



**2016 CLM Annual Conference
April 6-8, 2016
Orlando, FL**

**AT WHAT COST?
CURRENT ISSUES SHAPING ALTERNATIVE FEE ARRANGEMENTS**

Insurance 101

Who Are the Players?

Depending on the circumstances, one or more of the following may be involved in any given piece of litigation: (1) The client; (2) In-house/outside/national coordinating counsel for the client; (3) Primary insurance carriers that have issued insurance policies to the client; (4) Excess/umbrella insurance carriers that have issued insurance policies to the client; (5) Insurance consortiums that have issued insurance policies to the client; (6) Insurance brokers retained by the client; (7) Third-party administrators retained by the client; and (7) Case specific retained defense counsel.

Who is involved may impact how the litigation is supervised and managed.

Where Does the Money Come From?

When defense counsel is retained to represent a client in a specific case, that defense counsel often wants to know where the defense/indemnity dollars are coming from. Depending on the circumstances, the defense/indemnity dollars may come from the client (because the client is self-insured, has a large deductible or has a large self-insured retention), a primary insurance carrier, an excess/umbrella insurance carrier, or an insurance consortium. The source of the defense/indemnity dollars may impact how the defense is orchestrated.

Who is the Client?

When the defendant is self-insured and defense counsel is directly retained by the client or its third-party administrator, it is easy to identify the client. The defendant and defense counsel can collectively conduct their own cost-benefit analysis about defending the case versus settling the case.

When the defendant is being provided a defense and indemnity pursuant to one or more insurance policies and defense counsel is engaged in a tripartite relationship, although the defendant is still clearly the client, the defendant may be contractually obligated to comply with the defense strategy proposed by the insurance carrier/consortium – and ethical issues can arise from this tripartite relationship. In a lawsuit where there is a tripartite relationship, defense counsel is generally guided by the insurance carrier/consortium and resolves the lawsuit to the satisfaction of both the insurance carrier/consortium and the defendant.

Defense counsel, courts and legal scholars continue to debate who defense counsel actually represents – the defendant, the insurance carrier/consortium or both. Many legal scholars question whether long-

standing practices coincide with modern ethical rules. However, there is agreement on at least two things: (1) The issue of whether a lawyer-client relationship exists is a legal question rather than an ethical question; and (2) The defendant is defense counsel's client. However, the law is not consistent throughout the country as to whether defense counsel owes a duty, absent a conflict of interest, to the insurance carrier/consortium as well. This leads to the questions of whether the insurance company/consortium has a legal right to direct defense counsel's activity and/or to pursue defense counsel for malpractice (because it pays defense counsel's fees and the judgment against the insured).

Why Alternative Fee Arrangements?

The economic collapse of 2008 sparked an intense urgency for corporations and legal departments to cut expenses and consider alternative fee arrangements (AFAs)—approaches to billings that are not based on traditional hourly rates. AFAs often translate the value of legal services as the client sees it—not as the law firm sees it—and set forth an appropriate fee based on what value the client receives and how that client perceives value. AFAs are seen as not only a way by which to better manage legal fees and costs but also as a way to increase both the quality and the value of the legal services being provided in a changing, more competitive global environment. The refrains that "legal is different" and "the traditional billable hour cannot be replaced" are increasingly being challenged with the response of "we want better value from our law firm."

However, AFAs don't just benefit the client, they also benefit the law firm. AFAs can give the client cost predictability, efficiency, greater transparency, more targeted reporting and advice, and value. AFAs can give the law firm revenue predictability, gains in client trust, improved case management skills, the ability to more accurately predict hour and staffing requirements, and a competitive advantage over other firms not able to offer AFAs.

Types of Alternative Fee Arrangements

The most common types of traditional hourly fee arrangements involve discounted hourly rates, volume discounts, blended hourly rates, task/unit-based billing rates and retainers.

