



AFAs – The Search for Predictability

Pricing Perspectives from Industry Experts

Part 1

INTRODUCTION

Match the high costs associated with most legal work against the ever-present need to reduce expenses and Alternative Fee Arrangements (AFAs) are the likely result. The topic always grabs interest and attention. Beyond the financial focus, people generally want to know what others are doing, understand which approaches work well (as a substitute for billable hours), and be reassured they're doing all they can in their own departments.

Those points serve as rationale for this multi-part document, and the presentation of expert opinions captured during a recent industry panel session – Alternative Fee Structures: Starting and Sustaining AFAs through Collaboration. Each part will feature the perspectives of an individual panel participant representing either corporate legal departments or LexisNexis® Counsellink®.

The series starts with the **Counsellink Director of Strategic Consulting, Kris Satkunas**. With a current role involving analytical assessments for thousands of AFA-related matters, and considerable consulting experience on both the corporate legal and law firm sides (see biography after the Q&A), Kris brings unique insights to the topic. Her comments follow the format and sequence of the panel session.

TERMINOLOGY

For the purpose of this paper the following terms and topics are defined as follows:

- ▶ **AFA / Alternative Fee Arrangement:** Any pricing of legal work between a law firm and client other than detailed hourly-rate billing by a timekeeper.
- ▶ **Blended Rates:** A calculated hourly fee, used in proposals or performance assessments after work is completed, that combines the individual rates and hours contributed by multiple timekeepers (partners, associates, paralegals) on a matter or project.
- ▶ **Shadow Billing:** A method of cross-checking AFA performance and savings by requesting standard, detailed hourly billing invoices in parallel with agreed-upon alternative fee charges.
- ▶ **UTBMS / Uniform Task-Based Management System:** A standard set of codes used to classify the type of work or expense being entered into a billing system.

COMMENTARY

Q: Is there a legal department or law firm situation where an AFA would not work?

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A: K. Satkunas – Yes, theoretically. I think there are a couple of circumstances where a legal department would not be able to have an alternative fee arrangement work. One is if the general counsel simply has no interest in doing it, no buy-in, and doesn’t believe in anything other than the traditional hourly billing model. Without buy-in from the top, you’re not going to have AFAs throughout the organization.

Another possibility is a legal department with a complete blank check. Money is no object, and variability in your expenses is expected and normal and okay. Then, I suppose you wouldn’t need alternative fee arrangements. In my experience, I haven’t actually met anyone in those legal departments.

Q: Why use AFAs; what are the benefits to the different parties?

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A: K. Satkunas – There are lots of reasons; but for me, there are three primary ones, and the first two are the same. It’s predictability first ... predictability second ... and then third is cost savings. There are other reasons that are not as important as those, but in my experience it’s really about having that predictability. It involves knowing what you’re going to be spending on a month-to-month basis, knowing what a matter is going to cost you, and knowing what a particular phase of a matter is going to cost you. And, it’s also not having variances to budget, not having variances to your forecast, and not having to explain surprises to anybody within the organization. So those are first. Of course, cost savings are important as well; but from my perspective, predictability is number one and number two.

Q: Can you give specific examples of successful alternative fees being used?

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A: K. Satkunas – Many alternative fees are just different variations of a particular approach. For the most part, we see some sort of fixed fees. It can be a fixed fee for a particular stage or phase of a matter, for the whole matter, or an entire portfolio of matters. It’s still about establishing what a reasonable and fair price is, and how much value you are getting for the particular service that’s being provided. However you break it up, the same sort of exercise is involved in determining what the fixed fee should be. That’s the most common thing we see.

Less common, and more interesting, are alternatives that involve success fees and holdbacks and risk-sharing with the firm. I’m seeing a little bit more of that; but the fixed fee piece is by far the most common alternative that I see.

Q: Is a blended hourly rate an alternative fee; should you use them?

A: K. Satkunas – I have a pretty strong opinion about blended hourly rates. I think they're crazy and it's not in your favor to use them. There is a lot of value in knowing what the blended average hourly rate should be on a type of work, and you should be managing around that. But they ignore the fact that there are two cost variables in an hourly arrangement: one is rate, and the other is hours. The blended rate can be fabulous; but you're not controlling the hours by trying to manage to that. So, I don't like them.

Q: Shadow billing, agreements with caps and collars for risk sharing, and other techniques exist as safeguards on top of AFAs; what do you think of these methods?

A: K. Satkunas – Shadow billing is something we're asked about pretty frequently, and whether I think it's the best practice. There are circumstances where a collar or cap mechanism makes sense to put in place to safeguard the interests of both parties and determine if one or the other is entitled to some sort of refund. But, by and large, my sense is that alternative fees are all about sharing risk. Except for transactional activities in some of the smaller costing types of work, you're only going to enter into an alternative arrangement with a firm where you probably have a long and trusted relationship. Shadow billing kind of flies in the face of a long and trusted relationship. When you say, "I believe the value of this matter is \$100,000, and that's what I'm going to pay you," and then you say, "But I don't really believe you, so why don't you just send me some bills and let me make sure that I'm really paying you for the right hours for it," it doesn't feel trusting to me.

Having said that, I think there is a transitional period – as people start to play with AFAs and start to experiment a little bit and set them up – when it may be appropriate to have some sort of accounting provisions to help get you comfortable with it. But at some point, that transition ends and you stop the shadow billing. This is especially so with transactional types of work where you've got years of data that you're able to mine. You know when the average cost of a certain type of matter is \$1,000, and the variability around it is fairly tight, you know what your cost should be. You don't need shadow billing to help validate that.

