



Bringing IT and KM Value to AFAs

Alternative fee arrangements (AFAs) continue to be a hot topic in the legal market. When they first started their rise to prominence in 2008/2009, a number of lawyers suggested they would diminish in use once the Great Recession was over. With the downturn generally behind us, however, AFAs not only persist, they are expanding in certain markets.

AFA VARIATIONS

Although there may be no universally agreed upon definition of AFAs, they can be broadly defined

as any fee arrangement that does not follow the traditional billable hour. This definition does not include discounts on rates, as these are just reductions against billable hours. This leaves us with fixed fees (a broad category), fee caps, discount or bonus fees and contingency fees. Each of these types has variations, but any AFA will fit in one or more of these general categories. Following are brief definitions of each:

- **Fixed (or Flat) Fees:** A defined amount of work is assigned a set fee. This might be an entire matter, a group of matters, a stage of a matter or even

discreet tasks within a matter. A variation on fixed fees includes the use of a “collar” around the fee. This collar is a percentage over and under the fee amount. Time is actually recorded against the matter and if the resulting time-based fee total comes within the collar, the fixed fee is paid. If that amount is over the collar, work above the collar is paid at a deep discount off of hourly rates. If the amount is under, a percentage of the savings is shared.

- **Fee Caps:** A cap is the maximum amount that will be paid regardless of the amount of work done. This is usually calculated by using hours and rates.

- **Discount/Bonus Fees:**

This fee has the greatest variation, but the basic idea is that a discount (against hourly or fixed fees) is given if goals are not met. When goals are met or exceeded a bonus may be given.

Variations include not having bonus levels above the agreed upon fee, or not having discounts below it.

- **Contingency Fees:** All fees are contingent on success in a matter, such as a defined victory in a dispute, or the closing of a deal.

Current market surveys estimate that the percentage of billings under AFAs for Am Law firms is around 16 percent. Historically this number has been around five percent. These numbers are not easily available and therefore suspect, but, based on my experience, a tripling of AFAs is a probable number.

I suspect usage is actually higher, since most firms do not have centralized AFA approval and tracking processes and therefore do not have an accurate record of how many AFA engagements they actually have. Also, a lot of clients request AFAs, but then opt for discounted hourly rates in the end.

THE SECRET TO SUCCESSFUL AFAS

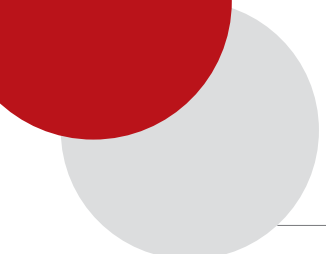
The most common queries I receive about AFAs are: Which one should we use, and how much should the fee be? Everyone is looking for the right type of AFA to use and the appropriate

fee for a given type of matter. The answer is...there isn't one solution. Of the more than 500 AFAs I have created, reviewed, analyzed and pitched, it is unlikely any two were identical (except maybe those that renewed for follow-on years). Even for like matters with the same

client, I have seen different AFAs utilized.

The real secret to implementing successful AFAs is talking with and listening to clients about their fee needs and concerns. When a client speaks about cash flow as an issue, fee predictability on a monthly basis may be the primary need. Other clients might need certainty of the total matter fee. Recently I heard one client say that being on or under budget on legal fees heavily impacted their personal annual performance reviews. These are just some examples of the kinds of client needs that can drive AFA decisions.

“Leverage is a key factor in determining the profitability of the AFA”



These varying needs and fee concerns have resulted in the application of a variety of AFA types, which means that the knowledge base and systems used to determine and track fees must be deep and flexible.

AFA IMPLEMENTATION PROCESS

Understand Client Needs

As noted above, the best first step in the process is talking with the client. The information gained in these conversations will prove quite useful throughout the AFA steps defined below.

Establish Budget and Expected Leverage

A basic requirement in implementing almost any AFA is creating some level of a budget, be it a very simple one, or one with a high degree of detail. The more detailed budget variations are essentially matter plans, which provide a basis for managing the matter against an AFA fee. Simple budgets may be just the total amount of a fee, but should also include an expected leverage for the work — leverage being the ratio of non-partner hours to partner hours spent on the matter. Leverage is a key factor in determining the profitability of the AFA.

