

An Important Development in the Pricing of Legal Services:

Clients Find Creative Opportunities in Alternative Fee Arrangements

By Reed S. Oslan

In recent years, the market has witnessed alternative fee arrangements (“AFAs”) increase in popularity among in-house counsel and law firms, as clients come to understand the creative opportunities presented by these types of arrangements.

AFAs are billing arrangements with law firms based on structures other than hourly billing and can take the form of contingency fees, value- or success-based fees, fixed fees or other alternatives to traditional hourly rate pricing. AFAs involve law firms bearing fee risk in connection with the client’s matter in return for a payment in excess of hourly rates for achieving a successful outcome. If success is not achieved, the law firm would receive a fee that is below what its hourly rates would generate.

Clients are recognizing the inherent benefits in shifting some or all of the legal fee risk to their law firms and law firms recognize that AFAs help attract a greater volume of work from current clients and draw new clients. In an April 2008 survey of senior legal officers, respondents ranked alternative billing as the “best initiative” law firms are taking to improve relationships. The findings of the survey demonstrate the importance of AFAs and signal a shift in the pricing of legal services.

Law firms have found that AFAs appeal to clients with both large and small legal budgets. Clients who lack the financial resources to pursue important but expensive litigation now have the opportunity to pursue these matters by having their law firm invest in the case alongside the client. In the absence of AFAs, these matters might never be pursued. Clients in this category include individuals or companies with patent claims, smaller companies with limited financial resources, or larger companies with depleted legal budgets. Clients with adequate funding for significant litigation are turning to firms who offer AFAs as a way to

reward firms for sharing risk and to control legal costs, in both plaintiff and defense cases. A 2006 outside counsel survey found that alternative fee structures have become a common method to control legal spending. According to the survey, 57 percent of respondents had participated in AFAs in some form. Utilizing AFAs ranked higher than re-allocation of work to firms with lower rates, signaling that clients are focusing more on partnering opportunities through AFAs with existing counsel than seeking to transition matters to lower-cost providers.

Clients are recognizing the inherent benefits in shifting some or all of the legal fee risk to their law firms ...

Clients also value AFAs because they can provide predictable cash flow and budgeting. An AFA with a fixed monthly fee element is a prime example of a structure that guarantees certainty on legal expenditures. A 2006 client survey found that, while cost is obviously a factor, a majority of respondents placed even greater value on budget certainty than on budget amount.

Kirkland & Ellis LLP has offered AFAs to its clients for more than 15 years. The firm’s depth of experience in creative risk-sharing solutions allows it to offer clients a variety of alternatives to standard hourly billing, depending on the nature of the case and the client’s needs and goals. The firm has employed AFAs in virtually every practice area from litigated matters (both plaintiff and defense work) to corporate transactions. AFAs have included

pure contingent fees, partial contingent fees or tiered contingent fees in litigation matters, fixed fees in litigated and non-litigated matters, and “holdbacks.” In certain matters, the firm has taken part of its fee in equity, stock or other assets. The types of matters in which AFAs can be employed is limited only by the creativity of the law firm and client, as well as the particular facts at issue. Because of its experience as an industry leader in AFAs, Kirkland has been asked to assist clients in evaluating AFA proposals made by other law firms.

While most matters can be structured as an AFA, the types of matters clients have found particularly well-suited to AFAs include the representation of:

- Plaintiffs in accounting fraud and breach of contract litigation
- Plaintiffs or defendants in patent litigation
- Plaintiffs or defendants in creditor rights or fraudulent transfer litigation
- Defendants in class action litigation
- Taxpayers in tax litigation
- Either appellants or appellees in appeals
- Plaintiffs in insurance coverage litigation

To be sure, hourly rate billing will continue to be the dominant pricing mechanism for clients and law firms alike. AFAs are emerging in the legal marketplace as an accepted alternative to the way clients compensate their lawyers.

References:

- “Despite Era of Startling Demands and Distrust, Chief Legal Officers Still Content With Their Roles: Results from ACC’s 8th Annual Chief Legal Officer Survey Reveal Overwhelming Satisfaction with Careers,” Association of Corporate Counsel Press Release, April 15, 2008.
- ACC Docket Special Section: Valuable Insights from the 2006 ACC/Serengeti Managing Outside Counsel Survey.
- “An InsideCounsel/Butler Rubin Survey: Managing Litigation Expenses,” *Special Section to InsideCounsel*, September 2006.

Reed S. Oslan is a litigation partner in Kirkland’s Chicago office.