

ETHICS PANEL: ETHICS AND REALITIES OF ALTERNATE FEE ARRANGEMENTS

**Moderator: Linda Woolf
Goodell DeVries Leech & Dann**

NAVIGATING THE WORLD OF ALTERNATIVE FEE ARRANGEMENTS

Presented by:

**Linda S. Woolf
Goodell, DeVries, Leech & Dann, LLP
One South Street
Baltimore, Maryland 21202**

INTRODUCTION

Billionaire Warren Buffet used the phrase “put skin in the game” to describe the investment by company insiders of their own money into an enterprise as a demonstration of confidence in the success of the enterprise. Increasingly, attorneys and law firms have been asked to “put skin in the game” by corporate clients who are eschewing traditional hourly fee arrangements in favor of various types of alternative fee arrangements (“AFA”).

Large corporations are increasingly turning to AFAs. For example, Pfizer, through the Pfizer Legal Alliance, contracts with a small number of outside law firms to provide over 75% of its legal services worldwide based upon an “all in” annual flat fee. According to published reports, Chrysler has an alternative fee arrangement with a single law firm to handle all of its product liability work. Similarly, Cisco Systems and Levi Strauss & Co. and an increasing number of insurance companies also make extensive use of AFAs. The increased popularity of AFAs is based in large part on the desire of corporate clients to promote efficiency, success and thinking “outside the box” by their legal representatives as well as a belief that they will foster trust, loyalty and a “partnership” mentality between corporations and their lawyers. The shift to

AFAs has also been prompted by the perceptions that the traditional hourly billing system does not provide incentive for lawyers to work efficiently or to seek an early resolution that is favorable to the client and that hourly billing can reward those who spend the most time on a client's matter without necessarily achieving value for the client.

AFAs present new challenges to corporate and outside counsel relating to both litigation management and law firm management and also present ethical concerns that must be addressed. As AFAs become increasingly popular, it is crucial that lawyers understand why their clients prefer them, how to use them for the benefit of both the client and the law firms, and the pitfalls they present.

WHAT'S ON THE AFA MENU?

The menu of AFAs is quite varied. Among the most common are "risk collars," fixed fees or flat fees, fee cap pricing, task-based billing, blended hourly pricing, and reverse contingency arrangements.

In a "risk collar" arrangement the client and lawyer agree on an estimated budget for a particular matter. If the work is completed under budget, the law firm earns a bonus, while the client receives discounted services if fees exceed the budgeted amount. In a fixed fee or flat fee arrangement, all work on a particular case is performed for an agreed-upon fee regardless of time spent or result. This model has been expanded by some corporations, so that a flat fee is paid for all work done on a company's matters by a particular firm in each calendar year.

Fee cap pricing may involve setting a cap on a certain aspect of the law firm's billable time, such as a fee for a certain time period, set fees for tasks or set fees for certain phases of a case such as discovery or dispositive motions practice. Similarly, task-based billing involves negotiating a fixed fee for various phases of a case.

In a blended hourly pricing arrangement, all lawyers are paid a single rate regardless of partner, senior associate or junior associate status. In considering this arrangement, law firms should carefully consider the complexity of the matter and whether junior level attorneys will be able to contribute significantly to the representation.

While contingency arrangements are traditionally the fee arrangement of choice of tort-plaintiffs, they are also being used by clients to reward particular results achieved by defense counsel. Under these arrangements, a law firm may be rewarded with a share of the difference between the settlement or judgment against its client and the amount the client anticipated having to pay or with a bonus if the firm is able to settle the matter favorably and avoid trial, sometimes tied to set time parameters.

Law firms may also offer alternative arrangements for costs whereby disbursements for, e.g., travel, internet research, communication costs, or copying costs are covered by an agreed upon monthly fee.

AFA PROS AND CONS

AFAs can offer advantages to both clients and law firms. Chief among these is predictability. By agreeing to fees in advance, a client can predict and therefore budget its legal costs more accurately and a law firm can better predict its income from a particular client. AFAs may also more closely align the interests of client and outside counsel. Because under AFAs, the law firm will often share in the risk, its interests are more aligned with the client's interests, *i.e.*, quick and efficient resolution of legal matters. This, in turn, may foster loyalty and trust between client and law firm. Also, by sitting down with a client to negotiate a flat fee for a case or task, the law firm will inevitably gain a greater understanding of the client's goals and objectives for a particular matter.

From an administrative perspective, AFAs can result in time saved by a law firm and client by eliminating the need to prepare and review complex budgets and traditional legal bills. Lawyers and clients may no longer need to spend time reviewing detailed bills with myriad entries by different lawyers and uncomfortable billing disputes that often arise from traditional billing arrangements can be eliminated.

