NEW FEES, SAME WORK – PREPARING AND RESPONDING TO ALTERNATIVE FEE ARRANGEMENTS

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# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. INTRODUCTION</td>
<td>1</td>
</tr>
<tr>
<td>II. CREATION AND USE OF ALTERNATIVE FEE ARRANGEMENTS</td>
<td>1</td>
</tr>
<tr>
<td>III. FORMS OF ALTERNATIVE FEE ARRANGEMENTS</td>
<td>3</td>
</tr>
<tr>
<td>A. Contingency or Success Fee</td>
<td>3</td>
</tr>
<tr>
<td>B. Fixed or Flat Fee</td>
<td>4</td>
</tr>
<tr>
<td>C. Task or Unit Based Billing</td>
<td>5</td>
</tr>
<tr>
<td>D. Percentage Fee</td>
<td>5</td>
</tr>
<tr>
<td>E. Retrospective Fee Based on Value</td>
<td>5</td>
</tr>
<tr>
<td>F. Blended Hourly Rate</td>
<td>6</td>
</tr>
<tr>
<td>G. Capped Fees</td>
<td>6</td>
</tr>
<tr>
<td>H. Fee Collar</td>
<td>6</td>
</tr>
<tr>
<td>I. Fixed Fee Plus Hourly Billing</td>
<td>6</td>
</tr>
<tr>
<td>J. Fixed Fee Plus Success Fee</td>
<td>7</td>
</tr>
<tr>
<td>K. Hourly Rate Plus Contingency or Holdback</td>
<td>7</td>
</tr>
<tr>
<td>L. Volume Discounts</td>
<td>7</td>
</tr>
<tr>
<td>IV. TYPES OF ALTERNATIVE FEE ARRANGEMENTS SUITABLE FOR FRANCHISE AND DISTRIBUTION PRACTICES</td>
<td>7</td>
</tr>
<tr>
<td>A. Formation of Corporate Entities</td>
<td>8</td>
</tr>
<tr>
<td>B. Drafting Form Documents</td>
<td>8</td>
</tr>
<tr>
<td>C. Initial and Ongoing Registration and Disclosure Work</td>
<td>8</td>
</tr>
<tr>
<td>D. Development of Manuals, Processes, and Related Documents</td>
<td>9</td>
</tr>
<tr>
<td>E. Leases, Construction Documents, or Other Transactional Matters</td>
<td>9</td>
</tr>
<tr>
<td>F. Intellectual Property Matters</td>
<td>9</td>
</tr>
<tr>
<td>G. Securities Offerings and Filings</td>
<td>9</td>
</tr>
<tr>
<td>H. Employment Matters</td>
<td>9</td>
</tr>
<tr>
<td>I. Litigation</td>
<td>9</td>
</tr>
<tr>
<td>V. MISTAKES IN FORMULATING ALTERNATIVE FEE ARRANGEMENTS</td>
<td>10</td>
</tr>
<tr>
<td>A. Some General Comments</td>
<td>10</td>
</tr>
<tr>
<td>1. Avoid getting pulled into a price war</td>
<td>10</td>
</tr>
<tr>
<td>2. Accept the fact that there is a learning curve and a growth curve</td>
<td>11</td>
</tr>
<tr>
<td>3. Implementing and monitoring an effective AFA requires work</td>
<td>11</td>
</tr>
<tr>
<td>4. An AFA does not work in every case</td>
<td>11</td>
</tr>
</tbody>
</table>
# TABLE OF CONTENTS

## (continued)

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>5. An AFA does not work for every client</td>
<td>11</td>
</tr>
<tr>
<td>6. Not every AFA works in every case</td>
<td>11</td>
</tr>
<tr>
<td>B. The Keys to Successfully Implementing AFAs</td>
<td>11</td>
</tr>
<tr>
<td>1. Become informed</td>
<td>12</td>
</tr>
<tr>
<td>2. Set the objectives and define the scope of the project</td>
<td>12</td>
</tr>
<tr>
<td>3. Inform your client and keep your client informed</td>
<td>12</td>
</tr>
<tr>
<td>C. The Most Common Mistakes That Law Firms Make</td>
<td>12</td>
</tr>
<tr>
<td>1. Fixed Fee</td>
<td>13</td>
</tr>
<tr>
<td>2. Blended Rate</td>
<td>14</td>
</tr>
<tr>
<td>3. Contingency Fee</td>
<td>15</td>
</tr>
<tr>
<td>VI. ENGAGEMENT LETTERS</td>
<td>15</td>
</tr>
<tr>
<td>A. Define the Client</td>
<td>15</td>
</tr>
<tr>
<td>B. Scope and Expected Outcome</td>
<td>15</td>
</tr>
<tr>
<td>C. Fees</td>
<td>16</td>
</tr>
<tr>
<td>D. Expenses</td>
<td>16</td>
</tr>
<tr>
<td>E. Billing</td>
<td>17</td>
</tr>
<tr>
<td>F. Cooperation</td>
<td>17</td>
</tr>
<tr>
<td>G. Use of Technology</td>
<td>17</td>
</tr>
<tr>
<td>H. Conflict Waiver</td>
<td>17</td>
</tr>
<tr>
<td>I. Termination</td>
<td>17</td>
</tr>
<tr>
<td>J. Client Documents</td>
<td>17</td>
</tr>
<tr>
<td>K. Dispute Resolution</td>
<td>17</td>
</tr>
<tr>
<td>L. Complete Understanding</td>
<td>18</td>
</tr>
<tr>
<td>VII. ETHICAL CONSIDERATIONS IN THE USE OF ALTERNATIVE FEE ARRANGEMENTS</td>
<td>18</td>
</tr>
<tr>
<td>A. The Model Rules</td>
<td>18</td>
</tr>
<tr>
<td>1. Capped Fee Arrangements</td>
<td>19</td>
</tr>
<tr>
<td>2. Blended Rates Arrangements</td>
<td>22</td>
</tr>
<tr>
<td>3. Retainer Agreements / Upfront Payment of Fixed Fees</td>
<td>22</td>
</tr>
<tr>
<td>4. Reverse Contingent Fees</td>
<td>23</td>
</tr>
<tr>
<td>VIII. IN-HOUSE COUNSEL PERSPECTIVE ON ALTERNATIVE FEE ARRANGEMENTS</td>
<td>24</td>
</tr>
<tr>
<td>IX. CONCLUSION</td>
<td>25</td>
</tr>
</tbody>
</table>

-ii-
NEW FEES, SAME WORK – PREPARING AND RESPONDING TO ALTERNATIVE FEE ARRANGEMENTS

I. INTRODUCTION

Lawyers and their law firms have long measured their value to their clients by the billable hour. While the billable hour is still the predominant method of valuing lawyers’ work, alternative fee arrangements (“AFAs”) emerged in the early 1990’s as a result of evolving market conditions for legal services. Their use as a pricing strategy has grown steadily over the past quarter century. The most basic definition of an AFA is the payment to a law firm or lawyer based on a method other than pure billable hours. The arrangements most associated with this definition are contingency fees and fixed fees; however, in recent years the types of AFAs used have expanded to include a wide variety of arrangements that meet the needs of the clients while providing proper compensation to lawyers for the work provided. For purposes of this paper, the authors have chosen to speak to the broadest definition of AFAs to allow for the fullest discussion on pricing alternatives that provide clients more innovation, more risk sharing, and ultimately more service delivery value from their counsel.

