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Alternative Fee Update ...

Anecdotal Evidence Shows Both Success and Failure with AFAs

In 2014 when a computer hardware manufacturer found itself embroiled in intellectual property litigation, the company's in-house lawyers called on its outside law firm, Silicon Valley-based Hopkins & Carley, for help. The firm and its client—one with whom H&C had a years-long relationship—agreed on an alternative fee arrangement. And, both the fee structure and the outcome of the case couldn't have gone better.

"The fixed fee worked out perfectly," says Hopkins partner John Picone. "The amount of work we had to do matched up with what they were paying us. We were pretty aggressive in our defense for the client, taking solid positions supported by the evidence, and we got a great result."

Picone and his team litigated the case to the point where it was positioned to go to summary judgment when it was terminated. "The client was very please," he says. "I've known the client for a long time and they've always tried to employ [AFAs]."

While law firms and clients have negotiated and implemented AFAs for at least a couple of decades, these arrangements have grown significantly, of course, since the Great Recession pushed clients to drive their law firms harder for efficiency and cost savings. Increasingly, clients seek out law firms that can make AFAs work. And, sometimes they require their outside lawyers to charge them

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through some form of flat fees, dispensing with the billable hour structure—what some clients characterize as "the dreaded billable hour."

Anytime clients talk to a law firm about alternative fee arrangements, they have particular goals in mind, says John Murphy, the CEO of Kansas City-based Shook, Hardy & Bacon, who has been a pioneer in and an advocate for the use of AFAs. (Murphy has had a lot to say about AFAs over the years and has frequently been an *Of Counsel* source on this topic; *e.g.*, see the lead story of the August issue for more of his thoughts on such fee arrangements.)

"Number one, they want to get some predictability to their legal spend," Murphy says. "Number two, they want to put some structure to their approach to their outside counsel programs. Number three, the overriding thing is that they have some sense in house, either directly with the legal counsel or maybe in conjunction with procurement with the CFO and management, that their legal spend is more than they want it to be."

Murphy says that, for the most part, when Shook Hardy has used AFAs, they've generally served both parties quite well, particularly when matters were conducted as a true partnership. "That happens when clients have a good understanding of what they're docket is," he says. "They have a good understanding of where they want to go with their docket. If it's handled by multiple members of the legal department, and there's good communication and collaboration as to the way matters are handled—when all that's in place, you have a good AFA."

At Detroit's Harness, Dickey & Pierce, partner Monte Falcoff agrees and adds that it helps a lot, particularly in his IP and patent practice, if the law firm understands the client and the client's products. "In the good scenarios, the outside counsel has already had some exposure to the technology from the client," he says. "So they already are up to speed technically and also know how that client wants their files handled and the level of quality they expect—the whole business picture."

He also says that for the legal matter to result in a win-win situation for both the company and the law firm both parties must be very realistic about what their expectations are. "That's the ultimate driver," says Falcoff, the chair of the firm's intellectual property practice group, which has used AFAs with

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The AFA Experience

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great success. "If goals on either side are unrealistic, then both parties are going to be very unhappy. Unrealistic goals get people fired even though the cost targets are met. They lead to huge problems down the road."

When Things Go Bad

Indeed, AFAs can go bad and problems can crop up; not all of these fee arrangements turn out as rosy as the one H&C's Picone describes. In fact, he says when he was at another firm early in his career—one that pitched a lot of flat-fee deals to clients and potential clients—an AFA ended up being a bust.

"I was brand-new at the time so I didn't know anything," Picone says with a laugh. "After a substantial chunk of the work had been done on the matter, the partners realized they hadn't done a very good calculation of the actual effort and resources that was required. They thought it was a commoditized experience and they could just flat-fee it. It didn't turn out that way."

Murphy recalls a negative experience with an alternative fee deal that Shook Hardy was involved in and says it was the client's fault and the client knew that. For one thing, he says, while the client recognized that their legal expenses were out of control, they engaged in an alternative fee structure before they fully realized the reasons their legal costs were so high.