On the flip side, AFAs can present pitfalls to both attorneys and their clients. Notably, for a legal relationship governed by an AFA to be reasonably profitable to a law firm, it must price its services correctly. While an agreed-upon fee is based upon predictability and certain assumptions, legal matters often do not proceed as predicted and assumptions may turn out to be incorrect, leaving the law firm to absorb cost overruns. AFAs may also require significant investment of resources on the front end of a representation during which a law firm spends time evaluating the nature, scope and cost of potential representation, time that for which it may not be compensated. These risks are lessened where AFAs are used by a law firm that has significant experience handling a particular type of litigation for a client.

A client's demands of a law firm may change when an AFA is in place. For example, a client may request that partner handle certain tasks that a firm would otherwise delegate to an associate because the client is not paying a higher rate for partner time. Also, when money is no object to the client, it may make unreasonable demands on an attorney's time or push for a less efficient result such as by insisting on trying a case that would be more efficiently resolved through settlement.

In the case of AFAs that use results to determine compensation, identifying what is considered a "win" and the value of that result may be the subject of conflict between attorney

and client. Thus, every effort should be made to spell these matters out as clearly as possible in advance.

AFA's present internal challenges as well. Because realization of a profit from a particular case may not align with a law firm's fiscal year, difficulties in determining proper compensation and accurate performance evaluations may arise. Furthermore, a law firm may have to re-train its personnel to shift their focus away from the typical billable hour approach toward efficient project management.

Use of AFA's likewise presents certain risks to clients. For example, a law firm may push work down to the most junior attorneys to allow more senior lawyers to work on matters for which the firm is being compensated based upon billable hours. There is also the risk that if a case drags on, the law firm will not devote the same level of attention to the matter because it is no longer profitable to do so. Conversely, from the client's perspective, if a law firm is allowed to build in too large a financial cushion or overestimates the cost of the representation at the outset, an early or efficient resolution could cost the client more than it otherwise would have paid for representation based upon billable hours.

AFA ETHICAL CONSIDERATIONS

AFA's present certain ethical issues for lawyers and their firms as well. Before entering into an AFA, a law firm must be certain that the arrangement does not hinder its attorneys' ability to meet their ethical obligation to exercise independent judgment and provide impartial advice.

When agreeing to a fee for services, care must be taken to conform to the requirement in most jurisdictions that fee agreements be reduced to writing. This is especially true if AFA could be viewed as the law firm becoming involved in a business transaction or common

enterprise with the client, a scenario governed by Rule 1.8 of the ABAs Model Rules of Professional Conduct (“Model Rules”). Pursuant to Rule 1.5 of the Model Rules a lawyer’s fee must be “reasonable.” Thus, if a fee is agreed upon with the expectation that a case will be litigated to trial and the case is ultimately resolved by an early dismissal motion, a court may not enforce the fee agreement even if it is in writing.

Any AFA should clearly address what will occur in the event the relationship is terminated mid-stream. First, there may be no clear way under an AFA to determine the value of services provided by the law firm if it does not resolve the case. Second, in some jurisdictions it is unethical to enter into a fee agreement that provides that advance payment of fees (which may occur under an AFA) will not be refunded regardless of the cause of termination.

Also, a decision by a lawyer to spend as little time as possible on an AFA matter or the appointment of junior associates to handle tasks without regard to whether they possess the skill to handle them in order to maximize profitability under an AFA creates obvious ethical issues and may violate Model Rule 1.5’s requirement that a fee be based, in part, on the experience, reputation, and ability of the lawyer performing the service.

AFA’s may also present a scenario where the interests of the client (the most positive result) and the law firm (efficient resolution of the matter) are divergent, thus creating a grave ethical violation of the lawyer’s obligation to always act in the best interests of her client.

AFA PRACTICE POINTERS

In light of the issues raised above, there are certain core steps that a law firm should take when providing representation pursuant to an AFA:

- Before agreeing to an AFA, outside counsel and the client should spend time analyzing the types of matters that could potentially fall under the AFA. The

more time spent up front, the greater the likelihood that both parties will be satisfied with the arrangement.

