



The use and effectiveness of Alternative Fee Arrangements in Property & Casualty claims and law departments

LexisNexis® P&C Claims and Litigation AFA Usage Survey

SURVEY OVERVIEW

This is the third in a series of online surveys of U.S. Property & Casualty (P&C) insurance carriers that LexisNexis has conducted recently. In this current survey we were interested in learning about the use of alternative fee arrangements (AFAs) by the claims and/or law departments at these carriers.

The recently released ACC Chief Legal Officers (CLO) 2016 Survey¹ found that AFAs are used most frequently by larger law departments, which certainly describes claims legal in the P&C industry. According to the ACC CLO survey, the use of AFAs by firms globally is increasing across the board, with flat fees (by matter and by matter stage) and retainers reported as being the AFAs used most frequently. And, as we noted in the [2014 year-end Enterprise Legal Management Trends Report](#), we see that more than 15 percent of all insurance matters in CounselLink are billed under an alternative fee arrangement.

In our last P&C survey, published in August 2015, we observed that 69 percent of the survey participants include some form of alternative fee arrangement (flat fee arrangements; volume discounts; discount rates with success bonuses) in their cost containment arsenal.

To find out which alternative fee arrangements U.S. Property and Casualty insurance carriers are using, how the departments rate the relative effectiveness of the AFAs they use, and other metrics related to AFAs, we conducted an online survey between January 29 and February 15, 2016. A total of 135 claims and/or law department professionals, whose titles included VP of Claims, Attorney, Associate/General Counsel, Staff Counsel, Head of Litigation and others, responded to the survey. The outside counsel spend of the companies represented in our survey ranged from less than \$10 million (42 percent) to more than \$500 million (5 percent). That puts the majority of respondents in the \$10 - \$500 million annual spend.

EXECUTIVE SUMMARY

Our survey of AFA usage by U.S. property & casualty insurance carrier legal and claims departments has revealed several insights:

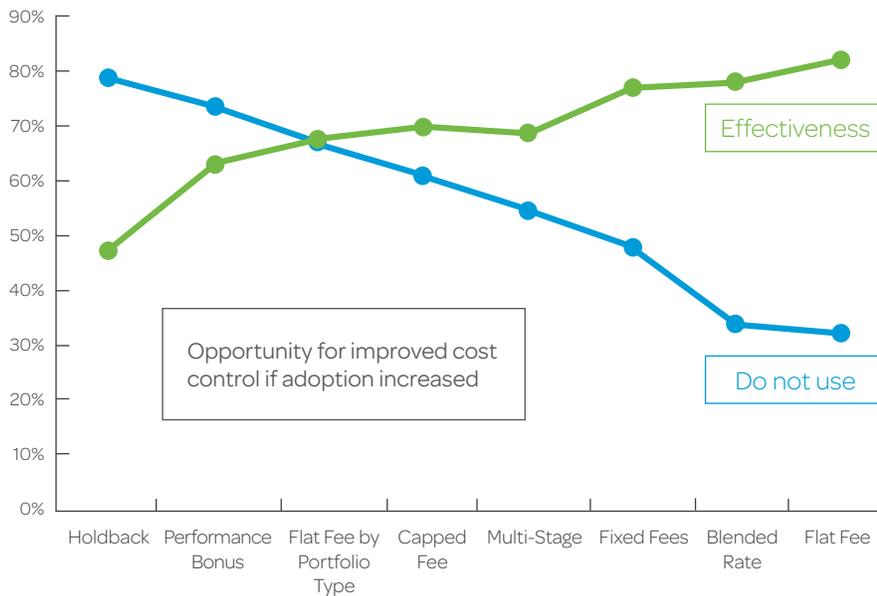
1. AFA usage has increased. 76.9 percent of the survey respondents reported having at least some matters billed under an AFA in 2015. In our August 2015 P&C survey, 69 percent of respondents reported that their billings include some form of alternative fee arrangement.
2. The majority of the survey respondents currently using AFAs plan to continue, or increase their use in the coming year, suggesting an overall satisfaction with AFAs.
3. There is still some resistance from law firms when attempting to implement certain types of AFAs, based on the reported experience of our survey respondents.
4. There is potential for significantly greater penetration of AFAs among the law and claims departments represented in our survey sample, with 40 percent of the respondents reporting that less than ten percent of their outside counsel spend is currently under an AFA, and an additional 13 percent reporting less than 20 percent spending under AFAs.
5. As articulated in the verbatim comments, those using AFAs obviously recognize the range of benefits that non-hourly-based billing schemes provide.
6. Respondents indicated a top challenge was effectively managing costs while still maintaining a high standard of work from their legal partners.
7. The use of AFAs allows users to better predict legal expenses.
8. The mix of AFAs being used and the wide range of adoption rates suggest that our survey respondents recognize that AFAs are not appropriate for every matter type.
9. Increased adoption of the most highly rated AFAs would provide additional opportunity to control costs.

