structures, including the hourly rate, a flat fee, a contingency fee, or an AFA.

Contingent Fee: Law firm gets paid only if it achieves a financial recovery or other result for the client. Typically, the law firm receives a percentage of the total recovery.

Partial contingency or success fee: Law firm might be paid a fraction of its fee under an hourly, flat, or capped-fee arrangement, and an additional amount if the result exceeds agreed-upon criteria.

Flat Fee with Shared Savings: If at the conclusion of the work fees calculated on the basis of the hours worked would be less than the flat fee, the client and law firm share the savings.

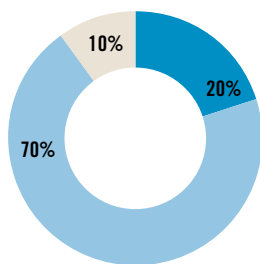
Defense contingency fee: Law firm defending a client against a monetary claim agrees with the client on an expected outcome. If the firm achieves a better result than the expected outcome, the client pays the firm a percentage of the savings.

Holdback: Client withholds an agreed-upon amount or percentage of the fee until an agreed-upon milestone or result is achieved, or until completion of the engagement. The obligation to pay the amount withheld is triggered if the law firm achieves a result.

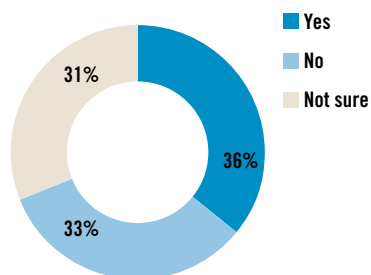
APPENDIX: SURVEY RESULTS

Has your legal department ever instituted / Has your firm ever been asked to bid on work via a reverse auction (or competitive bidding in an effort to get firms to lower prices on high-volume, repetitive work such as tax filings or IP transactions)?

Law Departments

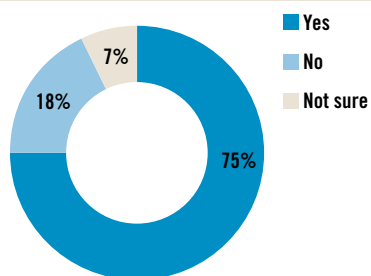


Law Firms



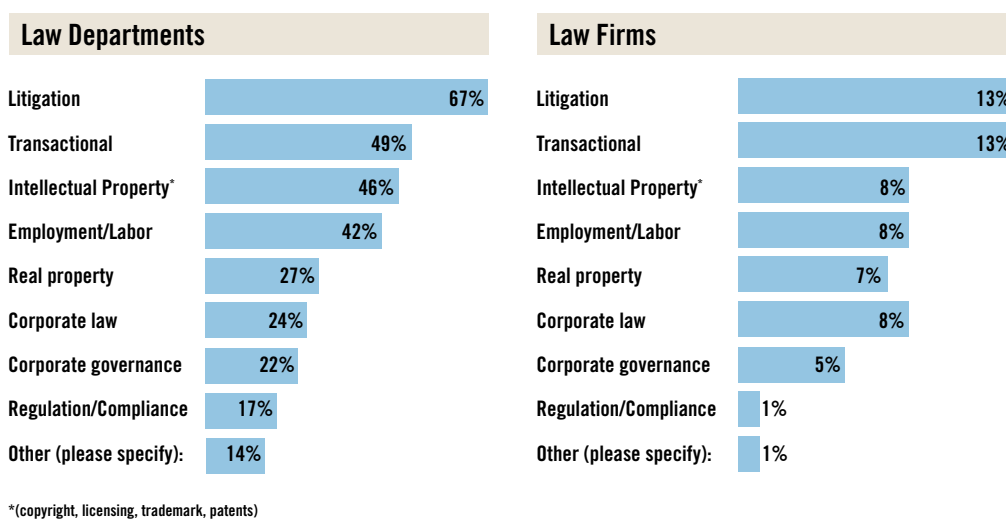
Has your firm bid on these reverse auctions?