- Carefully examine data relating to the time and cost of prior representations both for this client and for other clients on similar matters in order to accurately gauge the resources that may be required to handle the representation.
- Do not fall into the trap of using a form AFA. Different companies and types of matters present different challenges and issues. One size definitely does not fit all.
- Agreements related to AFAs, like other representation agreements, must be in writing and should accurately spell out both the scope of the engagement and the assumptions upon which the agreement are based.
- Include a fail-safe in all AFA agreement to protect the client and the outside law firm from truly unexpected and onerous situations that may arise during the representation.
- Include a provision in the AFA to address how a firm is to be compensated in the event that a law firm must withdraw or if the client chooses to seek other representation while a matter is pending.
- Consider pricing and agreeing to representation for multiple matters together. This will allow outside counsel and the client to spread the risk and protect both against a matter that does not go according to plan.
- Establish a centralized approval process for AFAs with a partner or committee of partners who can appropriately evaluate the viability and appropriateness of a proposed AFA.

- Despite the fact that the firm is not billing the client for its time, a close eye should be kept on the time being spent on AFA matters. If a law firm has agreed to bear the burden of cost overruns, it can hardly afford to be casual about how much of its lawyers' time is being devoted to AFA matters.
- Consider modifying internal attorney compensation and performance evaluation metrics to account for work performed under an AFA.
- Periodically conduct regular, detailed reviews of matters being performed under an AFA to exchange insights as to what works for both the law firm and the client.
- Remain flexible. A law firm and its client must be willing to re-evaluate and modify an AFA when necessary.

CONCLUSION

Alternative Fee Arrangements are increasingly replacing traditional hourly billing arrangements. While AFAs have the potential to make outside law firms more appealing to corporate clients and foster an increase in loyalty and trust between lawyer and client, the groundwork for a successful AFA must be laid through thorough analysis by the client and law firm, open dialogue between them and wise internal management of personnel and resources.



Linda Woolf

Managing Partner

lsw@gdldlaw.com
 (410) 783-4011

Commercial and
 Business Tort
 Litigation

Insurance Coverage
 Litigation

Employment
 Litigation

Environmental

Local government
 and Municipal
 Liability

Product Liability

General Liability
 Defense

Linda S. Woolf is the Managing Partner of the firm and one of its founding members. Ms. Woolf's practice is devoted to the representation of clients in complex commercial, insurance coverage, construction, government liability, and employment litigation.

Ms. Woolf is the Vice Chair of the Commercial Litigation Section of the Federation of Defense and Corporate Counsel and serves on several of its ad hoc committees. She is a past Chair of the Network of Trial Law Firms, Inc. (1999-2000), a non-profit corporation comprised of 26 independent law firms nationally recognized for their trial and litigation experience. Ms. Woolf is a past member of the Executive Board of the Maryland Association of Defense Counsel, and past Co-Chair of its Appellate Committee.

In 2007, Ms. Woolf was honored with the Daily Record's Leadership in Law Award and as one of the Top 100 Women in Maryland. From 2007-2010, she has been named as one of the Top 25 Women Super Lawyers in Maryland and recognized by Best Lawyers in Bet-the-Company (2009-2010) and Commercial Litigation (2008-2010).

PROFESSIONAL EXPERIENCE

COMMERCIAL AND BUSINESS TORT LITIGATION

Represents medical device manufacturer in class actions pending in various federal and state courts arising from sale and distribution of Class II medical device.

Represents food producer in multi-district litigation seeking certification of nationwide class of consumers involving allegedly false advertising claims.

Represents international pharmaceutical company in litigation arising from the divestiture of a wholly-owned medical device subsidiary. Represents an international manufacturer in litigation arising from the divestiture of a worldwide battery business. Has represented national and local corporations at the trial and appellate levels in state and federal courts in matters involving the sale of corporate subsidiaries and businesses, alleged predatory lending practices and consumer fraud, federal and state antitrust violations, claims arising from non-competition agreements and the misappropriation of technology and other contractual disputes. Represented a surety in protracted litigation with the Resolution Trust Corporation arising from the failure of a savings and loan institution. Represented the majority shareholders of two thoroughbred racing corporations in derivative lawsuits filed by minority shareholders, successfully retaining control of nationally known racetracks.

Has represented corporate directors and officers, trustees and other fiduciaries in various litigation including claims for diversion of corporate opportunity, claims under ERISA for alleged breaches of fiduciary duty, shareholder derivative claims. Defeated proposed class certification in two companion ERISA cases brought by retirees of non-for-profit health insurer seeking enforcement of former welfare benefit plan and damages for breach of fiduciary duty. Has represented a variety of businesses in complex business tort litigation. Defended a defense contractor against claims of defamation and tortious interference with economic relations, arising from responses to RFP's to NSA. Represented hospitals, health insurers and managed health care organizations and their officers and directors in various litigation involving billing disputes, alleged breach of physician participation agreements, credentialing disputes and claims of defamation, tortious interference with economic relations and other business torts.

