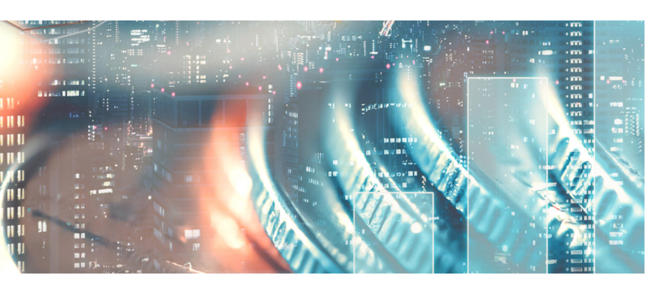

3 Insights We've Learned After a Decade of Alternative Fee Arrangements

AFAs have become a more common pricing method in the legal industry, but what have law firms learned — and what's changed about their use?

Before the Great Recession, some law firms may have agreed to a type of contingency pricing or, from time to time, offered a client a fixed fee.

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After the 2007–2009 economic decline, alternative fee arrangements (AFAs) became a much more common occurrence as legal departments — facing internal pressure to reduce expenses — urged firms to lower their costs, according to Michael Rynowecer, President of the legal research and advisory services company BTI Consulting Group.

"They provided tremendous savings," Rynowecer says. "Clients reported law firms were generally more focused and disciplined in developing a strategy, because in most cases, these were fixed fees, so they wanted to make sure they got to the endpoint as fast as they could. And clients said, 'In addition to the savings, I now have budget certainty.'"

Between 2010 and 2011, half of legal departments saw their AFA volume escalate by almost 30% on average, according to LexisNexis research; 62% of law firms reported the amount of AFA matters they were handling had increased.

A number of firms, at first, may not have known how to make AFA matters profitable. However, in the more than a decade since, industry members have found several factors — including the following three — will help eliminate some of the uncertainty that can arise when legal service billing isn't directly based on time tracking.

1. DATA IS KEY

Law firms have learned over the years that to best price legal matters, they need to be able to estimate the related time required, staffing demands and other aspects. That means they also need to keep accurate records of what past work was involved, according to Chris Ryan, Vice President of Client Development at HBR Consulting, which advises law firms and departments on operations.

"Without that data — without doing some of the unsexy stuff to put that matter taxonomy in place, which has really been challenging for law firms — it becomes really tough to price these things well," Ryan says.

Not all firms have embraced a data-driven approach to AFAs. The ones who have sought out ways to clean up and utilize that information, though, have reaped the benefits, Ryan says.

"Too many firms just back-of-the-napkin that stuff, or apply whatever historical team and people are working on things, without getting in front of it in a more thoughtful and perhaps strategic way," he says. "Law firms investing in the technology and people have seen the benefits both from a client relationship and a financial standpoint."

2. DEDICATED RESOURCES CAN HELP SUPPORT TODAY'S MORE SOPHISTICATED PRICING PROCESS

As of March 2020, 73% percent of firms with 250 lawyers or more employed pricing officer, director, coordinator or other pricing support roles, according to Altman Weil's Law Firms in Transition survey; 35% percent of firms with fewer than 250 lawyers had done so.

A fall 2021 survey found 75% of North American firms with 100 or more attorneys had hired a pricing expert in the past year and a half, while 23% said they were planning to recruit a pricing professional in the next two years.

Numerous firms, according to Ryan, see the benefit of having business professionals working with partners to develop proposals, figure out how to coordinate annual rate increases, and make sure any discounts and rates are properly applied in the firm's financial systems.

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"It may be they're literally the director of pricing, or there's a small team of them," he says. "[At] some firms, their remit is across a few different things — they're in the finance team, and pricing is one of a few main responsibilities."

International labor and employment law firm Ogletree Deakins added a director of pricing position several years ago, according to Chief Client Services Officer Jim McGrew. The firm also has a pricing committee that reviews all proposed AFAs, which can range from flat fee arrangements to blended rates, where the firm will charge a partner and an associate fee.

Typically, a client will express an interest in an AFA to the attorney it's working with, either through a request for proposal (RFP) or informal conversation. The attorney, McGrew says, may then work with the pricing director to develop a potential arrangement. After it's approved by the pricing committee, the firm formally makes the AFA offer.

"It has become a much more engaging conversation between the law firm and the client," McGrew says. "Sometimes — for example, if a client wants you to do a flat fee for a large amount of work — you might need some data to try to help you understand how best to price it. So it becomes a more open flow of information on what [makes] the most sense."

> "Law firms investing in the technology and people have seen the benefits both from a client relationship and a financial standpoint."

Project management is also becoming more of a focus for law firms, according to Rynowecer. This is helping to increase their confidence in their pricing abilities. More than half (58%) of the firms that participated in a Citi Private Bank survey said they planned project manager-related growth in 2022.

"You're seeing the large and midsize firms adding it; you're seeing the smaller firms maybe contracting it out or doing it themselves," Rynowecer says. "Either way, it's definitely coming into the mainstream, and that's been helpful, especially when you have a fixed price — making sure you're doing what you need to do within a level of effort that makes sense."

3. ONGOING REPORTING KEEPS ALL PARTIES IN THE LOOP

Law firms, according to Ryan, have been investing in tech tools such as dashboards that provide visualization and reporting capabilities, which can help them share data internally to identify any ways the trajectory of a matter should change. This may potentially also offer additional benefits, such as helping the firm track its progress toward diversity employment goals.

Some are also using technology, Ryan says, to communicate matter progress and financial information to clients — a request a *Harvard Business Review* survey found roughly two-thirds of law firms reported a client had made.

"Some have built homegrown tools to display that information; some have purchased technology by vendors to display that on," Ryan says. "Anytime law firms can be proactive and share the time and investments they've put toward innovation — and share how some of these tools will benefit the matter and the client — that means a lot to clients."

FUTURE ALTERNATIVE FEE USE

Although AFAs have grown in use over the years — and likely will continue to — they don't appear to be close to completely replacing the traditional law firm pricing model. For instance, AFAs are more prevalent at larger law firms, yet more than 3 out of 10 large firms only use AFAs for 10% or less of their work, according to Bloomberg Law's 2020 Legal Operations Survey.

"The vast majority is still by billable hour," Ryan says. "If you looked in the last 10-plus years, that [AFA] trajectory has gone up — maybe not as significantly as we anticipated. The majority of corporate legal departments have an AFA program. I'd say less than 10% are starting the process of requiring an AFA for a certain type of work."

Alternative fee arrangements aren't the right fit for all clients: Some may only want a portion of the work a firm does to not be hourly; others may not want any kind of AFA at all.

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Over the years law firms have found that a number of clients do like having the option of an AFA, according to Rynowecer.

Due to some of the benefits this pricing approach can provide, law firms may, too. AFAs' positive marketing factor has influenced 35% of law firms to use the pricing structure, according to Bloomberg Law's 2021 Legal Operations Survey; 33% of firms feel AFAs can provide them with cost and revenue certainty.

That's contingent, of course, on law firms thoroughly understanding what the work will require and how to efficiently perform it. That's why Rynowecer says budgeting, monitoring and managing can mean the difference between a successful AFA and ending up with overworked attorneys and lower-than-expected revenue.

"About 30% of law firm partners will tell you they have higher profits under the alternative fee model," Rynowecer says. "The ones that are really good at it generally have some kind of system they have developed over the years. The big thing is they know how to plan and — equally, if not more importantly — they know how to measure costs on a very near real-time basis. They're very good at controlling the time that gets charged to their matters."

About the Author

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