Law Firms

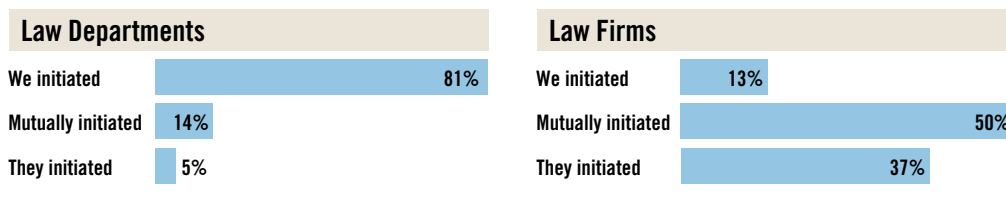


APPENDIX: SURVEY RESULTS

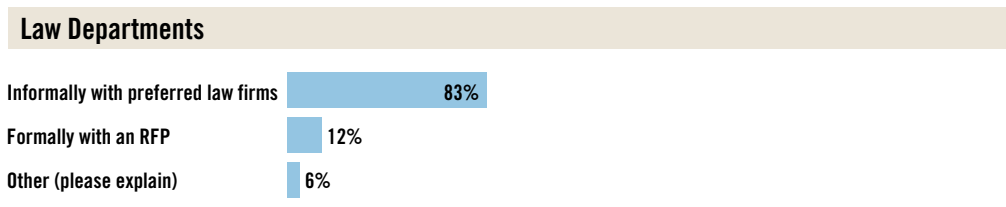
In some cases, AFAs are isolated to certain legal practice areas. In which of the following practice areas do you work to arrange AFAs? (check all that apply)



Thinking about the majority of matters billed using an AFA in 2011, how were they generally initiated?

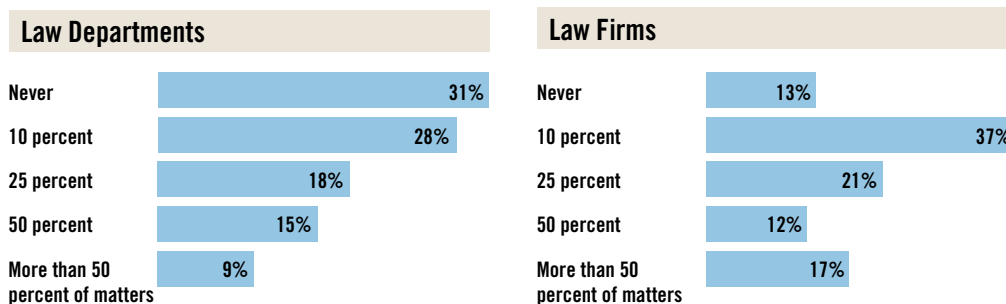


In general, how do you approach law firms when requesting AFAs?

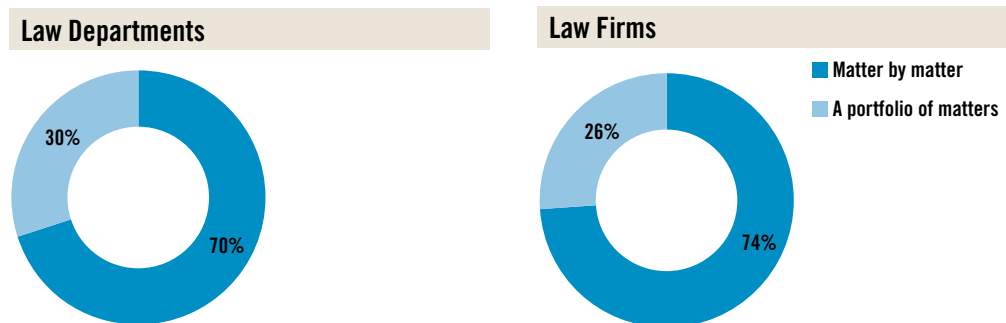


APPENDIX: SURVEY RESULTS

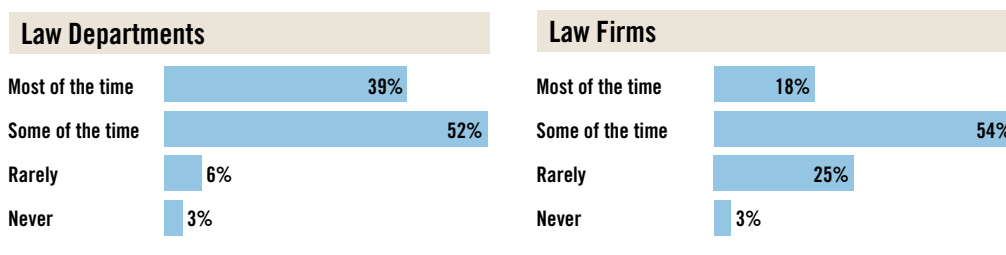
In approximately what percentage of matters did you discuss an AFAs with a law firm / law department but end up reverting to a billable hour model or billable hour with discounting?



Thinking about firms / law departments with whom your law department / law firm negotiates and institutes AFAs, what percentage of AFAs are on a per matter basis vs. a portfolio of matters?



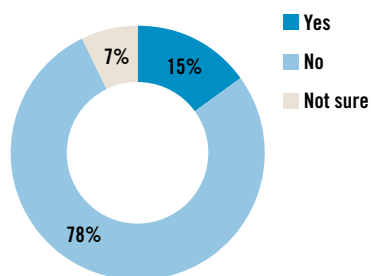
How often does your legal department / law firm make specific suggestions as to how to structure an AFA?