Too often, at this stage in the evolution of AFAs, not enough thought is given to scope of work. It is not a good idea to take work on a fixed fee without some understanding of the work that will be done. There appear to be efforts emerging to define out-of-scope activities. This can take the form of a list of assumptions or events that trigger a re-negotiation of the AFA.

Maintain Profitability

Once the budget and leverage is established, it is possible to predict the profitability of the AFA.

Perhaps more importantly, different variations on the AFA can be explored to see how profitability might be improved. I think this is a critical step for successful AFAs. Lawyers tend to think solely in terms of hours and revenue, and assume whatever approach they take will generate positive financial results.

Secure Law Firm and Client Approval

With a defined AFA in hand, depending on a firm's policies, it is important to have this AFA approved by the firm's leadership. Some firms may include this approval step earlier in the process, or approval authority may exist at the individual partner level. However it is accomplished, the fee deal must be well-defined, and partners and leadership must have a good understanding of its potential profitability.

The approved version of the AFA should be logged in the appropriate system. Entering the parameters of the AFA into a system will allow monitoring of the actual-to-budget performance.

Of course, at some point the AFA needs to be shared with the client. The best practice is to do this in person. Emailing these is not recommended, since too many nuances of an arrangement are lost and the client sees only the number. Another best practice here is to leave room for negotiation. Lawyers are generally surprised when clients don't accept the first offer. Clients may have accepted the first one in the past, when budgets were not so concrete, but now most expect to see some give-and-take in the negotiating process.

Monitor Work Against Your Budget

Once a firm secures an AFA engagement, another best practice is to monitor the actual work put into the matter against the predicted budget. Most budgets

will not have a high level of detail, so monitoring can be kept at a simple level. Lawyers in charge can look at the financial metrics and weigh those against their estimates to determine how far into the work they are. Budgets are monitored for two reasons: first, to maintain profitability of work and make sure AFAs are financially viable for a firm; and second, to catch any surprises and share this information with the client. Even in a purely fixed-fee deal, identifying out-of-scope events early will make adjustments to AFAs easier to accomplish. This will also help clients manage their cash flow and internal budgets against the work. A suggested best practice is to have ongoing conversations with clients about fees. Clients appreciate knowing things are on track so they don't have to worry about surprises or problems. This is simply Client Service 101.

Review and Evaluate

At the end of a matter, some level of review is advisable. If firms are going to secure and manage AFAs in a profitable manner, they will need to learn from them and improve their performance on them over time. Well-executed AFAs can become templates for future AFAs.

THE ROLE OF IT AND KM

Using Budget-Building Tools

There are a number of budget-building and AFA tools on the market now. These include: Redwood Analytics Planning Application, with a Profitability

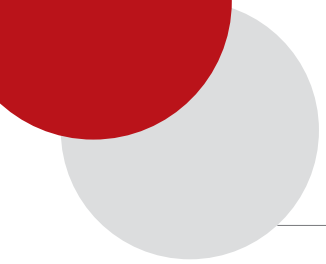
Module, from LexisNexis; Thomson Reuters ENGAGE; Expert Matter Planning from Aderant; BudgetManager from Randy Steere LLC; and IntelliStat Financial Planning from DataFusion. Of course, the ever-popular Excel spreadsheet is still widely used as well. Each of these products has its strengths and weaknesses. They are all dependent on the ability of a lawyer to build a budget and the existence of budget templates. Budget templates — or even better, template

building blocks — are hard to come by. This is one point where IT and KM can provide value. A firm needs the right tools and the right knowledge to put together useful templates. A word of caution, though: a lawyer's behavior should not be expected to change dramatically to suit a technology solution. It has been my experience that the

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more effort required of lawyers on non-billable tasks for any project, the less success a firm will have with the project. This is important to keep in mind when evaluating systems and processes for building budgets.

Most of the tools mentioned above can also assist in determining the profitability of a given AFA. This may sound like a basic and rudimentary activity, but law firms have not traditionally focused on profitability. They focus, instead, on hours and revenue. Fixed-fee deals and other AFAs do not follow the same logic. Therefore, budget-building must include



a profitability analysis component. A budget that matches scope of work and meets the client's costs needs, but will be unprofitable for a firm, will become a problem over time, especially if it is utilized as a template. So profitability analysis must be embedded in the systems and processes used.