When looking at alternative fee arrangements, they generally fall into one of three categories: (1) Risk-based fees; (2) Value-based fees; and (3) Hybrid fees. Risk-based fees include contingency fees, success incentives (usually coupled with reduced rates), fixed/flat fees, capped fees, collared fees and holdback fees. Value-based fees include stage based fees, market priced fixed fees, bundled pricing and "pure value" fees. Hybrid fees consist of fixed fees that include an hourly element, fixed fees that include a success fee, and an hourly rate that includes a contingency fee element. However, the following outlier alternative fee arrangements do not fall into one of the three aforementioned categories: (1) Percentage fees; (2) Retrospective fees based on value provided; and (3) Statutory fees.

Law Firm Management

Law Firm Goals

Defense counsel goals include, but are not limited to increasing the client's satisfaction with both the value and the quality of the services provided and achieving acceptable results for the client while achieving reasonable returns for the law firm. Some law firms opine that AFAs, when properly implemented, help achieve these goals by requiring law firms to (1) define the goal, whether that be by the outcome delivered, the cost of comparable services or the "cost to produce" plus reasonable profit, (2) determine the scope of the work that needs to be completed to achieve the goal and then to manage that work efficiently, (3) identify the individuals best suited to perform this work and pursuant to which specific AFA this work is to be performed, (4) implement the AFA so terms of the engagement are clearly defined,

the work is properly tracked, updates are provided and elements are included to address changed assumptions, (5) manage the AFA so the work is done efficiently, timely and in response to changed assumptions, and (6) evaluate the work completed to determine if the goal was achieved and how to better reach the stated goal the next time.

Law Firm Challenges That Impact the Engagement and Beyond

Defense counsel must be aware of the challenges they face with AFAs. Mistakes that impact retention and beyond include those that are made in (1) the estimation of the fees/costs that will be incurred in association with the defense of the client, (2) identification of the risk, and (3) determination of the scope of the work to be performed. In addition, the client and defense counsel must make sure they collectively define the goal. Defense counsel must invest more in project management to understand the scope and the timing of the work to be performed, the resources required to achieve the goal, and the price paid in the past to achieve the goal. Defense counsel must then supervise the project to ensure efficiencies are maximized at all stages of the process.

Requirements

AFAs require defense counsel to invest more heavily in (1) "up-front" planning, (2) management, (3) monitoring of spending, (4) standardization, (5) accepting additional risk to lower costs, (6) efficiency, and (7) tracking/reporting results.

Ethical Considerations

With regard to law firms, AFAs can discourage boilerplate excess work while encouraging increased attorney efficiency and rewarding speedy resolutions. However, attorneys should be aware of ethical considerations raised by the existence of an AFA. All attorneys are bound by the Model Rules, which mandate that an attorney's work be "competent." Individual states also may have ethical rules governing attorneys and their practices. When it comes to AFAs, the largest area of concern centers around whether the economic arrangement imposed by AFAs will limit tasks conducted by the law firm such that the competent rendering of legal services is called into question. Law firms that have appropriately planned for the handling of matters via AFAs through extensive tracking and communication with the client should be able to readily demonstrate that their competence should not be called into question by showing acceptable results for satisfied clients. Nevertheless, attorneys always need to be conscious of their ethical duties and ensure that competent representation of a client is not being compromised as a result of a fee arrangement.

The Next Step

Insurers cite certainty/predictability (knowing the fees/costs up front), simplicity (having fewer complex itemized accounts) and clarity/transparency (knowing what is going to be done and when) as the biggest reasons to adopt AFAs - even over savings. Defense counsel cite revenue predictability, gains in client trust, improved case management skills, the ability to more accurately predict hour and staffing requirements, and a competitive advantage over other firms not able to offer AFAs as some of the biggest reasons work with insurers on AFAs.

As AFAs continue to grow in popularity, insurers will look to law firms to help forecast and predict outcomes and to better utilize analytics and metrics to assist with evaluating how well they have done collectively to reach the goal of increasing the value of the services provided at an identified (and hopefully reduced) cost.

Take Away?

There is no question that insureds and insurers can both benefit from controlled litigation costs. As law firms, legal departments and insurance carriers continue to question the billable hour model and embrace AFAs, more analysis and training is needed to manage matters within a budget while keeping an eye on profits.