APPENDIX: SURVEY RESULTS

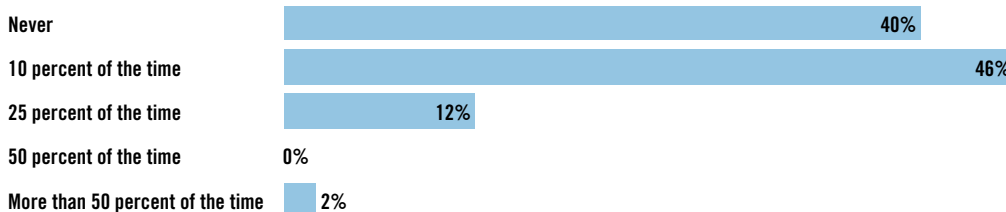
Does your legal department demand that first- or second year associates not bill time on matters?

Law Departments



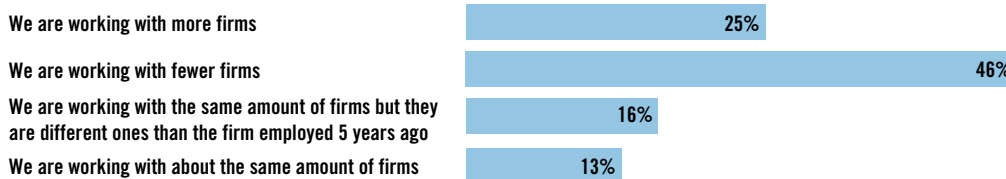
How often do clients demand that first- or second year associates not bill time on matters?

Law Firms



Compared to five years ago, is your legal department working with more or fewer outside law firms?

Law Departments



APPENDIX: SURVEY RESULTS

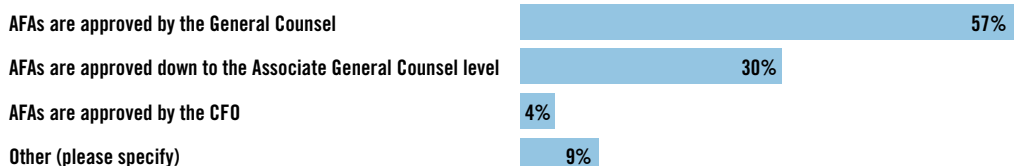
What role did receptivity to AFA pricing play in any changes your legal department has made to its roster of outside counsel?

Law Departments



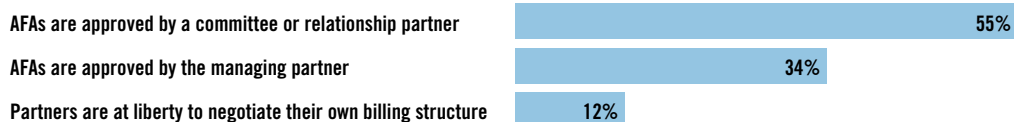
Who approves alternative fee arrangements in your company?

Law Departments



Who approves alternative fee arrangements at your firm?

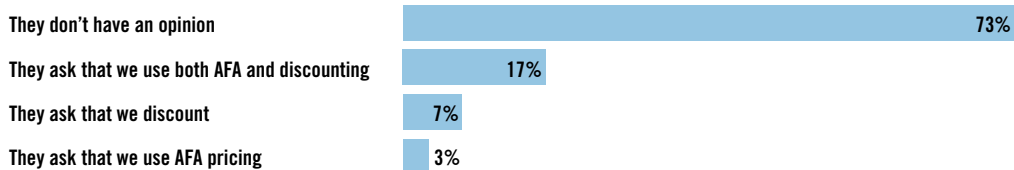
Law Firms



APPENDIX: SURVEY RESULTS

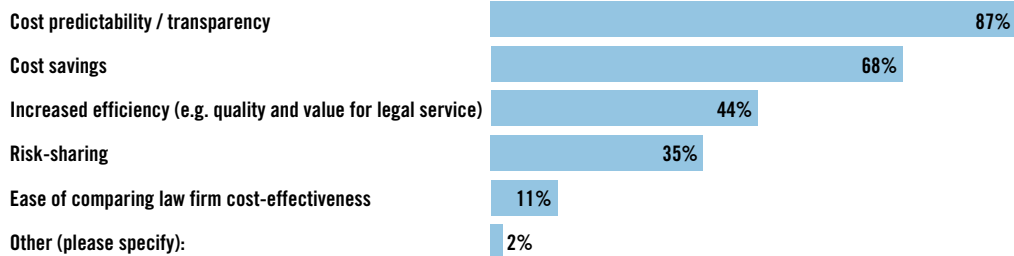
If your company puts pressure on the law department to demonstrate value, do they request that the law department use AFAs, discounting, both or do they even have a preference?