¹ <http://www.acc.com/legalresources/resource.cfm?show=1422253>

Key takeaways:

AFA's are widely used, and are expected to grow in use, although not all law firms are eager to embrace them. Carriers find that AFA's benefit them by helping them predict expenses, lower costs, manage risk better, and more easily measure outside counsel effectiveness. There are still barriers, but insurance companies are reporting that their AFA programs are successful.

Opportunity to Reduce Costs



DEFINITIONS

To ensure accurate and consistent reporting of AFA usage metrics by the respondents, the online survey included the following definitions of alternative fee arrangements.

Flat Fee - Client pays an agreed upon sum of money for an agreed upon amount of work

Capped Fee - Client pays up to an agreed upon sum for an agreed upon amount of work

Blended Rate - Agreed upon hourly rate that applies to all lawyers working on a matter

Multi-Stage - Agreed upon fees for discreet phases of the work - different phases may use different structures

Holdback - Client withholds an agreed upon amount or percentage of the fee until completion of the milestone or engagement

Fixed Fees - Client pays a specified, negotiated amount for a single case (or portion of a case)

Performance Bonus - Client pays an extra payment that depends on case resolution, such as level of success, speed of resolution, or cost savings

Flat Fee by Portfolio Type - Client pays an agreed negotiated amount for a "book" of cases (multiple similar cases)

SURVEY FINDINGS

Following is a review of the findings from the P&C Claims and Law Department Survey, concluding with a summary of the key insights that an analysis of the survey responses revealed.

To help provide context for the metrics related to the survey respondents' use of AFAs, we began the survey by asking an open-ended question to learn about the overall challenges the P&C carriers' law and claims departments face.

THE TOP CHALLENGES FOR P&C LAW AND CLAIMS DEPARTMENTS IN 2016

We asked respondents the open-ended question: "What are the top 2 challenges facing your Claims and/or Law Department in 2016?" Responses covered a wide variety of issues that could be grouped into the following four general categories:

1. Controlling Litigation Costs/Reducing Costs
2. Risk Management
3. Vendor Management
4. Measuring Effectiveness

Controlling Litigation Costs/Reducing Costs – In their own words

When it comes to controlling litigation costs/reducing costs, the common concern voiced in the comments was that the respondents didn't want cost reductions to come at the expense of the quality of the legal services their firms provided.

- *"Reducing legal spend without reducing quality."*
- *"To continue outstanding legal representation of insureds ...and contain expenses."*
- *"Controlling defense costs."*
- *"Rising costs of legal fees."*

Stated another way, both the demand for quality legal work and the requirement to understand and manage costs are equally high.

Risk Management – In their own words

Responses falling under the risk management category included,

- *“...proper analysis of full value exposure settlements versus strategic litigation.”*
- *“...obtaining authority from management to handle and resolve large claims.”*
- *“Promptness of litigation.”*
- *“Preventing cases from entering into litigation when possible.”*
- *“Protecting against Bad Faith and Fraud.”*
- *“Defending minimal exposure to insured claims that have a viable or probably viable plaintiff attorney fee award hook by statute.”*

In aggregate, the responses indicated a desire on the part of the survey participants to ensure that claims are handled timely and appropriately to minimize financial risk. This is another instance where the respondents reiterated the need for quality legal partners to help them manage the risk of their litigated matters.