This paper will provide an overview of why AFAs were created and have continued in use over the last quarter century. The paper will also discuss the various AFAs in use today and which AFAs may be suitable for use with franchise clients. It will address common mistakes law firms make in formulating AFAs and how to avoid these mistakes. The paper will further inform the reader of important terms to consider in the drafting of an engagement letter where the client and the lawyer will agree to some form of AFA, and will also address ethical considerations associated with the use of AFAs. Finally, a view of AFAs from the in-house counsel perspective will be provided.

II. CREATION AND USE OF ALTERNATIVE FEE ARRANGEMENTS

What created the need for AFAs and, more recently, the growth in the types of AFAs used in a wide variety of legal services? Certainly, economic conditions in the early 1990’s and again with the 2007-2008 recession created financial pressures on clients, leading to the following market conditions for legal services:

a. Pressure on general counsels to reign in legal spending, as many businesses believed legal spending was one of the last untapped sources of cost optimization in the business;

b. Pressure on law firms to be efficient in providing legal services and predictable in the fees they charge in performing those services;

c. Entry of low cost legal service providers into the marketplace, which put downward pressure on hourly rates;

d. Reduced demand for outside counsel services as in-house legal teams were increased to handle legal needs seen as more transactional or commoditized; and

e. Emergence of client value and service delivery quality as greater considerations in evaluating outside counsel.
In particular, the focus on client value and service delivery quality has led to a change in the way law firms and clients view the value of the work provided by law firms.

AFAs are not about charging more than what an hourly rate might be – they are about charging an appropriate fee based on what value the client receives and how that client perceives value. Alternative billing should be based on what is fair and reasonable both to the client and the lawyer. Keeping track of time should be the lawyer’s measure of cost, not necessarily a measure of the value he or she is providing the clients in their legal needs.¹

Many articles have been written about the use of AFAs, particularly in the past ten years. Most of these articles focus on the relationship between the value of the legal services provided and the fees charged.² The 2002 ABA Commission on Billable Hours Report states:

The billable hour is fundamentally about quantity over quality, repetition over creativity. With no gauge for intangibles such as productivity, creativity, knowledge or technological advancements, the billable hours model is a counterintuitive measure of value. Alternatives that encourage efficiency and improve processes not only increase profits and provide early resolution of legal matters, but are less likely to garner ethical concerns.³

If structured thoughtfully to address both the client’s needs and the lawyer’s costs, an AFA can create greater alignment around the objectives, scope and expectations of an engagement. The lawyer must be mindful of the work needed to achieve the client’s objectives and plan accordingly. The client must be clear on the scope and expected outcome of the work to be provided, and the value the client places on the outcome. Structured appropriately, an AFA should provide greater predictability of both the client’s costs and the lawyer’s revenue, allowing both parties to plan with greater certainty. An AFA will not work if one party wants to get a deal at the expense of the other party.

Beginning with their 2010 Law Firms in Transition survey, Altman Weil, a consulting firm which provides services exclusively to legal organizations, has surveyed the use of AFAs by large and mid-size law firms.⁴ Since 2010, the reported use of AFAs by these firms has remained relatively constant: 94.5% of respondents in 2010 reported using AFAs⁵, and 92.9%


³ ABA Commission on Billable Hours, Aug. 2002, p. ix


⁵ Id.
of respondents in 2017 reported using AFAs. Respondents were also queried about their belief that the use of AFAs is a permanent trend going forward. 78.7% of respondents replied affirmatively in 2010, and 78.8% replied affirmatively in 2017. The survey has also inquired annually as to whether law firms are reactive and only offer AFAs when requested by clients, or are proactive in offering these arrangements upfront. Interestingly, 41.3% of participants in 2010 indicated they offered AFAs proactively. This number has dwindled over the years with 26.2% of 2017 respondents reporting a proactive approach to AFAs. However, the survey has also asked about the profitability of AFAs compared to hourly billing. Of the firms that responded, 49.7% in 2010 and 57.5% in 2017 reported that AFAs are as profitable as or more profitable than hourly billing. However, for the subset of firms that reported that they are proactive in suggesting AFAs to clients, the numbers that report AFAs are as profitable and more profitable was 62.7% in 2010 and 72.7% in 2017.

These results seem to indicate that firms that take the time to develop good alternatives to hourly billing and then “sell” those alternatives to clients reap more profit from AFAs than the reactive approach taken by most firms. If firms are experiencing profitability from the use of AFs, especially those firms that use them proactively, and the majority of firms believe AFAs are here to stay, one must question why the proactive use of AFAs has dwindled over the years.

III. FORMS OF ALTERNATIVE FEE ARRANGEMENTS

There are a variety of AFAs in use today, some more prevalent than others. In selecting from these choices, law firms must use historical knowledge of the costs involved to handle a specific type of matter. First and foremost, to develop an appropriate AFA the law firm and the client must work together to define the scope of the project and legal work to be performed. Clients must consider historical knowledge of their costs for previous matters, the lawyer’s expertise in a specific type of matter, and the law firm’s proposed staffing model for the matter. As stated above, for any type of AFA to work successfully, both the client and the law firm must make an informed decision to use an AFA so the arrangement works successfully for both parties. The types of fee structures listed below in subparagraphs A-E are true AFAs as they are not based on any hourly billing. The remaining AFAs listed are hybrid fee arrangements, with some component of the fee based on a billable hour.

A. Contingency or Success Fee

The typical contingency or success fee is based on the results obtained for the client by the lawyer or law firm, most commonly a percentage of the recovery obtained for the client in a litigation matter or a percentage of the transaction for a successful closing of a transaction (e.g.,

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7 Id., at p.71
8 Id., at p. 68
9 Id.
10 Id., at p.70
11 Id.
a percentage of the amount financed in a loan transaction). A reverse contingency fee is based on the percentage of the amount the firm saves for the client in defending a lawsuit. The parties must agree on the maximum exposure the client faces; the reverse contingency fee is then calculated as a percentage of the difference between the maximum exposure and the outcome of the matter.