Law Departments



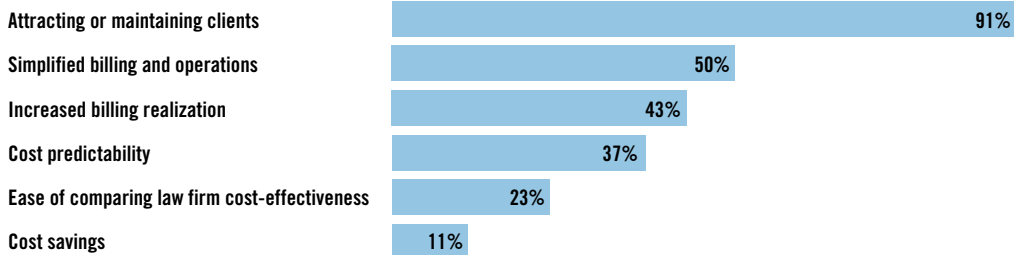
What do you believe to be the major benefits of using alternative fee arrangements for a legal department?

Law Departments



What are the major benefits of using alternative fee arrangements for the law firm?

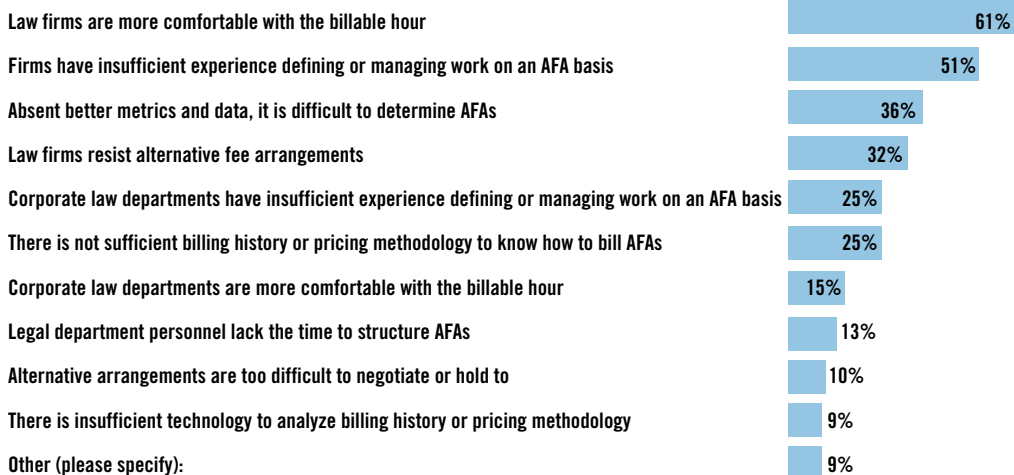
Law Firm



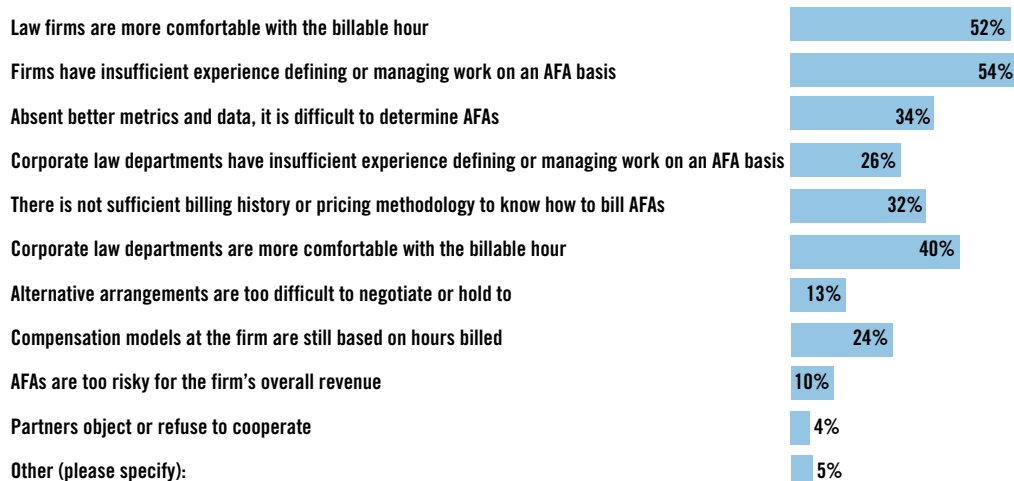
APPENDIX: SURVEY RESULTS

What do you believe to be the biggest obstacles to the growth of AFAs?