"We entered into an AFA that went south on us because, frankly, it went south on the legal department first," Murphy says. "They did not have a good understanding of what their docket looked like or what they hoped to accomplish in the future with going to an alternative fee arrangement. There certainly was not a true willingness to partner throughout. And, communication was weak on their end. This was several years ago, and it's not a client we work with anymore."

The client told the Shook Hardy legal team that the docket consisted of 100 cases, or something like that, Murphy recalls, and that's what the AFA was termed on. But the client actually had more than 200 cases. "Frankly, I don't think they realized that they had that many cases," he says. "What they did realize was that they were spending more money than their board and upper management thought they should be spending on this particular docket, and they wanted to reduce it. So, they said, 'Hey, let's go to an AFA.'" That clearly wasn't the solution.

One recommendation to prevent such problems is to thoroughly define the scope of the matter and write it all down in the engagement letter, which Shook Hardy had the client do and that made it easier to disengage the working relationship. Still, that can be tricky. "You have to have a frank conversation with the client," Murphy says, "explaining that the engagement letter or the memorandum of understanding that constituted the framework of the AFA simply isn't accurate, vis-à-vis the number of cases that might be involved, the legal spend wasn't accurate, or whatever might be wrong."

Suzanne Hawkins, the senior practice director of legal operations at the global consulting firm RGP, works with law firms often on AFAs and agrees that the terms must be clearly set out at the onset and that there should be opportunities to adjust them if the matter changes. "The law firm and the client really have to come together," she says, "and write down in the engagement letter: This is what it covers and if this circumstance arises we will agree to meet and readjust the fee. For example, if it's believed that the matter requires 10 depositions but that turned out to be 40 depositions, well that's a material change and the law firm would need to be compensated. Or similarly, if some

[legal work] didn't occur but it was assumed it would, then the fee might be adjusted downwards."

Hawkins says in her experience most AFAs sail along smoothly, when they're carefully constructed and fair. She currently consults for a client in the transportation industry that has entered into a fixed-fee arrangement with its preferred law firms, and it's working out "extremely well," she says. "It was the subject of negotiations but the view of the client was to make it an equitable number, so that both the law firm and the client would receive benefits from the arrangement. The client has been able to achieve some cost savings that they had hoped to receive and the law firms are very pleased with it as well."

When Things Turn Ugly

Sometimes what can really undermine an AFA is a lowball rate that translates into low-quality legal work. "I can give you a nightmare scenario," Harness Dickey's Falcoff says. He tells of a good friend of his who was in-house counsel for a very large Fortune 50 company, one that holds many patents. The company had hired a law firm to conduct patent work, and that work turned out to be shoddy.

"My friend was distraught to no end because his manager was getting all over him for the poor quality of the patents," Falcoff says. "He said, 'Shame on my management for expecting high-quality and shame on the outside law firm for throwing numbers out there that weren't realistic.' They were doing patent applications for a price that was staggeringly low. I told him I wouldn't do the work for that rate."

It turns out the law firm was using brand-new people not adequately trained in patent law, who didn't conduct thorough research. "They weren't even talking to the inventors," Falcoff says. "They were just taking the invention disclosures, writing the patent applications, and they were garbage. This was for the company's bread-and-butter technology, and the patents were so bad they felt they couldn't even sue their competitors over them [to protect their intellectual property]."

In all likelihood, this was a case where the outside law firm—not a huge partnership but one with as many as 25 patent attorneys—simply wanted to bring in a small stream of revenue, train their people by having them do the work, and then be able to name the high-profile company as one of its clients in the hopes that it would help attract other clients.

Falcoff says that he and his team make sure they offer AFA rates that work for both parties. He cites a recent AFA-priced matter for an automotive industry client that was very successful and says most of the firm's alternative fee deals are. "There was a price certainty and it worked out wonderfully," he says. "We were able to keep the rates the same for a three-year period. And then we increased them slightly for inflation over the next three-year period. These were competitive numbers, but it was very fair and everybody was happy. All the objectives were aligned." ■

—Steven T. Taylor