Vendor Management – In their own words

Regarding the vendor management challenges the departments face, comments indicated that retaining quality representation and cooperation between the departments and their firms were top-of-mind issues for the survey respondents. P&C carriers are still searching for qualified representation from law firms they can trust.

- *“Finding Competent Defense Counsel.”*
- *“Finding an attorney for claims in different states.”*
- *“Maintaining quality representation across the board.”*
- *“Lack of planning and collaboration between Claims and law firm.”*

Measuring Effectiveness – In their own words

Verbatim answers that can be categorized as related to measuring effectiveness were the fourth most frequently mentioned type of response.

- *“Measuring the effectiveness of our flat fee program.”*
- *“Compliance with legal and billing guidelines.”*
- *“Measuring counsel with metrics and finding effective alternative billing arrangements.”*
- *“Ways to measure how Counsel is handling the file and the chances of Counsel overbilling.”*

Property and casualty claims and legal professionals are faced with constant pressure to demonstrate their own value in the organization, with their performance measured continually. They are looking for ways to bring that same kind of measurement to the relationships they have with their law firms. Their goal is to demonstrate that they have the right controls in place to deal with outside counsel fees, one of their company's largest expenses.

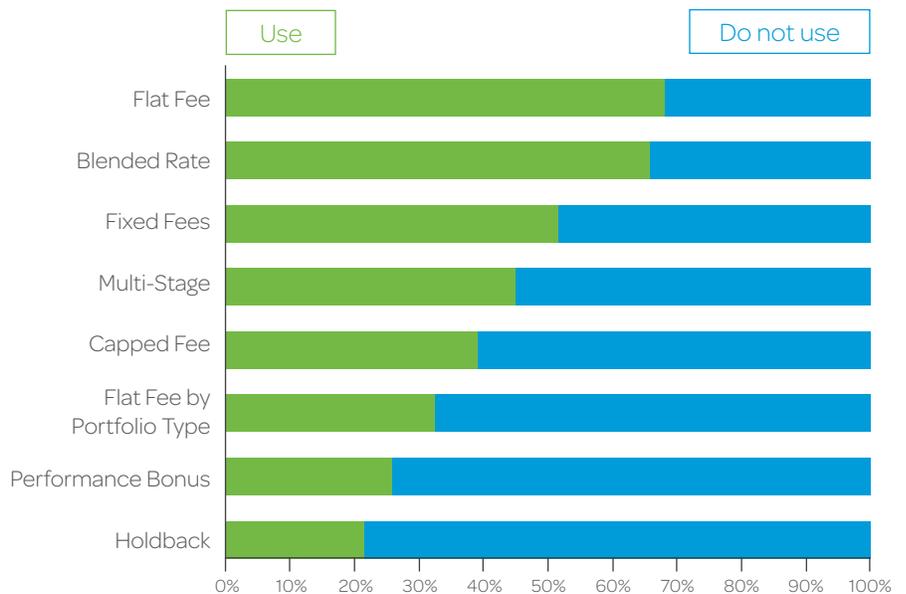
P&C INSURERS EMPLOY A VARIETY OF ALTERNATIVE FEE ARRANGEMENTS

We wanted to know which alternative fee arrangements our survey respondents were using. We also wanted to determine the relative effectiveness of the AFAs being employed in terms of how they help them lower costs, increase predictability and/or manage matters. The survey asked participants to rate the effectiveness – ranging from very effective to very ineffective – of the alternative fee arrangements they use.