Law Departments



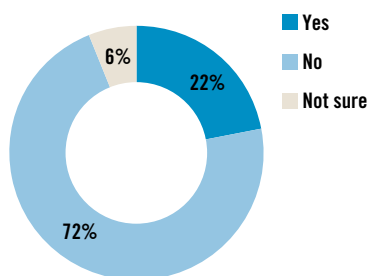
Law Firms



APPENDIX: SURVEY RESULTS

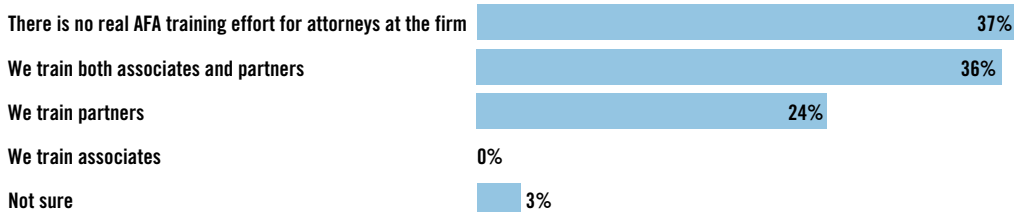
Is there an effort underway at your law department to train legal staff in requesting or implementing AFAs?

Law Departments



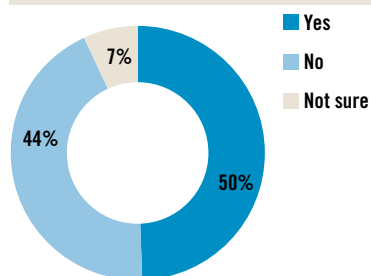
Is there an effort underway at your firm to train associates and/or partners in implementing AFAs?

Law Firms



Thinking about project management (the process of tracking, controlling, analyzing, and reporting on work flow), does your legal department train staff in improving efficiencies and understanding costs per matter?

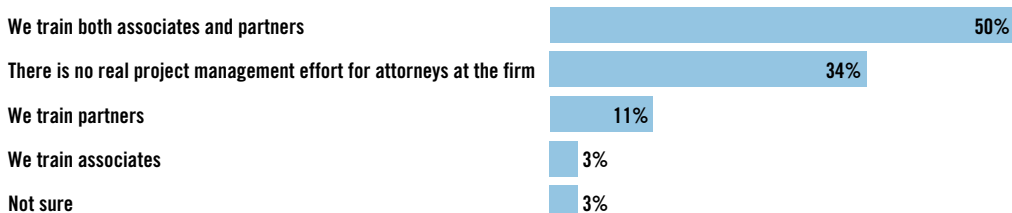
Law Departments



APPENDIX: SURVEY RESULTS

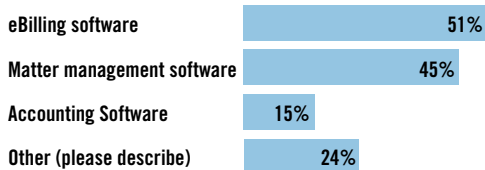
Thinking about project management, does your firm train attorneys in improving efficiencies and understanding costs per matter?

Law Firms

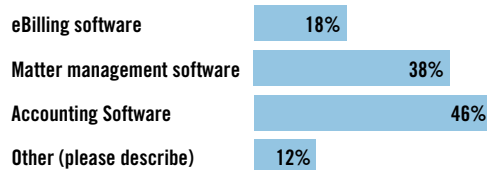


Do you use software to plan, manage and track AFAs? If so, which? Check all that apply.

Law Departments



Law Firms



Has the use of any of these software systems actually helped facilitate the use of AFAs with your law firms / clients? (Scale: Always=1, Often=2, Sometimes=3, Never=4)

Law Departments

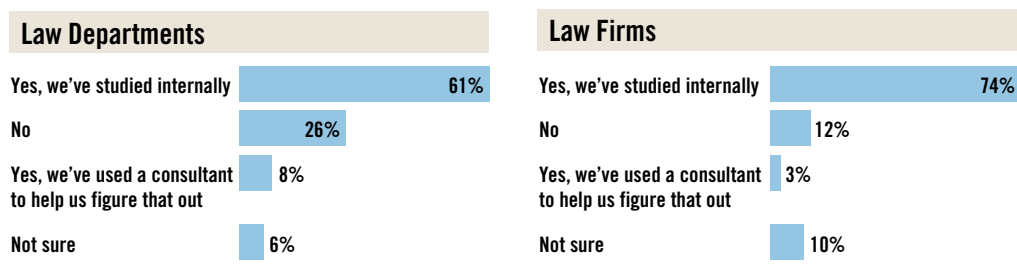
	Mean	Responses
Matter management software	3.3	58
Accounting Software	3.5	46
eBilling software	2.9	61
Other	3.2	22