In each of these AFAs, the written retainer agreement must clearly describe the client’s desired outcome and what will be, and what will not be, covered by the contingency or success fee. For example, the agreement should provide if the client will pay ongoing expenses of the litigation or transaction during the matter, or if those expenses will be paid out of the contingency or success fee. If expenses are to be paid out of any recovery obtained, the agreement should be clear on whether the expenses will be paid to the law firm first, before the calculation of the contingency fee, or if they will be included in the percentage to be paid to the law firm. In addition, in describing the services that will not be covered by the contingency or success fee, the engagement letter must set forth in detail how the law firm will be compensated for such additional services.

B. Fixed or Flat Fee

The fixed or flat fee is an agreed upon charge for the defined service to be provided by the lawyer. This type of fee allows the client to achieve certainty and budgetary control. It also provides the law firm with predictable payments, reduced billing work, and less chance for billing disputes with the client. The best practice for setting a fixed or flat fee for a matter is for the client and lawyer to discuss and agree upon the scope of the various tasks needed to accomplish the client’s objectives successfully. A detailed budget and flat fee arrangement can then be modeled and agreed upon based on the scoping exercise. In many instances, the flat fee is then spread out over the expected timeframe of the engagement and billed monthly to the client.

Fixed fees can also be based on phases of a matter, either stages of litigation or a transaction. If the parties can realistically define the scope of each phase of a matter at its inception, the entire matter can be properly structured for several fixed fee phases.

In a fixed or flat fee scenario, both parties take the risk that the fee set will be proper to cover the actual work provided. In some instances, the parties can agree to share any gains by splitting the difference between actual costs and the flat fee if the litigation or transaction is successfully concluded earlier than expected. They may also agree to share the downside by splitting any cost overruns. This type of arrangement requires both parties to keep a continued watch of the hours and costs, and the justification for any cost overruns.

Ultimately, lawyers and law firms are still judged by the outcome they achieve for their clients. The fixed fee AFA is conducive to establishing incentives or disincentives applicable to the outcome achieved. For a litigation matter, the monthly payments could be 80 percent of the fixed fee. If the matter is settled satisfactorily, which must be defined in the engagement agreement, the firm receives the withheld 20 percent. If the matter goes to trial with a positive result, the firm receives an agreed upon amount exceeding the full fixed fee, e.g., 125 percent of the fixed fee. If the matter is not settled or if a good trial outcome does not occur, the firm

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12 Ben W. Heineman, Jr. & William F. Lee, Getting Your Fix, Corporate Counsel (Sept. 2009).
receives only the original 80 percent of the fixed fee.\textsuperscript{13} For transactions, a portion of the fixed fee could be paid through the closing of an acquisition, with the balance held until after acquisition integration occurs successfully. This allows the client to determine if the due diligence performed by counsel appropriately uncovered all issues.\textsuperscript{14}

According to the 2016 BTI Consulting Group’s survey of general counsels and legal decision makers, the fixed fee is the preferred type of AFA by 60 percent of corporate clients.\textsuperscript{15} This is three times more than the second preferred AFA of capped fees.\textsuperscript{16}

C. Task or Unit Based Billing

This type of AFA provides for specific tasks or components of a matter to be identified to measure the fee. For example, the parties may agree to a task fee for drafting a contract as part of a broader transaction, or for handling a specified number of depositions in a litigation matter. Commercial real estate transactions could be charged on a per-square-foot basis instead of on an hourly basis. A task or unit based billing arrangement provides the client with cost certainty, either for the entire matter or for specific portions of a larger matter. While it potentially limits the full fees to the law firm for a matter that would otherwise be billed on a strictly hourly basis, the balance between cost certainty for the client for specific portions of the work and the hourly billed costs for the remainder of the work can also help promote greater alignment between the client and the law firm. Law firms use this type of AFA with matters for which they have sufficient experience to properly calculate the time and resources needed to accomplish the tasks to be billed using a task or unit based billing.

D. Percentage Fee

A percentage fee is different than the contingency or success fee discussed above. The percentage fee is derived from a sliding scale related to the amount of work involved in the matter being handled. This type of fee is appropriate for certain transactional matters where the amount of work involved is known from the beginning, such as loan documentation or the sale or purchase of real estate. The fee could then be based on a percentage of the amount of a loan or the value of the real property. The client will know the exact fee to be charged for the matter. The law firm will also have certainty of the revenue it will receive for the work provided. However, in situations where unforeseen issues arise resulting in additional work over the anticipated time used to calculate the sliding scale of fees, the law firm may receive less than its actual costs as a result of the percentage fee agreement.

E. Retrospective Fee Based on Value

This fee is different than most other AFAs as the exact amount of the fee will not be known to the lawyer or the client until the conclusion of the matter. The fee agreement must be clear on the factors the parties will use to set the final fee and may include a minimum or

\textsuperscript{13} Id.

\textsuperscript{14} Id.

\textsuperscript{15} Jayne Reardon, Embrace Alternative Fee Arrangements; Kill the Billable Hour (Apr. 27, 2017) (available at https://www.2civility.org/embrace-alternative-fee-arrangements-kill-the-billable-hour/).

\textsuperscript{16} Id.
maximum fee. While this form of AFA is rarely used, likely due to the uncertainty of the fee for both the law firm and client, if used fairly by both parties it offers the best way to relate the fee charged with the value received by the client.

F. **Blended Hourly Rate**

Under this type of arrangement, a single hourly billing rate is calculated for a labor category (e.g., Senior Partner, Senior Associate) or for the entire lawyer team, and all time on the matter is billed on that rate structure. The calculation of the blended rate is based on the economics of the engagement team that will be handling the work, along with the targeted ratio (i.e., ratio of partner to non-partner time) required to efficiently and effectively handle the work. While clients benefit from this type of billing since the same rate applies regardless of who is working on the matter, this form of AFA does not prevent excessive hours billed and may not provide the full benefit of an AFA form previously listed. For law firms, blended rates within a labor category or across all lawyers assumes some hours allocation as part of the calculation of the blended rate. If a change in scope of the matter occurs that alters the assumptions about the distribution of work, the blended rate can have a detrimental impact on the firm’s financial position.

G. **Capped Fees**

In this scenario, the client pays on an hourly basis but the total fees are capped at an agreed upon amount. The cap can be determined for each stage of a matter or for the entire matter. A capped fee provides the client with greater cost certainty than pure hourly billing or even many other forms of AFAs. However, capped fees may not be appropriate for law firms for matters where the scope of the work is uncertain or the type of work is not routine for the law firm. In some instances, the parties may use a “soft” cap by agreeing to a maximum fee based on specific assumptions. The client and law firm agree upfront that if those assumptions prove incorrect, they will negotiate in good faith to adjust the fees.

