**The New Normal –
Alternative Fee Arrangements and Project Management for Lawyers
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By Frederick J. Esposito, Jr.

The big question many law firms ask is how many other law firms are actually achieving profitability by using AFAs? According to the recent Altman Weil 2011 Law Firms in Transition survey, alternative fee arrangements (AFAs) are used by 95% of all participating firms, and by 100% of firms with 250 lawyers or more. Also, the amount of non-hourly billing in 2010, measured as a percentage of revenue, increased in 58% of all participating firms, and in 81% of firms with 250 or more lawyers. Two-thirds of law firms reported their use of AFAs is primarily in response to client requests, while only a third offer AFAs proactively as a means of creating a competitive advantage.

There is no question under the “new normal” that clients are interested in AFAs, but trends would suggest that hourly billing arrangements are not going to phase out completely. While there are arguments about the pros and cons of AFAs versus hourly billing arrangements, the issue comes down to clients perceiving a widening gap between the amounts they are charged for legal services and the value of the services provided. AFAs have turned the tables, providing more certainty and less risk for clients, up front, AND law firms now sharing more of the risk.

Under the new normal, law firms must deal with the realities of client expectations and focus on delivery of legal services in an efficient and cost-effective manner. Law firm management is faced with the challenge of shifting from an hourly rate-focused paradigm to that of an efficient-focused business. Therefore, proper and thoughtful planning will be key to making AFAs, or any other billing arrangement, viable and successful. Law firms that preemptively think through the issues of internal efficiency and utilizing project management skill will be prepared to deliver projects more profitably.

Timekeeping will continue to play a critical role. Clients can perceive the value of AFAs, but law firms must continue to track the time it takes to accomplish tasks. Timekeeping data will become a powerful planning tool, rather than something that is passed on to the client in the form of a monthly bill. Law firms will get better at estimating fees to be charged for services and get a better handle on firm investment and generating profit.

There are five key elements to consider when making the shift to AFAs:

1. Focus on historical time investments. Lawyers should be recording time using task-based billing codes. This will enable law firms to determine how much time is required to complete specific tasks and will assist the firm in developing sound AFAs.
2. Improving time management. Law firms that use AFAs must pay serious attention to their lawyer/other timekeeper capacity and utilization. This is an area where project management skills will become essential. Firms will need to get serious about the proper leveraging of lawyers/other timekeepers to maximize client value, provide more predictability and minimize firm costs.
3. Adhering to budgets and time-tracking procedures. Lawyers will need to be trained to review and live by case or matter budgets. Again, this becomes a project management issue. Despite the many perceived imperfections of recording time, tracking time is a logical means of measuring the firm’s effectiveness in efficiency and managing productivity.
4. Evolution of AFA systems. As law firms learn more about their costs and better understand client concerns, they will refine their pricing strategies. Pricing systems might include blends of hourly rates, fee caps, menu, project and portfolio pricing. The key is to keep the AFA as simple as possible. Many law firms develop pricing systems that are often too complex and clients become frustrated and lose interest.
5. Profitability. Understanding how much it costs the firm to produce a billable hour per task and per lawyer is essential to AFA success. Successful firms are heavily focused on efficiency and value, and have been successful in changing the paradigm not only in terms of timekeeping and economic monitoring, but in changing internal behaviors.

The big question many law firms ask is how many other law firms are actually achieving profitability by using AFAs? The short answer is some firms are making more profit, but many law firms repeatedly make mistakes that vastly reduce profits. There are already a large number of firms engaged in large scale AFA pricing, and doing so profitably. However, many of those firms made costly mistakes, and learned from those mistakes, before becoming successful.

Some of the mistakes when implementing AFAs include:

1. Firms/lawyers don’t currently use AFAs, or have done so haphazardly.
2. Firms/lawyers that have implemented AFAs, failed to place conditions on work or enforce change orders (i.e. changes to the terms of AFAs based on changing events in the matter), or failed to manage their teams effectively or failed to approach the AFAs methodically, or
3. Firms/lawyers became intimidated by clients when there was resistance to pricing changes.

Those that have been successful with AFAs understand the economics and understand the need to pay more attention to the mechanics of their practices through better planning, organizing and managing of their firms and engagements. Examples include:

1. System Tools. As noted above, law firms perform historical time investment analysis and determine how much time lawyers have historically taken to complete specific tasks, and creating criteria for assessing change order conditions, e.g. identify potential obstacles that could impact and require modifying AFAs.
2. Training. Lawyers receive training on budgeting tools, pricing negotiations and assumption building, pricing renegotiations, project management and managing projects and staff to budgeting. Law firms train their lawyers to review and live by a budget, or to contact an in-charge/supervising partner when budget assumptions are being violated. Regular monitoring becomes critical to success.
3. Resources. Lawyers are provided with resources such as pricing personnel, generally non-lawyer personnel, which can include a firm’s Executive Director or CFO, to assist the lawyers with preparing profitable AFAs. Other personnel include project/team managers that are responsible for monitoring the progress of matters and implementing initiatives for completing a matter timely and profitably.
4. Personnel Management. Law firms have the challenge of helping lawyers understand the systems tools, training and resources, and they provide guidance for approaching matters in a different way. All of these tools assist law firms with improving internal and external communication, team building and accountability.

Two significant benefits of personnel management include clear, ongoing oversight of a matter, with the goal of creating value for the client, and completing the matter in an efficient and cost-effective manner, and the firm’s ability to learn new skills to improve internal behaviors and build success.

AFAs and project management are not a passing fad. Many law firms struggle with the balance of making the practice of law satisfying and financially rewarding. Now, under the new normal, the balancing act adds client expectations of efficiency, reduced legal fees and added value to the mix. The balancing act becomes more complicated, but not insurmountable.

Project management requires identifying a problem, setting goals and developing a process to keep matters on track. Law firms with this edge will understand their costs, be able to provide accurate estimates and deliver more value to their clients in a timely manner at a lower cost.

Clearly, lawyers and management staff that possess project management skills will gain a competitive advantage.