Law Firms

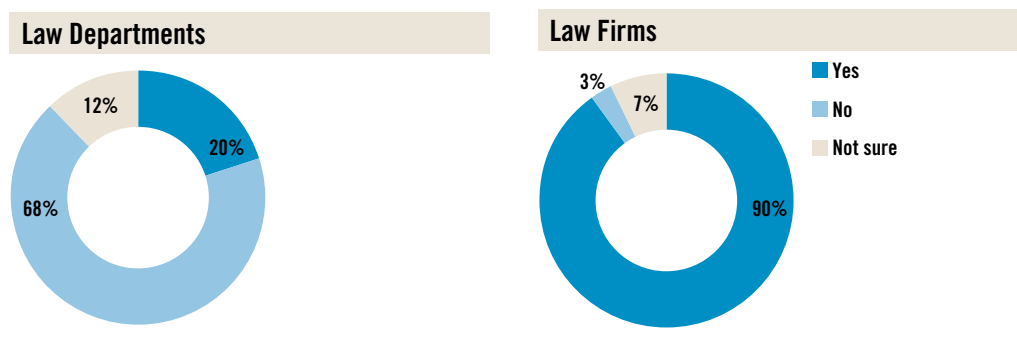
	Mean	Responses
Matter management software	2.7	77
Accounting Software	2.7	77
eBilling software	3.1	55
Other	3.0	18

APPENDIX: SURVEY RESULTS

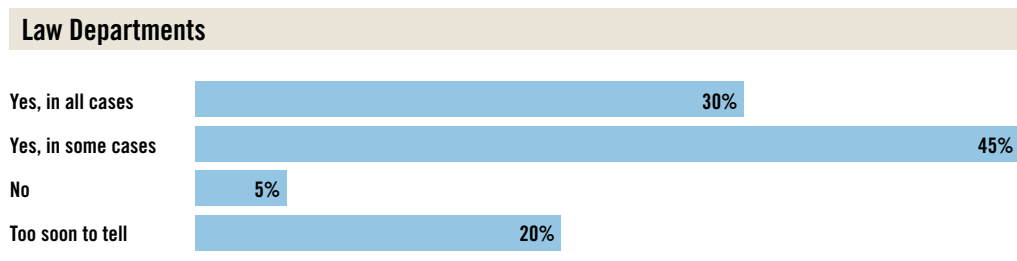
Has your legal department / law firm studied past expenses on outside counsel billing in an effort to learn how costs should be structured for matters or ongoing legal work?



Does your legal department / law firm have measures in place to determine the value or ROI / financial success realized from an AFA?



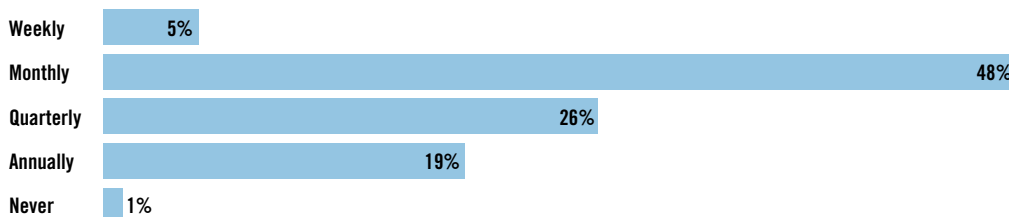
When your department has used AFA pricing structures, has your department realized value or ROI than matters with costs structured strictly on the billable hour or with discounts?



APPENDIX: SURVEY RESULTS

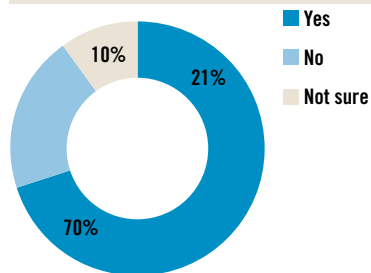
With what frequency does your firm monitor the profitability (or loss) of alternative fee arrangements?

Law Firms



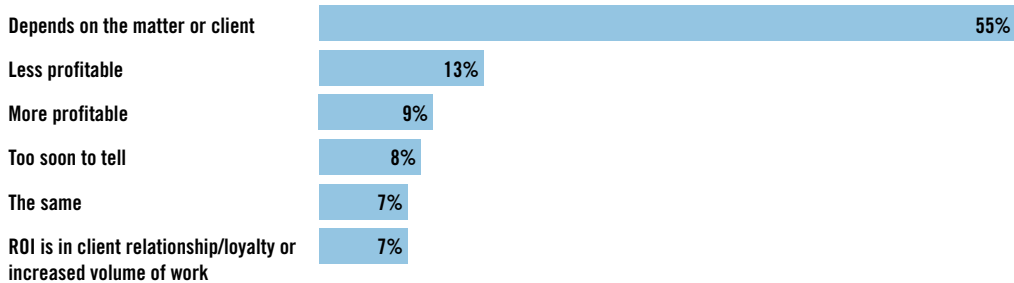
Does your firm record and code hours spent on a task or matter so that the firm understands how long similar tasks might take in the future?