Regarding the various AFAs in use by the survey participants, we learned that:

- Over half of respondents use flat fee, fixed fee or blended rate AFAs
- Over one-third use multi-stage, capped fee or flat fee by portfolio type AFAs
- Performance bonus and holdback AFAs are used the least

Alternative Fee Arrangement Usage

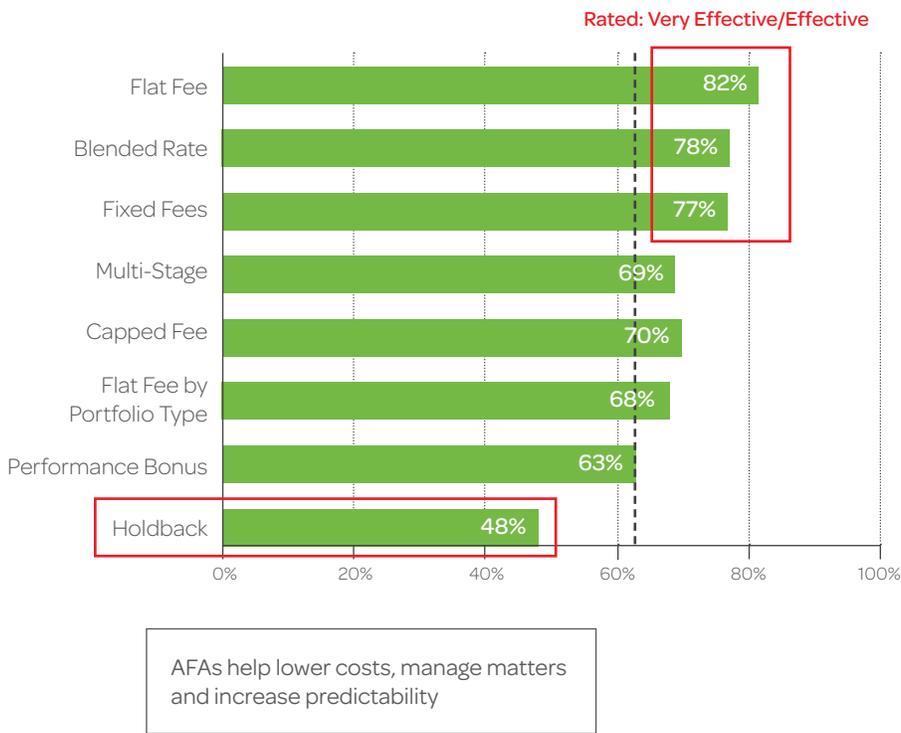


A wide range of AFAs are being used by P&C Carriers

We asked the survey participants to rate the effectiveness of the alternative fee arrangements they use in helping them to lower costs, increase predictability and/or manage matters. Overall, respondents using AFAs report them as effective.

Holdback was the only type of AFA that was rated by fewer than half of the respondents as either effective or very effective. All of the other AFAs were rated as either effective or very effective by two-thirds or more of the respondents.

Q. Please rate the effectiveness of the following AFAs in helping you lower costs, manage matters and/or increase predictability:



MAJOR BENEFITS OF ALTERNATIVE FEE ARRANGEMENTS

We followed the question about AFA usage/effectiveness with an open-ended question: "What do you believe to be the major benefit of using AFAs?" We grouped the responses to the question into three broad categories:

1. Control/Reduce Cost – In their own words

- *"We have control of the costs and more options as to the handling firm."*
- *"Controlling costs with right firms in place."*
- *"Control costs; clear expectations."*
- *"Controlled costs and incentive for firms to close cases."*

2. Predictability/Greater Certainty – In their own words

- *"Better able to budget."*
- *"Easier to reserve legal costs"; "Expense reserving ease"; "Able to reserve more accurately."*
- *"Predictability of expenses and law firms become more efficient and are aligned with corporate partner."*
- *"Provides greater certainty over legal spend."*
- *"Predictable costs that allows underwriting to know expense loads to consider in rates."*

3. Efficiency/More Defense Options – In their own words

- *"Better provides an understanding of costs of defense and allows claims to make better decisions."*
- *"Encourages firms to be efficient in their work- discourages unnecessary work and ultimately helps control lit spend costs."*
- *"Gives better options for moving cases and holds firms to outlined budgets."*
- *"It allows defense of a matter that you may not otherwise defend as the cost of defense can be higher than the full value of the case."*
- *"Incentivizing efficient work"; "Promotes proactive handling by the attorney."*

These comments show that AFAs are helping carriers hit all four of their objectives: there is clear cost control, risk management is attained through better reserve planning and alignment of law firms with corporate goals, vendor management is improved through better firm handling and fee management, and the effectiveness is measured through efficient work and case movement in accordance with budgets.