H. **Fee Collar**

Building on the concept of a capped fee, a fee collar is an agreed maximum and minimum for a matter which is billed at an hourly rate. The client and law firm agree on a budget for the matter, then apply the fee collar as a minimum and maximum around the agreed upon budget. The fee collar can be simply applied, providing certainty to the client that the costs will not exceed the maximum while providing the law firm with a guaranteed minimum amount for the work. Alternatively, the parties can agree on a variation that further encourages risk sharing between the client and lawyer while promoting efficiency and collaboration between them. The work can be measured at the agreed hourly rate, and at the conclusion of the matter, if the actual fees fall within the collar under the budgeted amount, the client and law firm share the savings, and the law firm is awarded a percentage of the savings as an efficiency bonus. Conversely, if the actual fees exceed the budgeted amount within the collar, the firm affords the client a discount.

I. **Fixed Fee Plus Hourly Billing**

In this arrangement, the law firm and client agree to fixed fees for specific portions of the work but then agree to hourly billing for other portions of the matter for which a fixed fee cannot

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17 **Robertson, supra note 1.**
properly be determined. While similar in concept to the task or unit based billing discussed above, this type of fee arrangement is suitable for matters where the scope of specific portions of the work can be defined with a fair amount of certainty, while other portions of the required work cannot. For instance, in litigation matters, fixed fees may be determined for all work up to the trial but the trial activities are billed under an hourly arrangement. Alternatively, a fixed fee may be set for a specified number of depositions with any additional depositions charged at the hourly billing rate.

J. **Fixed Fee Plus Success Fee**

As the name suggests, this AFA contemplates an agreed upon fixed fee for a matter with the law firm entitled to receive an additional defined fee at the conclusion of the matter if agreed upon outcomes are obtained. For example, the firm may bill a fixed fee for work to prepare a securities offering, and a success fee if the offering closes. Not only does this arrangement provide cost certainty for the client, it also shares the risks between the client and the law firm. This type of arrangement requires the law firm to have a strong knowledge of the work required for the fixed fee charged and to understand the risks associated with reaching the desired outcome.

K. **Hourly Rate Plus Contingency or Holdback**

Under this scenario, the law firm charges an hourly rate for work provided, often at a lower hourly rate, in exchange for a lower percentage contingency fee based on a successful outcome. The law firm is guaranteed a minimum amount for the work provided, but shares some risk of the outcome with the client. Alternatively, the client may agree to the regular hourly rates for the firm but only pay an agreed upon percentage of the amounts billed each month, holding back the balance to be paid upon the successful completion of the matter. If the matter does not meet the defined success level, the client does not owe the law firm the balance.

L. **Volume Discounts**

Although not an AFA by definition, a volume discount can be a tool for an innovative, or at least alternative, billing and payment arrangement when the scope of the representation is uncertain and the lawyer is motivated to secure increasing levels of revenue. If the client has a large litigation spend and is seeking to centralize that spend to one or a few law firms, offering a volume discount to the client can be advantageous to both the law firm and the client.

IV. **TYPES OF ALTERNATIVE FEE ARRANGEMENTS SUITABLE FOR FRANCHISE AND DISTRIBUTION PRACTICES**

Many of the services offered by lawyers and their law firms to franchisor or franchisee clients are conducive to one or more of these AFAs. While the types of work discussed below are not exhaustive, many franchisors or franchisees hire outside counsel to assist them with the following types of work that could be performed under AFAs.

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18 Id.
A. Formation of Corporate Entities

The first time a new franchisor or franchisee may retain outside counsel is to assist them in the formation of a new entity under which the franchisor or franchisee will do business. As the formation of new entities is work that many law firms perform on a regular basis, establishing the cost to the law firm to do this work is often a simple exercise or even a known amount. The law firm staffing required for the formation of an entity is also easy to ascertain. Therefore, a fixed or flat fee is appropriate for this type of work.

B. Drafting Form Documents

Either at the inception of the franchise offering or during the life of a franchise system, a franchisor will often request that outside counsel draft form documents for use within the franchised system such as the franchise agreement and related documents. Experienced franchise counsel should have a solid base of experience in the time and cost needed to draft these form documents. This type of work is also conducive to a fixed or flat fee. If the client seeks documents that are unique to its system which may require additional time to formulate and draft, the lawyer could offer a fixed fee for the more routine documents and hourly billing, perhaps with a cap, for the more unique documents.

Issues can arise with the use of a fixed fee for this type of work if the scoping exercise is not thoroughly discussed with the client. For a new franchisor, the lawyer must take the time to understand the nuances of the business and discuss the type of franchise system the franchisor wishes to develop. Does the franchisor intend to offer single unit franchises only? Or has it thought about offering area development franchises? Are there elements of a typical franchise system that the prospective franchisor has not considered? Avoiding future changes to the format of the system, or even just components of the franchise system, will increase the likelihood that the fixed fee set for drafting form documents is sufficient for the amount of work required by the lawyer. The scoping exercise is equally important with an established franchisor if the lawyer is providing form documents for a fixed fee. If the client and lawyer do not take the time to have a candid conversation about the various aspects of the franchise system, and the work required to reflect those terms in the franchisor’s form documents, an AFA arrangement will not ultimately be successful for either the client or the law firm.

C. Initial and Ongoing Registration and Disclosure Work

Drafting the initial franchise disclosure document ("FDD") typically requires more extensive involvement by outside counsel as they learn about the franchise system. The drafting of the initial FDD could be billed as a fixed or flat fee, or a capped fee or a blended hourly rate could be used. Ongoing updates to the FDD can also be provided with a fixed fee, capped fee or blended hourly rate.

The initial and ongoing registration of a franchisor’s FDD could also be handled by these types of AFAs. A law firm and franchisor client may also agree on a fixed fee plus a success fee, or use a fee collar, if there is some anticipation of additional work or issues to resolve prior to obtaining registration of the franchisor’s FDD in all registration states.

As with the use of a fixed fee for drafting commonly prepared documents, identifying the scope of work needed for drafting and registering the FDD, particularly for a new franchisor, is imperative to insure the agreed upon fixed fee is appropriate for both the client and the law firm.
In particular, unanticipated requests for changes to an FDD by state examiners can greatly increase the amount of work needed to finalize registration in all registration states.

D. Development of Manuals, Processes, and Related Documents

As with the above described matters, experienced franchise counsel should be well versed in the costs associated with assisting a franchisor client in developing or updating its operating manuals or written processes. For this work, the fixed or flat fee, capped fees, or blended hourly rate arrangements would be appropriate.

E. Leases, Construction Documents, or Other Transactional Matters

Franchisors or franchisees might retain outside counsel to negotiate and draft real estate leases or construction agreements. This type of work could be billed using a flat fee, a capped fee, a percentage fee, a blended hourly rate, a fee collar, or a task or unit based fee. These same types of AFAs could be used for other transactional matters, including the acquisition of a business or a franchised location. With so many different options, both the law firm and the client should consider the complexity of the matter and the time and resources needed for success to determine which AFA provides the most value to the client for the work provided.