Law Firms



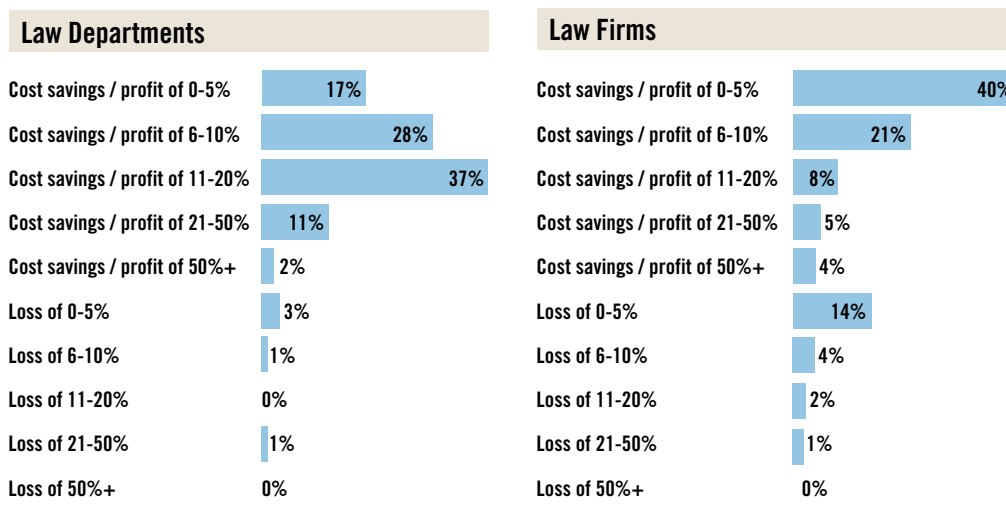
In your best estimation, are matters structured with AFAs more or less profitable to the firm than matters with costs structured strictly on the billable hour or with discounts?

Law Firms

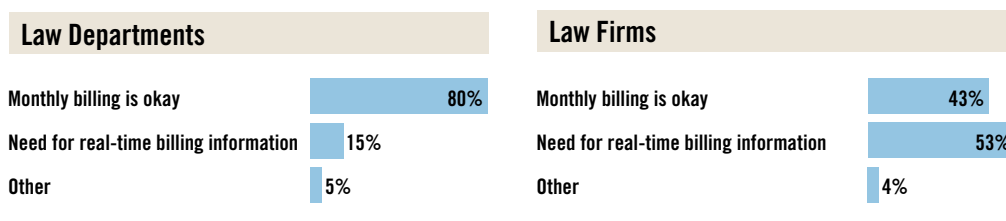


APPENDIX: SURVEY RESULTS

What kind of cost savings / profit or losses has your law department / law firm realized as a result of AFA billing?



What are your timing needs for billing information in order to manage matters around AFAs?



APPENDIX: SURVEY RESULTS

How do you foresee the volume of alternative fee billing changing in the next year?
How about 5 years from now?

Law Departments

2011 to 2012



2012 to 2016



2011 to 2012



2012 to 2016



Law Firms

2011 to 2012



2012 to 2016



2011 to 2012

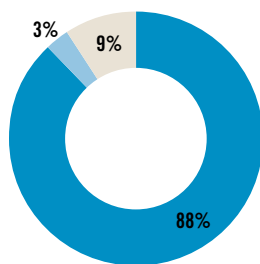


2012 to 2016

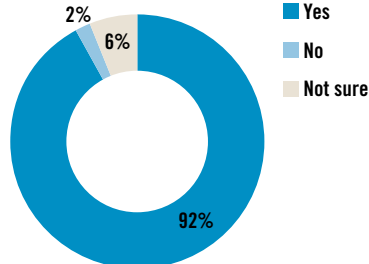


Do you think AFAs will remain a permanent part of legal matter billing?

Law Departments



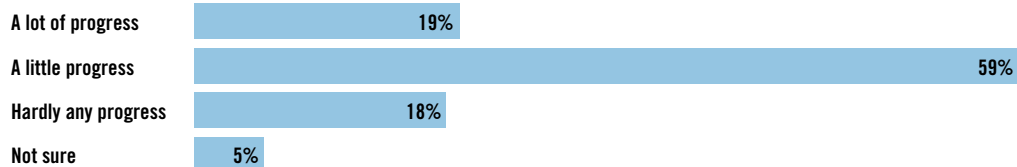
Law Firms



APPENDIX: SURVEY RESULTS

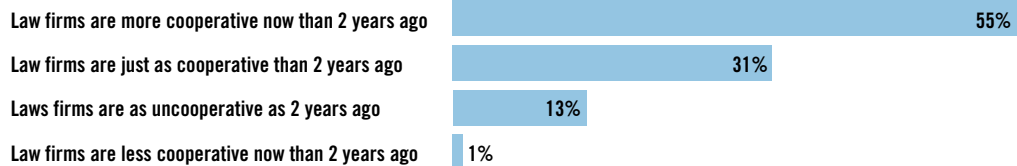
Relative to two years ago, do you think that law firms are making progress understanding and implementing AFAs in general?