Initially, approval processes will be relatively simple; however, a defined workflow should soon emerge. Again, IT and KM can play a role with workflow tools and knowledge to support an efficient, technology-enabled workflow process.

Monitoring Budget to Performance

Second to a budgeting tool, monitoring the progress of AFA engagements may be the best opportunity for IT and KM to provide value, especially in the long run. Most of the budget-

building tools noted above are also designed to provide monitoring abilities. Again, the level of detail required by the client and the type of AFA will determine the level of detail in monitoring. Most firms already have tools that can be used for simple monitoring of budget-to-performance. Elite has basic budget-monitoring abilities, as does Aderant's CMS. So it is possible to provide some level of monitoring support with existing systems. Many firms may also have their own reporting tools built on Crystal Reports or a similar system.

Making sense of monitoring reports will likely require a human element. Too many of the reports I have seen are complicated and will benefit from analysis and explanations by nonlawyer experts. These analysts may be existing financial personnel, or new-breed project managers. As the level of detail rises in

Business Intelligence Leads to Success

by Saul Himelfarb of Data Fusion Technologies, Inc.

With the rapid adoption of alternative fee arrangements (AFAs) in the legal industry, firms are scrambling to see how they can configure their various systems to better support non-hourly billing models. One of the key systems within the firm that is central to tracking AFAs is the firm's business intelligence (BI) system.

When attorneys enter into AFAs with the firm's clients, how do they determine what amount to bid for a particular engagement? The purpose of using an AFA is to create a "win-win" situation where the firm and its client each get a fair deal on the project. The client gets a better total cost than

he would with an hourly engagement, and the firm still makes a profit. But how does the firm know if the amount they will be bidding will end up making it a profitable project?

A comprehensive BI system will allow the firm to look at previous matters that are similar to a new matter to determine its potential profitability. Once the data is captured, the matter is analyzed based on billing rates, leverage of partners to non-partners and hours assigned. The model matter can then be updated based on any differences between the model matter and the new matter being analyzed. How would the project look if we assigned

a budget, the need for analyst and project manager involvement will also increase.

Capturing AFA Knowledge

The final aspect of AFA monitoring is capturing AFA knowledge as it is created and then making it available for future AFA deals. KM teams can provide significant value here. A challenge I have identified is that traditional law firm billing knowledge is not well-structured for serving AFAs. More specifically, time entries are designed to be included in invoices. They are not structured to be analyzed by type of matter, type of work and specific task. Having analyzed hundreds of past matters, I have found little value in the data. One product designed to address this challenge is the Matter Experience module for Lexis Search Advantage. This product is designed to analyze time entries and

programmatically tag them with task codes. Even if the tagging is not always 100 percent accurate, it will offer more consistency than a manual process where lawyers code time entries. Analysis tools like the Matter Experience module will go a long way to bringing KM value to AFAs, and I hope to see more of them emerge in the market.

AFAs appear to be here to stay and most likely will continue to grow in the legal market. AFAs are evolving within firms and processes are emerging to manage the review, approval and monitoring of these engagements. IT and KM are positioned to bring high value to these processes as they evolve. The ability for a firm to successfully respond to the changes brought on by AFAs is dependent on doing well with these systems. **ILTA**

Successful AFAs

more associates? How can the attorney give the client an extra discount on top of the special rates they already have? Would there be any major difference if we assigned more fourth-year associates and less fifth-year associates?

Some alternative fee arrangements will be based on individual amounts for various tasks and activities and not a total amount for the entire engagement. The analysis for each portion of the project would be the same, but on a smaller scale. Many firms have been coding time entries for years with task and activity codes. For firms that have not yet done this universally, a plan to implement AFAs may be

another reason to get your timekeepers into the habit. As anyone who has had to go back and code time entries after the fact knows, it's much easier to do this the first time around!

Once the firm creates a model for new matters, it will be able to project the profitability of new work. Of course there may be situations where the firm takes on work that is not profitable for some reason, but at the very least, management should know that at the start. Without a business intelligence system in place, entering into an AFA can be a risky proposition. **ILTA**