THE BIGGEST IMPEDIMENTS TO USING ALTERNATIVE FEE ARRANGEMENTS

An additional open-ended question sought to identify what the survey respondents believed to be the biggest impediment to using AFAs. We grouped their responses to the question into three general categories:

1. Case Complexity/Unique Cases/Ability to Handle Change Over Time – In their own words

- *“I think with set fees, you run the risk of the case being much more complicated and time consuming for the defense attorney for the amount of the set price.”*
- *“Cases change during their course, the agreements do not adapt to that”; “When cases are dissimilar and require different approaches, it can be hard to lock in a fixed rate or capped amount.”*
- *“This arrangement does not work for complex cases. Partners are not willing to work for the amounts paid on these cases, so inexperienced associates end up handling the cases with spotty oversight from a partner. Complex cases should not be handled by inexperienced attorneys.”*

2. Fear of Poor Defense – In their own words

- *“Attorneys tend to either give the work to the lesser paid associates if they are not getting their usual fee which results in more research hours, and less adept and qualified handling of case.”*
- *“Making sure cases are properly defended.”*
- *“Poor work product and inexperienced lawyers being assigned to cases to maximize returns for law firms.”*

3. Creating a Win-Win / Being Fair to Firms – In their own words

- *“More work is done than may be warranted by the fee if the fee is lower than the hourly rate.”*
- *“How to decide the fee arrangement to be fair to all sides and still provide an effective/aggressive defense.”*

These responses show that there is some concern that AFAs are not appropriate for every matter type and also that firms may not feel incentivized to put in the necessary work for the proper defense. There is also a concern expressed here that AFAs may not be fair to the law firm.

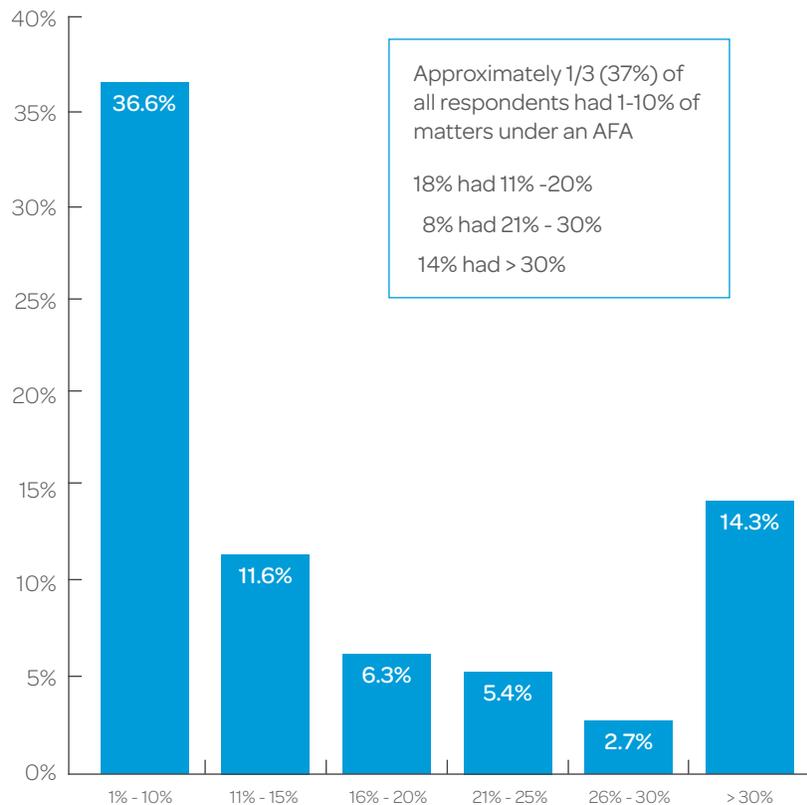
MATTERS UNDER ALTERNATIVE FEE ARRANGEMENTS

We were curious to learn what percentage of the survey respondents' matters had billings under an AFA in 2015

The survey revealed that approximately one-third (37 percent) of all respondents reported having between one to 10 percent of matters under an AFA. Eighteen percent reported that they have 11 to 20 percent of matters under an AFA. Eight percent of the respondents had between 21 and 30 percent of matters billed under AFAs; 14 percent of those surveyed had more than 30 percent of matters billed under AFAs.