F. Intellectual Property Matters

Franchisors typically require the assistance of outside counsel for the registration and defense of their intellectual property. This type of work is suitable for a fixed or flat fee, a task based fee, a blended hourly rate, or a fee collar. The number of trademarks to be registered, as well as the number of jurisdictions in which the franchisor wishes to register its trademarks, are all important considerations. Defending a franchisor’s intellectual property, whether at the United States Patent and Trademark Office or in an infringement claim, can also be suitable for a contingency or success fee, a fixed fee plus a success fee, or hourly billing with a contingency fee.

G. Securities Offerings and Filings

As with the franchise documents discussed above, a fixed fee with a success fee can be used for an initial security offering. For the subsequent preparation and filing of required SEC documents, a fixed fee is an appropriate alternative to the billable hour. A fixed fee can also be used for securities compliance work.

H. Employment Matters

Both franchisors and franchisees may find they need to hire outside counsel to provide employment law advice or employment litigation defense. This type of work is suitable for a capped fee, a fixed fee, or a blended hourly rate.

I. Litigation

Routine franchise litigation, such as the termination of a franchise, is suitable for a fixed or capped fee. An agreement on fixed fees or capped costs for various stages of this type of litigation can also be used. If the franchised system is one that has regular franchise termination matters, including litigation, the law firm may also agree to volume discounting as they can develop form documents for the specific franchisor’s matters. Other forms of AFAs
can be used in franchise litigation matters, such as the fixed fee and hourly billing arrangement, a blended hourly rate, or success or contingency fee arrangements (either based solely on the outcome or a mixture of hourly billing and some success or contingency fee).

If litigation results in an appeal, the fees associated with the appeal can be structured on a flat fee for the entire appeal, or broken down into the stages of the appeal. This allows the client flexibility within each stage of the appellate process to consider potential settlement and to know the exact cost for the entire appeal. A success fee could also be considered where the client and law firm agree that if the appeal is won, the law firm is then entitled to the success fee. Alternatively, if the appeal is lost, the success fee is not paid or the overall fee is reduced by an agreed upon amount.

V. MISTAKES IN FORMULATING ALTERNATIVE FEE ARRANGEMENTS

While AFAs are becoming far more commonplace than they once were, their proliferation has not come without discomfort. As more and more firms are embracing (or by force of the market being pushed to accept) AFAs, more and more firms are experiencing the problems that come with implementing a new compensation model. Much of this can be attributed to inexperience. Many lawyers lack project management skills, experience with alternative pricing models, and the historical information they need to accurately predict future expenditures.

Certain problems can also be attributed to what some would characterize as a natural tension between certain types of fixed fees and the inclination of many lawyers to do whatever is reasonably necessary to solve a problem. “Many lawyers are trained to get to the bottom of something and spend whatever time necessary … and that may be inconsistent if you told the client $100,000 in fees.”

Below we offer (i) some general comments about AFAs, (ii) guidelines on how to best implement AFAs and some suggestions regarding their use, and (iii) advice on how to avoid some of the mistakes that are commonly made in proposing and implementing AFAs.

A. Some General Comments

1. Avoid getting pulled into a price war.

As one commentator recently noted, “there will be laws firms that enter the AFA arena by trying to buy a prospect’s business, undercutting firms in the process. Though serving a client’s needs is important, the first duty a firm owes is to itself, and devaluing your services to originate new business is a risky proposition.”

The competitive nature of the legal industry can lead to situations where one firm will go to extraordinary lengths to underbid its competition. Learn to say no.


2. **Accept the fact that there is a learning curve and a growth curve.**

An analysis of the profitability of AFAs performed by LexisNexis concluded that initial profitability of AFAs was likely to be below law firm norms. The same study nonetheless concluded that, over time, AFAs were at least as profitable as or more profitable than projects billed using an hourly rate model. This is consistent with the fact that, as it concerns AFAs, experience matters. It is difficult to create an effective AFA for matters with which the lawyer or law firm has no experience.

3. **Implementing and monitoring an effective AFA requires work.**

In addition to the planning that needs to take place before an AFA is proposed, most AFAs require constant monitoring to oversee whether the matter is adhering closely to the assumptions that were made when the AFA was prepared. Lawyers must carefully monitor if they are staying close to the budget and the schedule and, if not, address what changes need to be made. For example, is senior partner time in excess of what had been anticipated? If so, what work can properly be pushed down to a junior partner or senior associate?

4. **An AFA does not work in every case.**

While each AFA brings with it the risk that mistakes will be made in estimation, risk identification, staffing and scope, it is exceptionally difficult to create an AFA for an exceptionally difficult case. If a case is complicated and high risk, it may not make economic sense for either the law firm or the client to try to price it out in advance.

5. **An AFA does not work for every client.**

Different clients have different goals. One general counsel may want to reduce legal spend; another may want to pursue litigation to the fullest extent regardless of the costs. Recognize the needs and desires of your client in deciding whether to propose an AFA.

6. **Not every AFA works in every case.**

Just as AFAs do not work in every case, there are times when a firm proposes one AFA when another would be more appropriate. Carefully consider the type of project, and the risks associated with scope creep, in deciding which type of AFA makes the most sense.

B. **The Keys to Successfully Implementing AFAs**

There are several keys to the successful preparation and implementation of AFAs. As a rule, all of these keys depend on two things: obtaining the information necessary to prepare an effective AFA and sharing that information and your understanding with your client.

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22 *Id.*

23 David Brown, *Approaching Alternative Fees*, Chicago Daily Law Bulletin (Nov. 18, 2010) (observing that “one-time deals … are much harder to predict and control, making it that much more difficult to employ alternative fee arrangements”).

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1. **Become informed.**

Yogi Berra once said that “Prediction is difficult, especially about the future.” Because AFAs generally seek to predict what will happen on a particular project in the future, an effective AFA cannot be prepared without becoming as informed as possible about the nature of the project. Here are some important questions to ask:

- What is the client looking to achieve?
- Do you understand all of the risks?
- What will fall within the scope of the AFA and – more importantly – what is outside the scope of the AFA?
- What do you need to do to accomplish the client’s goals?
- What internal resources do you need?
- Do you have any data that you can look at to determine the historical costs for similar matters?
- Have you determined how the matter can be staffed, and what can be done by associates and what needs to be done by partners?
- Are there options for improving efficiency?

2. **Set the objectives and define the scope of the project.**

Write a short summary of the project and its objectives and share it with the team members and the client. If the client’s objectives are different than what you have put together, determine what the client’s additional “wants” will cost. Be specific about those matters that are carved out from the AFA.

3. **Inform your client and keep your client informed.**

As described more fully below, a successful AFA depends on a shared understanding of what is encompassed by the AFA. One of the key advantages to clients in using an AFA is cost predictability. You will gain trust if you anticipate and document with the client the scope of the services you are required to provide under the AFA. The converse is equally true: “[a] billing dispute damages an otherwise productive attorney-client relationship and, because of the breached trust, opens the door for competition.”