Law Departments



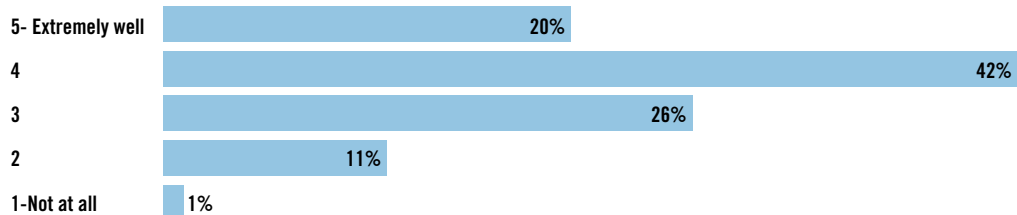
Relative to two years ago, how well are law firms cooperating with legal departments on structuring and implementing AFAs?

Law Departments



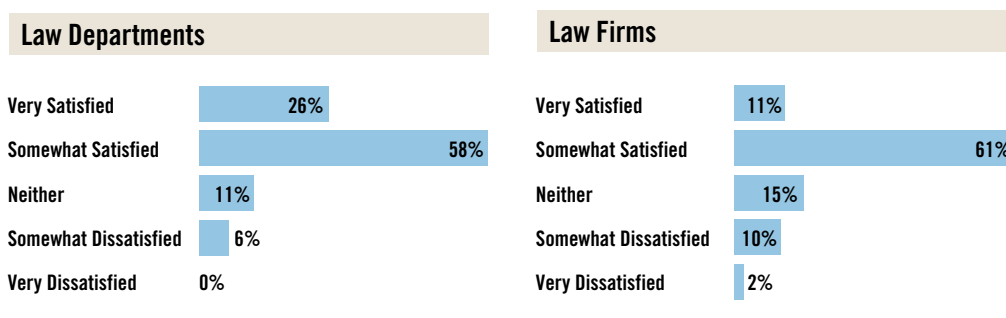
Assuming AFAs become a more significant form of legal fee arrangement, how well would you say your firm is equipped to embrace this paradigm shift?

Law Firms

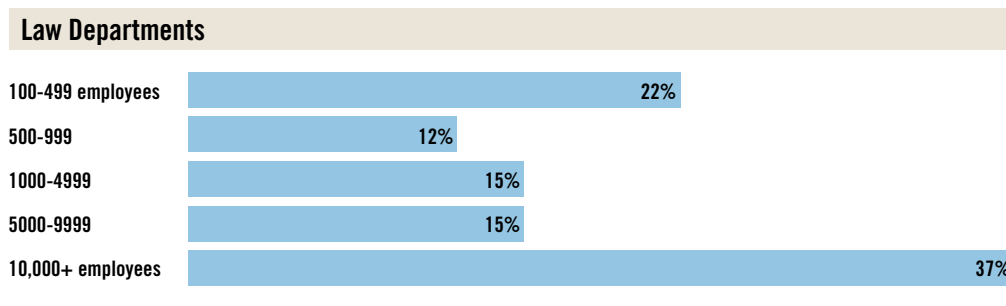


APPENDIX: SURVEY RESULTS

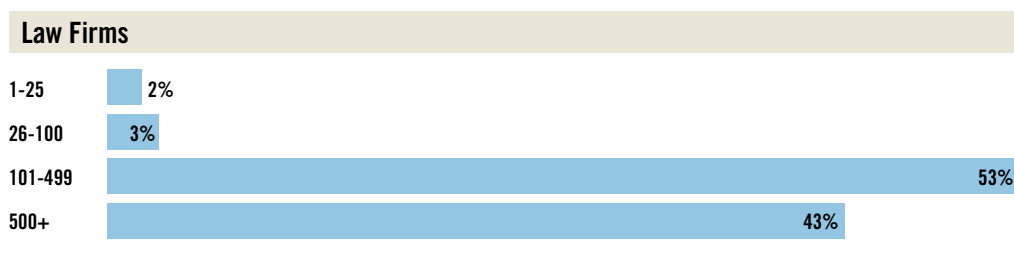
Overall, how satisfied is your law department / law firm with AFAs?



How large is your organization?



How many lawyers are in your law firm (nationwide)?



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