As an additional data point, it's interesting to note that the LexisNexis 2014 Year-End Enterprise Legal Management Trends Report showed that 17 percent of insurance matters billed through CounselLink were under some sort of AFA.

Q Approximately what percentage of your matters in 2015 had billings under some sort of AFA?

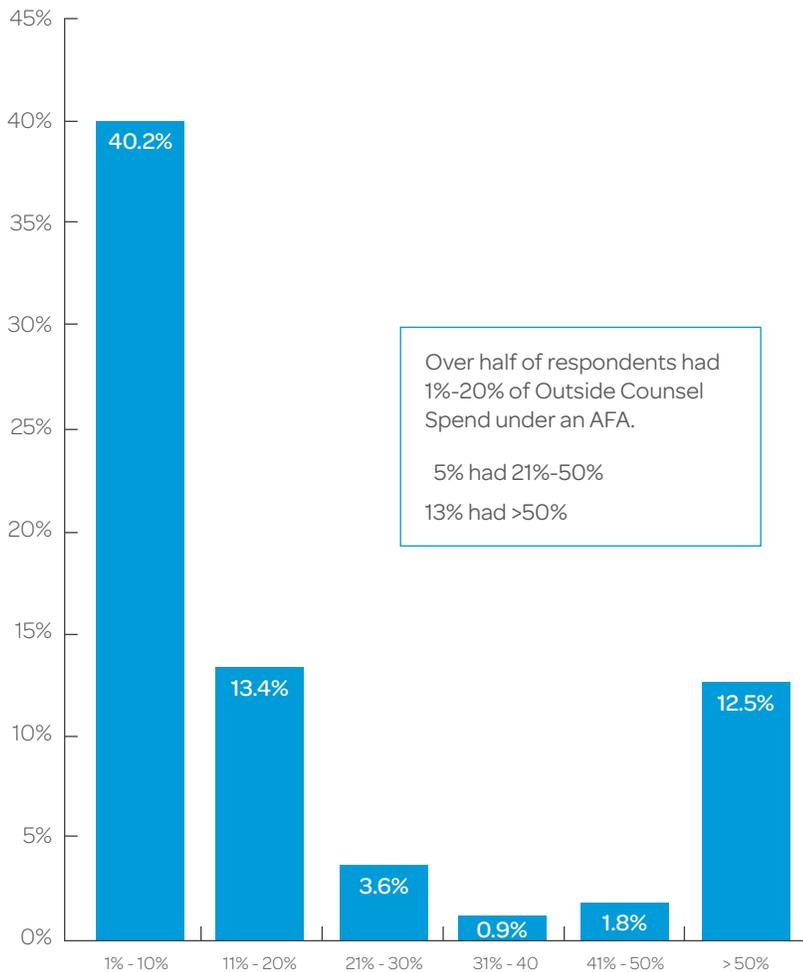


OUTSIDE COUNSEL SPEND UNDER ALTERNATIVE FEE ARRANGEMENTS

Next, we asked the survey participants what percentage of their outside counsel spend in 2015 was done under an AFA. More than half of the respondents reported that they had 1 to 20 percent of their outside counsel spend under an AFA. An additional 5 percent reported that 21 to 50 percent of their outside counsel spend was under an AFA, and another 13 percent responded that AFAs account for more than half of their outside counsel spend. Spend is shown to be far less than matter count, which could mean that AFAs are being used principally for lower exposure cases.

Referring again to the 2014 Year-End Trends Report, it showed that approximately 8 percent of all insurance practice area billings processed through CounselLink were under an AFA.

