

REVISITING ALTERNATIVE FEE ARRANGEMENTS

Properly Structured Alternatives Can Yield Financial Benefits

As a result of current economic times, many law firms have experienced pressure to reduce fees. Proposing an alternative fee arrangement (AFA) is one way to address client concerns. It's a concept that has been covered in legal industry trades for 20 years now, but, due to mixed reaction, it still remains an emerging trend. On the surface, any alternative to hourly billing may appear to mean a loss for the firm, yet if properly structured, firms can realize sizeable financial benefits.

For those law firms that have not had clients request lower rates, they likely will soon and need to be prepared to present AFAs. Furthermore, in some cases, it may be prudent for attorneys to take a proactive approach with certain clients and offer an AFA to help maintain the client relationship.

Regardless of the reason you may propose an AFA, the most important consideration is the client's perception. The value of the legal services from the client's perception is that the benefit justifies the fee. AFAs can help firms communicate the value and the results of the services rendered. They also pair the client's needs and expectations with the method that most equitably measures the value of the service.

Based on our experience, there are three primary AFAs: blended hourly rate, fixed- or flat-fee plus hourly rate, and task-based rate. Your accounting firm can help you examine which arrangement—whether one of these methods or an

approach customized for your firm—will afford the greatest benefits to the firm.

A **blended hourly rate** is a hybrid of an hourly rate in that one rate applies to all of the hours billed on a matter. This structure has the advantages of a traditional hourly rate—along with the disadvantages of that method. Work may be delegated to individuals with lower billing rates, yet

The **task-based fee** method is a hybrid of a fixed-fee arrangement, in which the fee is based upon identified tasks or components of the transaction, such as a loan amount or tasks related to a litigation matter. In this approach, it's relatively straightforward to state the terms in the representation agreement, and the lawyer and client share the risks and benefits. This method is not dependent on the

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the quality of work may be endangered if there is improper delegation of the work. If the blend in the practice is at the high-end of the hourly rate structure, this method may not prove to be profitable. A blended hourly rate is best used when the "mix" needed to do the work is reasonably foreseeable.

In a **fixed- or flat-fee plus hourly rate** arrangement, the portions of services that have a definable scope are charged on a fixed-fee or flat-fee basis, and the portions that cannot be defined are charged on an hourly or time-rate basis. In this approach, you are offering the client a compromise between the two methods. The client also has an economic basis upon which to decide to proceed. This arrangement is best used when some of the contemplated services can be definite so that a fixed- or flat-fee can be quoted.

time spent. However, if the fees are set too high, they may not be competitive, and if set too low, the engagement may become unprofitable. In order to use this method, the attorney needs to have a strong understanding of the amount of work required and the costs associated with the work. It also forces the lawyer to bear the risk if complications arise and extra services are required, unless the representation agreement defines the services included.

When considering AFAs, take a close look at each of these variables:

- Clearly understand the deliverables
- Accurately project the cost of services
- Know the level of timekeepers and the levels of expertise that will be needed
- Consider what work can be delegated to less costly timekeepers without compromising quality

- Understand the client's budget constraints
- Determine the level of profitability that is deemed reasonable and within the firm's realization guidelines
- Prepare a budget and have a system in place to monitor the budget.

Hourly billing will continue to be a prevalent method as certain types of tasks, such as those that are time intensive and outside the control of the law firm, are

still best billed on an hourly basis. However, the current state of the economy has caused a paradigm shift in the lawyer-client relationship and AFAs have grown in popularity. AFAs may be a necessary means to maintain a competitive advantage and the key to the success of AFAs is to justify the fees by accurately communicating the value of the service. At J.H. Cohn, we can help you analyze the variables related to AFAs and find the solution that works best for your clients—and your bottom line. ■

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