The devil truly is in the detail. Define as much as possible, and make reasonable assumptions for making mistakes or missing information as to the scope of the project. Share and document your understanding with your client. If there are events that you believe will require a modification to the scope of the project, document those events.

C. **The Most Common Mistakes That Law Firms Make**

Just as the keys to successful AFAs are good information and a shared understanding, the most common mistakes that law firms make in formulating AFAs typically result from poor

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information and a lack of communication. What follows are some specific examples of mistakes that are typically made with certain types of AFAs.

1. **Fixed Fee.**

When creating a budget for a fixed fee per matter or a fixed fee by phase, the most important facet of fee development is a clear understanding of the requirements and the project. In addition to having a clear understanding of the scope (and what it will take to complete the task or matter), the correct mix of timekeepers, their corresponding rates, and the hours necessary to complete the tasks are all vital to the success of AFAs. A common mistake related to scope is underestimating or overestimating the hours necessary to complete the task. Underestimating the scope might lead to the award of a matter, but it also could lead to the work being unprofitable. Overestimating the scope and the fees could lead to the loss of the work to another firm. In order to correctly scope a matter, the firm must ask many questions, plan for risks, and have a clear understanding of the client’s expectations.

Further, a firm must continually monitor an AFA to assess its ongoing adherence to the assumptions that went into preparing the AFA. Specifically, if a firm is awarded a fixed fee arrangement, it is imperative to monitor the financial progress of the matter on a weekly or monthly basis. Monitoring typically entails tracking the billable hours against the proposed budget, and keeping the lead attorney advised about actual performance against the budget, especially if the matter is going over the proposed budget. Once a firm is locked into a fixed fee, it is typically impossible to renegotiate the terms of a fixed fee arrangement, and the financial impact can be a quagmire for months or even years.

Consider, for example, the following: A client asks you to submit a fixed fee for filing a complaint and prosecuting a preliminary injunction that seeks to enforce a franchisee’s post-termination obligations. The client makes clear that the proposal is to cover all matters through the court’s issuance of a ruling on the motion. You believe, based on your experience with the assigned judge, that you have a good sense of what will be involved in prosecuting the motion, as the judge rarely even holds oral argument on motions for preliminary injunction. Therefore, you submit a fixed fee that addresses the costs associated with (i) reviewing the client’s documents, (ii) preparing the complaint, the supporting memorandum of law and all required affidavits, and (iii) preparing a reply memorandum of law. You include in the proposal a slight cushion in the event the judge deviates from standard practice and wants oral argument before ruling on the motion. After the initial set of papers is submitted, you review your billing records and determine that the time spent is in line with what you budgeted in estimating the fixed fee.

One week later, the franchisee’s counsel submits not only an opposition to the motion, but a motion for expedited discovery, which the franchisee asserts is necessary to address the propriety of the underlying termination. You prepare a response to the motion, and the court hears argument on the request. The judge grants the franchisee’s motion, and orders expedited document discovery and expedited depositions. He also permits the parties to supplement their filings with any materials they deem relevant from the discovery process. Ultimately, based on these submissions, the court decides to hold an evidentiary hearing on the preliminary injunction motion and, after the completion of the hearing, asks that both parties submit proposed findings of fact and conclusions of law. While you would hope that a client would understand that this was far beyond what the parties had contemplated when the fixed fee was proposed, addressing possibilities and being clear as to the scope of what is included in the fixed fee can help avoid both a client relationship issue and a significant financial loss.
While the foregoing example may seem extreme, the effects of adopting an overly aggressive fixed fee arrangement impact even the largest, most sophisticated firms. At some point in 2011, Quinn Emanuel Urquhart & Sullivan began performing litigation services for Uber under its “preferred counsel” program. That program, which Uber created to help contain litigation costs, required participating firms to accept fixed prices for specific litigation tasks. In 2016, Quinn Emanuel terminated its relationship with Uber because, in the words of Quinn Emanuel’s Chicago office managing partner, the prices Uber was willing to pay were “below the threshold” for the firm’s financial needs. Apparently, the firm accepted the rates available under the preferred counsel program because it believed it would also be retained to handle more significant cases that would offset the discounts applied to the smaller cases. As the office managing partner told Uber, “if QE was also getting the cases with larger amounts in dispute involving more significant budgets, the smaller tasks on the smaller cases would be part of the overall relationship. But we have not gotten any of the larger disputes for Uber under the preferred counsel program.” While Quinn Emanuel and Uber were apparently able to sever their relationship without incident (Quinn Emanuel ended up withdrawing from five pending cases), the law firm is now embroiled in controversy over its decision to take on a piece of litigation adverse to Uber about 30 days after it ended its relationship with the company.

2. **Blended Rate.**

As noted above, a blended rate can offer the most flexibility of any AFA for a law firm, as timekeepers can typically be reallocated without having to get approval from the client. Yet to use a blended rate properly, a firm must have a clear understanding of the timekeeper allocation necessary to sustain the blended rate. The financial impact to a firm can be disastrous if the allocation is developed incorrectly or not adhered to (if, for example, senior partners with higher cost rates are billing many more hours under the blended rate allocation than were anticipated).

Consider, for example, the following: For years, you and a mid-level associate at your firm have handled all of the corporate work for a client, including franchise agreement negotiations, day-to-day advice, and disclosure compliance. To address the client’s concerns about rising costs, you propose to bill the client at a blended rate for all of its corporate work excluding amending the FDD and handling the annual registration process. You calculate the work based on an analysis of previous bills and a breakdown of the number of hours spent by you and the associate.

As the type of work coming in is initially in line with prior experience, the proposal is profitable. The client then advises you that its largest franchisee is looking to sell out to private equity and the franchisee association is seeking to negotiate the creation of a supply chain cooperative. The mid-level associate who has been working for the client for years has no experience dealing with private equity, and the client is adamant that you are the only one who is authorized to interact with the franchisee association’s counsel. If your proposal does not clearly define the type of work that is covered by the blended rate, the assumptions that you made in formulating the blended rate will collapse, as the hours mix that you relied on will no longer be applicable.

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26 *Id.*

27 *Id.*
3. **Contingency Fee.**

Representing a client on a contingency basis is perhaps one of the oldest and most recognizable AFAs. When taking on a client under this arrangement, a firm must weigh the risk of hundreds or thousands of non-billable hours against the possibility of a payout for a successful outcome. For this reason, this type of AFA is susceptible to the same major risk as the others: a mistake as to scope. It is almost impossible to gauge how many hours or attorneys it will take if a case goes through trial before pretrial motions begin. There have been firms that have accepted a case on a contingency basis only to realize that, while they obtained a $2M judgment, they expended over $6M in fees in obtaining that judgment.

Mutually successful AFAs depend on the willingness of both the firm and the client to share in risk. Eliminating the aforementioned common mistakes will not only lead to better value for the firm, but will enhance the client experience.