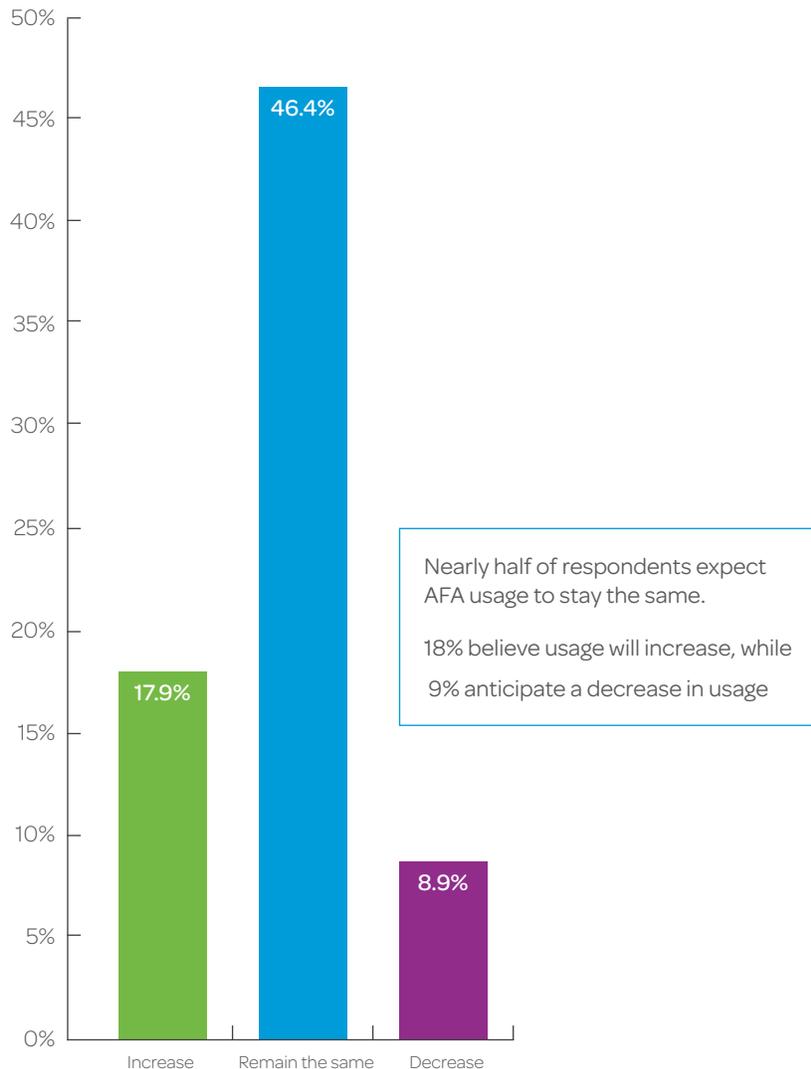
Q Approximately what percentage of your outside counsel spend in 2015 was done under an AFA?



DEPARTMENTS DON'T ANTICIPATE A SIGNIFICANT CHANGE IN THEIR USE OF ALTERNATIVE FEE ARRANGEMENTS

When we asked survey participants how they expected their use of AFAs to change in the next 12 months, nearly half reported that they expect their use to remain the same. Eighteen percent believe that their use will increase, and half that many anticipate that their use of AFAs will decrease. This means AFAs are here to stay – at least for the coming year. Since carriers tend to be measured in their approach to change, AFAs will likely remain beyond the next year, as more than 64% of US insurance companies will be using them next year.

Q How do you expect your use of AFAs to change in the next 12 months?



CHALLENGES TO MEASURING AFA SUCCESS

Our next question was directed at learning what challenges the survey respondents encountered when measuring the success of the AFAs they implemented. Responses provided insights into the wide variety of specific challenges they faced when attempting to measure success with using AFAs. Following is a representative sampling of the responses, grouped into three general categories:

1. Tracking/Measuring/Comparing – In their own words

- *“How to measure (both what factors reflect true success and obtaining such data from systems not designed to track for that purpose).”*
- *“Difficult to compare what we would have spent otherwise.”*
- *“Having the system track and compare the AFAs compared to regular litigation files.”*
- *“Lack of an industry benchmark.”*

