



Time to DIVE IN?

Understanding the ebb
and flow of AFAs

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“The water looks great, but I don’t really want to get wet.”

Perhaps this captures the sentiment of both law firms and corporate legal departments as they contemplate how to tackle alternative fee arrangements (AFAs).

In late 2009, *The American Lawyer* and the Association of Corporate Counsel conducted a joint survey of approximately 587 general counsel (GC) and chief legal officers regarding the use of AFAs. The survey provided interesting statistics:

- 48 percent of the GCs and chief legal officers had paid a flat fee for an entire matter.
- 36 percent of the GCs and chief legal officers reported paying a flat fee for at least some stages of a matter.
- Only 24 percent of the corporate legal decision-makers reported having paid all of their law firms by the billable hour.



are still circling the perimeter cautiously. Because GCs work against a budget, the hourly rate model incents lawyers to bill as much as reasonably possible, rather than as little as is reasonably necessary. So the company bears the risk of a lawyer's inefficient or excess work on a case, which can blow an in-house legal budget.

AFA's have the potential to readjust incentives. AFA's with a fixed fee by case or by phase, with a performance bonus tied to results, would create better incentives. With firm fees capped, lawyers have an incentive to work efficiently toward a kicker tied to the outcome in the case. For many, the main reservation is the fee-setting process.

In-house counsel, risk managers and insurers are not alone in their uncertainty regarding the use of AFA's. Law firms have related concerns. They are concerned that they will propose an AFA without sufficient knowledge to accurately assess the case or portfolio of cases, underestimate the work required, realize a loss on their time and ultimately drown.

So, should everyone jump in the pool, continue walking around it or pack up and go home? This question disregards the presence of lifeguards and flotation devices available to all. No one has to jump off the deep end alone when entering into an AFA. Rather, both client and outside counsel should consider these tips when inching into AFA waters:

Get Your Toe Wet. AFA's can be limited to certain projects or phases in litigation; they do not have to encompass the whole life of a case. If either client or firm is nervous or uncertain about what course the litigation may take, they can negotiate AFA's for specific tasks. For example, project fees can be set for tasks such as conducting an early case assessment or investigation, drafting written discovery, or preparing for and attending mediation. An AFA does not have to be an all or nothing proposition.

Agree to Throw in a Life Preserver if Necessary. Define the scope of work encompassed in the AFA and agree that any additional legal work will be compensated under a separate fee arrangement. For example, an AFA may set a project fee for discovery in a

case. The scope of that discovery phase can set assumptions such as no more than 10,000 documents for review, no more than six fact depositions, no more than two experts named by the opponents and no more than one discovery-related motion filed. A project fee with defined assumptions gives reasonable budget certainty, while protecting the law firm from cost overruns for unanticipated discovery issues.

If You Don't Know the Depth of the Pool, Don't Dive In. Try AFA's first with familiar litigation. The best way to come up with an AFA that is beneficial to both client and law firm is to use historical data about similarly litigated cases. Although it is generally true that no two cases are exactly alike, some categories of cases are sufficiently predictable to be useful in setting AFA's, especially for a portfolio of cases. The more comparative information available to both parties about past similar litigation, the greater the chance of AFA success.

Synchronize the Swim. One way to share risk and reward is to agree to an AFA with outcome-, budget- or time-dependent holdbacks or contingency fees. Such AFA's benefit clients by reducing their monthly legal spend and maintaining budget certainty even with the specified contingencies. Firms also benefit from the steady monthly payments and with the prospect of greater financial reward if the agreed-upon objectives are met. Attorneys performing the work also benefit by being able to focus on results. Under this type of AFA, both client and firm can find satisfaction in knowing that everyone's interests are aligned.

Whether AFA's are beneficial or desirable is no longer an issue. AFA's are in the main stream. The challenging question is choosing which AFA is best for any given situation. The answer may simply be: You'll be in the best position to swim when you jump in and get wet. [LM](#)

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But perhaps even more interesting are the statistics surrounding the initiators of the AFA's:

- 54 percent of the surveyed GCs and chief legal officers claimed to have initiated the use of AFA's.
- 18 percent reported that the AFA's used were jointly initiated by them and their outside counsel.
- Only 3 percent of the GCs and chief legal officers surveyed said their outside counsel first raised the issue of AFA's to them.

Less than two years later, the climate seems to be the same. There are a few swimmers in the AFA pool. But a lot of bystanders