**VI. ENGAGEMENT LETTERS**

All lawyers and law firms have a standard form of an attorney engagement letter, but an engagement letter for an AFA is anything but boilerplate. Like all agreements for legal services, the engagement letter using an AFA should establish the terms of representation, including what the client should expect from the law firm and what the law firm expects from the client. When drafting an engagement letter for an AFA, one should consider the following main points:

**A. Define the Client**

It may seem obvious, but the definition of the client should be clear as to what individuals and corporation(s) the representation covers. Many companies have various subsidiaries that handle different aspects of the business. Individuals that require representation may operate in different capacities within an organization. The engagement letter should clearly name the correct entity or the individual, and that individual’s role within the organization, as the client.

**B. Scope and Expected Outcome**

For the reasons discussed above, one of the most important clauses in an AFA engagement letter is the description of the work the law firm will be doing for the client. Because AFAs typically do not involve the traditional hourly billing, it is important to clearly articulate the scope of the work to be done. In doing so, the matter should be identified. Is it representing the client in the one named case, or many cases of the same type (*i.e.*, breach of franchise agreement)? If it is handling a specific transaction, clearly describe the transaction. If it is handling ongoing transactions, such as FDD updates and registration, be specific about that work. The agreement should also address what is not covered (*i.e.*, appellate work). By explaining what is and is not covered, the exact scope is better defined. If a later disagreement arises, the parties have a clear definition of the scope. This is particularly important with the use of AFAs where the fees to be charged to the client are tied directly to the scope of work (*i.e.*, flat fee).

In addition to a carefully crafted scope of work, AFAs that have some or all of the lawyer’s compensation tied to the outcome of the matter also require careful drafting of the issues relating to the expected outcome, in particular what constitutes success. The more
specific both parties are in agreeing to the definition of success in the engagement letter, the more aligned the parties will be as they work through the matter and the less likely the parties will encounter disputes about the fees to be paid to the lawyer at the conclusion of the matter.

C. Fees

Just as with the scope of the representation, the fees clause needs to be clear and concise. Depending on the type of AFA, the language will need to accurately reflect the parties understanding of billing and what is and is not included. Take, for example, the description of the fees for a fixed fee arrangement, which may say something like the following:

The parties agree that the fee for this engagement will be fixed at $5,000.00. This fee is payable within 15 days of execution of this agreement. All expenses will be billed separately each month. It is agreed by the parties that the fee is based upon the scope of work defined in this agreement. Any other work to be done outside of the scope will require a separate written agreement between the parties.

As you can see from this simple example, it is very important to have the scope of work clearly defined, as the scope and billing typically are directly correlated. As often happens, unforeseen issues can arise during the representation that fall outside of the defined scope. Should that happen, a new engagement letter should be drafted and agreed to by the parties.

In addition, if an AFA is going to be in effect for an extended period, attorneys should consider including in their engagement letters provisions that allow the parties to reassess their fee agreement at certain specified points over the course of the representation. By doing this, both the client and the attorney will have the ability to revisit assumptions that have not played out as they anticipated when they originally formulated the AFA.

As a reminder, the ABA’s Model Rules of Professional Conduct require that a contingent fee arrangement be in writing and signed by the client. 28 The written agreement must provide (i) how the fee is to be calculated, including the percentage the lawyer will receive if the case is settled before trial, won after trial, or won after appeal; (ii) what litigation expenses are to be deducted from the recovery; (iii) whether deductions for expenses will be made before or after the contingent fee is calculated; and (iv) what expenses the client must pay, whether or not the client wins the case. 29

D. Expenses

Depending on the matter, the expenses associated with a matter can be very expensive, especially when dealing with class action litigation or large-scale discovery matters. The engagement letter needs to be clear so the client understands whether expenses are included in the overall fee or not. Assuming they are not, the parties should agree on what types of expenses the client will pay for and when. Expenses that typically should be addressed include such items as court filing fees, copying fees, transcript fees, discovery fees, expert witness fees, and any other third-party fees.

28 Model Rules of Professional Conduct R. 1.5(c).

29 Id.
E. **Billing**

Again depending on the particular AFA used, billing may be monthly, quarterly, or when certain milestones are reached. The parties should agree on how and when billing will occur when negotiating the fee arrangement and state that agreement in the engagement letter.

F. **Cooperation**

The client should agree to cooperate fully with the law firm and promptly provide any information that they may request or that could be related in any way to the representation.

G. **Use of Technology**

The parties should identify and discuss what technology will be used and any costs associated with the use of a particular technology, and the client should consent to this use.

H. **Conflict Waiver**

This is especially important for larger law firms that have a national or international practice. Because many times there may be a “conflict” among clients, the parties agree to waive any current or future conflicts of interest. It is common course that all the parties agree to the waiver of any conflict. Of course, if there is a known conflict then that should be addressed under this section as well.

I. **Termination**

While no one ever plans to have to terminate a relationship, the parties should know their responsibilities and rights should the relationship come to an end. While everyone knows the client has the right to terminate the relationship at any time and likewise counsel may withdraw for good cause, it should be clear to the parties the events that will take place after termination. For example, when will any outstanding bills be due, how soon will the client receive all files and will the firm have a lien on the file. This is especially true for many forms of AFAs as the amount owed to the law firm may be tied to the outcome of the matter or fixed for the entire representation. How much the firm is owed if a client terminates the relationship early should be set out in the engagement letter.

J. **Client Documents**

The parties should agree on how client information will be stored. This is very important in this digital age with the risk of cyber-crime and hacking. Many law firms have fallen victim to such crimes and clients’ information has been compromised. This should also include how documents will be returned, destroyed or kept, and for how long, when the representation ends.

K. **Dispute Resolution**

No one likes to think about a dispute arising between the client and the law firm but engagement letters can and should provide for how such disputes will be resolved. Many engagement letters include agreements to arbitrate disputes arising from the representation. The parties should also agree on what venue and law will govern the relationship and any disputes that may arise.
L. Complete Understanding

Always include a clause that states the agreement sets forth the complete terms of the agreement between the parties, and that no other promises or representations have been made. The agreement should also provide that it cannot be modified in any way without a writing signed by both parties.

As with any agreement, an engagement letter can be as short or as long as the parties want. While the items listed above are important for all engagement letters, and some are crucial for engagement letters for AFAs, other clauses that can be used include mediation, privacy, communication, insurance coverage, estimates, and a retainer fee. It is also a best practice to have an engagement letter check list to insure all necessary clauses are included.

VII. ETHICAL CONSIDERATIONS IN THE USE OF ALTERNATIVE FEE ARRANGEMENTS

The potential benefits of properly formulated and implemented AFAs are obvious. On the one hand, clients can more accurately anticipate and budget for legal costs. On the other, AFAs encourage lawyers to focus on the efficiency and value of the services they provide. If properly used, they can also be at least as profitable as the billable hour.