What you should be doing to measure success is making sure that your law firms start there and, as time goes on, they continue to manage that cost down for you. They should help you get more and more efficient. That's your measure of success. You've negotiated the right price up front. You've achieved your goals of having predictability. And over time, you've started to negotiate better prices by managing that cost down. Some of the more unique approaches being adopted today are just the sign of an industry that is still in an experimental phase of using alternative fees.

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Q: It’s been suggested that some firms don’t know how to do an AFA or will turn one down because they don’t have enough information about their profitability; do you agree with that?

A: K. Satkunas – Well, before my experience with CounselLink, I spent over ten years working with large law firms helping them deploy software to measure things like profitability, model alternative fee arrangements, and understand the impact of AFAs on their profitability. Easily, half or more of the Am Law 200 has tools – either LexisNexis products or others – that do this in a very straightforward way.

If law firms turn down an alternative fee arrangement, the decision may be driven by knowing a lot about their profitability now. They can model exactly what their bottom line is going to be based on what they’re going to charge – either on an hourly basis and how they choose to staff it and how much they discount, or if they price it on a fixed basis – and see exactly what their margin is. And, if they’re smart, they are turning down work that is not profitable. In years past, they probably couldn’t do that; but within the last ten years, they gained the tools to understand profitability. It’s actually a positive step for the industry when people don’t do unprofitable work.

In my experience working with large law firms, I did hear feedback about AFAs and working with clients. Firms would be asked to list all of the AFAs, and all the possible ways that they might structure a particular matter and price it, which would be a fairly lengthy thing for them to do. When they returned the RFP, the client would say, “Okay, thank you. I’ll take the hourly arrangement.” Firms were frustrated by going through the process of trying to find an alternative arrangement, and nobody would take it. So, there is a communication problem between inside and outside counsel that would be fabulous to bridge, because there is interest on both sides for finding ways to do alternative fee structures that benefit both parties.

Q: Some types of matters will likely be better for AFAs than others. Is there some way to capture the data you need to see which ones work well, understand how you’re doing, or find appropriate benchmarks for comparison purposes?

A: K. Satkunas – For self-analysis, you will build up more and more data over time. So, it’s important to make sure you capture the right kinds of data that you will need for analysis once you’re at the point of having enough data to do it. You want to be able to slice it in all the ways that are relevant to you – for example, work being done in other countries, or firms by country or work by firms.

Looking beyond your own data, there are sources of alternative fee information and matter typing close at hand. Our Insight module is a benchmarking tool within CounselLink. We look at thousands of matters and matter types customers use, and map that data into a set of normalized matter types. At this point, we have details for twelve different matter types, and over time, we’ll get it to be more granular which is what you need. At the present time, we like

to give you flexibility to call your matter types whatever you want, and we do our mapping behind the scenes. Down the road, I believe we'll have a more structured way of setting up matter types so customers automatically map into one of the standard types. Hopefully, our industry evolves toward having some sort of a standard set of matter types that everyone uses, not just our customers.

Q: Do UTBMS codes have an AFA role in terms of tracking how the money is being spent and simplifying the process and necessary information exchange between legal departments and law firms?

A: K. Satkunas – I'll admit it, I think UTBMS codes are a waste of space in a database; I have not seen any consistency. In theory, it would be great if you could see task-level data that was accurate and that you could rely upon. It would be a great way to look at how to price things and understand what's really going on. In the times I've tried to dig into it, I see inconsistency even within one firm and how they code things. You can tell when you're looking at two very similar cases and see what gets coded in the first month and the second month. People just pick whatever "all other" bucket they can choose in some cases. In other cases, it's the attorney doing the coding, and in some it's their admin. All they are trying to do is fulfill the request to have it coded, without really thinking it through.

If you go beyond a specific firm and start comparing law firms, it's also inconsistent. I have tried to find a use for UTBMS data, and would welcome hearing from anyone who has done so with success. I have not found it to be useful for understanding where you're spending your money.

Q: Can alternative fees benefit every department; and, if so, what should they do to get started?

A: K. Satkunas – I don't think there is a department that couldn't benefit from AFAs. For some, the approach will be easier if they've got more data to mine with greater volume and more history. That's the place to start. Even if you don't have a lot of case histories, you can break down cases into different phases. You won't know whether or not you're sitting on a goldmine of data until you start to try to do some things. Relatively new CounselLink customers can try some of those data-mining exercises and quickly determine if they're not capturing some fields they really should be. Then, they can set them up as a custom code or find some other way to capture that data that could be essential down the road. It's better to know that sooner rather than later. Every department has data they can be mining; I would encourage everyone to get in there and start doing it.

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About Kris Satkunas



As Director of Strategic Consulting, Kris leads the Counsellink team in advising corporate legal departments on improving operations with data-driven decisions. Kris is an expert in managing the business of law and in data mining, with specific expertise in matter pricing and staffing, practice area metrics and scorecards.

Prior to joining Counsellink, Kris served as Director of the LexisNexis Redwood Think Tank, which she also established. For five years, Kris worked closely with thought leaders in large law firms conducting unbiased data-based research studies focused on finding solutions to legal industry management issues. Earlier, she led the Redwood Analytics services group and the business of law consulting practice for large law firms. During this time she worked with key management at over a hundred law firms to evolve the financial models and analyses developed by Redwood Analytics for large law firms.

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