2. Resistance from Firms – In their own words

- *“I had several of our AFA attorneys refuse, or complain about, doing a lot of work on AFA cases due to the flat fee.”*
- *“Trying to entice defense to continue to negotiate settlement as new facts come up and not just proceed to another stage.”*
- *“Buy in by senior law firm partners.”*
- *“Motivating counsel.”*

3. Quality of Work – In their own words

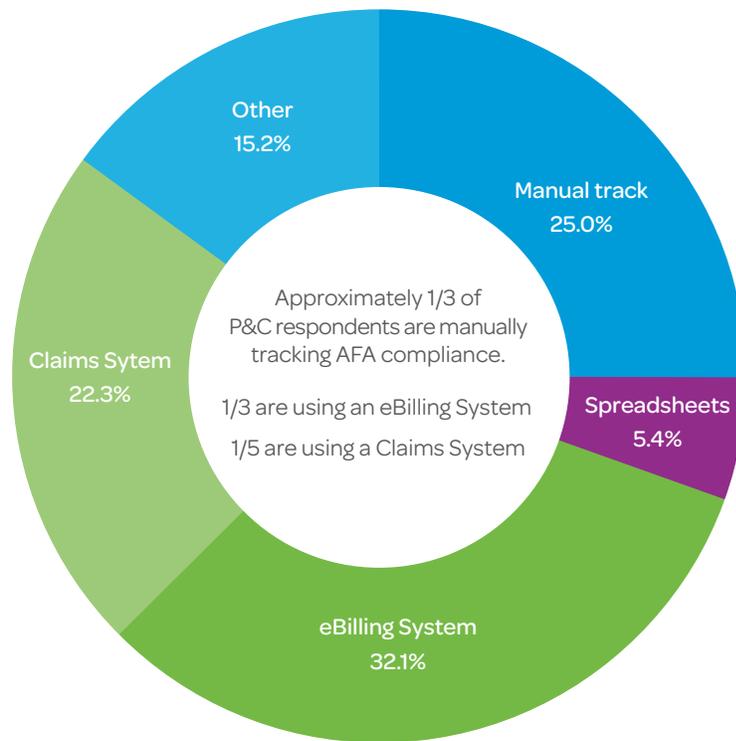
- *“Cases languished when no greater financial incentive to move file forward.”*
- *“To provide the best defense to our insureds and resolve the claims at a reasonable claim amount in the shortest period to keep the defense costs down.”*
- *“Do not know how much effort was put into handling a matter, just the final cost.”*
- *“Blended rates - work passed down to low level associates.”*

There is concern about the ability to be successful as well as the methodology of measuring that success.

MANAGING AFA COMPLIANCE

For our final AFA-related question, we asked survey participants how they manage compliance with their alternative fee arrangements. We learned that approximately one-third track compliance manually, with an additional one-third tracking compliance with an eBilling system, and one-fifth using a claims system to track AFA compliance. An additional 15 percent reported managing compliance via another method. The opportunity for increased usage may tie itself with the ability to more easily measure the success of AFA programs. AFAs are rated as more efficient, but measuring effectiveness is listed as an impediment. Companies need to look to their eBilling systems for improvements in managing and measuring their AFA success in order to reap greater rewards from these initiatives.

Q. How do you manage compliance with your alternative fee arrangements:



Additional Resources:

- [U.S. P&C Law Departments Rate the Metrics They Use to Manage Costs and Performance – LexisNexis® Property & Casualty ALAE Cost Containment Survey](#)
- [P&C Law Departments Prioritize and Rate Initiatives for Controlling Costs – LexisNexis® Property & Casualty Claims and Litigation Cost Containment Survey](#)

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The CounselLink solution is an Enterprise Legal Management solution suite for matter management, legal spend management, legal hold, analytics and strategic consulting services. LexisNexis CounselLink Solution is positioned in the “Leaders” Quadrant of the Gartner’s Magic Quadrant for Enterprise Legal Management and has earned an industry reputation for helping to improve legal department performance and outcomes. CounselLink has been selected by **4 out of the 5** top Insurance carriers as their Enterprise Legal Management solution of choice.*

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*Source: National Association of Insurance Commissioners: Total All Lines

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