The potential risks associated with the use of AFAs are less obvious. “Financial risks aside, practitioners face a plethora of potential ethical pitfalls when implementing AFAs.”

Alternative fee arrangements cannot alter or operate to change the fundamental attorney-client relationship, even if the client agrees to do so. Typically, this means alternative fee arrangements cannot ethically limit an attorney’s independent professional judgment; create a conflict of interest between the client’s interest and any other interest, including the attorney’s; or impair the client’s absolute right to terminate the attorney-client relationship.

The ways in which AFAs can violate these tenets are addressed in detail below.

A. The Model Rules

While they do not address every potential fee issue that may arise, the ABA’s Model Rules of Professional Conduct set forth a series of guidelines that govern any potential fee arrangement.

The governing standard is set forth in Model Rule 1.5(a), which provides that “A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an


32 Note that the Model Rules are not self-executing; they must be adopted by a state before they govern an attorneys’ conduct. However, “nearly every state bar and the District of Columbia bar has adopted some version of the Model Rules ….” Gregory Hanthorn, Ethical Principles Applicable to Alternative Fee Arrangements and Related Areas, ABA Section of Litigation, 2012 Section Annual Conference, at 2 (Apr. 18-20, 2012).
unreasonable amount for expenses." The Rule goes on to list 8 factors that determine the reasonableness of a fee. These include “the fee customarily charged in the locality for similar services,” and “whether the fee is fixed or contingent.”

Further, “[m]any alternative fee arrangements will likely involve sharing risks and rewards associated with the normal representation between the lawyer and the client.” “That is, there will be some effort to change what either a ‘normal’ contingent fee or hourly billing arrangement would yield.” This brings two other rules into play.

The first is Rule 1.8, which recognizes that “[a] lawyer’s legal skill and training, together with the relationship of trust and confidence between lawyer and client, create the possibility of overreaching when the lawyer participates in a business, property or financial transaction with a client ....” As a result, business arrangements between a lawyer and client must be “fair and reasonable” to the client following full written disclosure of the nature of the transaction.

The second is Model Rule 1.7, which provides that a “lawyer must disclose the risks associated with the lawyer’s dual role as both legal adviser and participant in the transaction, such as the risk that the lawyer will structure the transaction or give legal advice in a way that favors the lawyer’s interests at the expense of the client. Moreover, the lawyer must obtain the client’s informed consent.”

How these principles apply to certain specific AFAs is addressed below.

1. **Capped Fee Arrangements**

As noted above, Model Rule 1.5 expressly notes that a lawyer’s fee can be fixed. However, one of the comments to that Rule is of particular note for any AFA that seeks to cap a client’s payment at a specific amount (like fixed fees, capped fees, or flat fees):

An agreement may not be made whose terms might induce the lawyer improperly to curtail services for the client or perform them in a way contrary to the client’s interest. For example, a lawyer should not enter into an agreement whereby services are to be provided only up to a stated amount when it is foreseeable that more extensive services probably will be required unless the situation is adequately explained to the client.

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33 Model Rules of Professional Conduct R. 1.5.
34 *Id.* R. 1.5(a)(4), (8).
36 *Id.*
37 Model Rules of Professional Conduct R. 1.8 cmt. (1).
38 *Id.* R. 1.8(a).
39 *Id.* R. 1.8 cmt. (3).
40 *Id.* R. 1.5 cmt. (5).
This imposes a very high standard on an attorney, for under the terms of the comment, “any type of fixed or capped fee arrangement might induce an attorney to curtail his or her services after the specific cap has been reached.” Comment 10 to Model Rule 1.7 expounds on this, stating that “[t]he lawyer’s own interests should not be permitted to have an adverse effect on representation of a client.” As one commentator explained, these rules raise potential ethical issues when a fixed, flat or capped fee has been reached but work must still be done:

[A] law firm and its commercial real estate client implement a portfolio fee arrangement pursuant to which the client pays the firm $400,000 per year for the firm’s legal services related to all the client’s real estate closings. The standard hourly rate for the attorneys on the file is $400, meaning that it would take 1,000 total hours at the attorneys’ standard rate to reach the $400,000 annual fee. A potential issue arises when the firm reaches or exceeds those 1,000 hours prior to the end of the year and additional work on the client’s files is required.

In addition to Rules 1.5 and 1.7, lawyers who used capped or fixed fee arrangements need to be mindful of the Preamble to the Model Rules, which states that a lawyer must “zealously assert the client’s position under the rules of the adversary system.” Aside from the total hours spent, an AFA that caps fees at a certain level presents a risk that an AFA may make an attorney less zealous or more willing to settle a case at an early juncture.

The state ethics rulings, which often arise in connection with fee agreements that are dictated by insurance companies, underscore these concerns. In 1994, the Kentucky Bar Association issued an ethics opinion which provided that a lawyer could “not enter into a contract with a liability insurer in which the lawyer or his firm agrees to do all of the insurer’s defense work for a set fee.” Echoing the principles embodied in Rules 1.5 and 1.7, the ethics commission noted that this sort of arrangement creates a conflict of interest between the insured and the insurer, as “the lawyer stands to gain by limiting the services rendered to the client.” The commission emphasized the fact that, in situations like this, the lawyer does not reach an agreement with the insured (the actual client) about a particular case or the work to be performed.

The Kentucky Supreme Court affirmed the commission’s opinion, stating:

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41 Friedman and Freed, supra note 30, at p.12 (emphasis added).
42 Model Rules of Professional Conduct R. 1.7 cmt. (10).
43 Friedman and Freed, supra note 30, at p. 12.
44 Preamble, Model Rules of Professional Conduct.
45 Kentucky Bar Association E-368.
46 Id.
47 Id.
[The pressures exerted by the insurer through the set fee interferes with the exercise of the attorney’s independent professional judgment, in contravention of Rule 1.8(f)(2). The set fee arrangement also clashes with Rule 1.7(b) in that it creates a situation whereby the attorney has an interest in the outcome of the action which conflicts with the duties owed to the client; quite simply, in easy cases, counsel will take a financial windfall; in difficult cases, counsel will take a financial loss.\(^{48}\)

Other jurisdictions have not taken such strident positions. For example, the Ohio Supreme Court has held that an agreement to perform an insurer’s work for a fixed or flat fee is permissible as long as the agreement provides reasonable and adequate compensation to the lawyer.\(^{49}\) The court premised this limitation on the same concern expressed in Rules 1.5 and 1.7: namely, that “the legal fee to the lawyer or law firm may not be so inadequate that it compromises the attorney’s professional obligations as a competent or zealous advocate.”\(^{50}\)

While these opinions highlight the need to consider the rules in your jurisdiction in accepting fixed or flat fee arrangements, lawyers must also take into account the ethical issues that can arise if they enter into a fixed or flat fee arrangement that, in hindsight, turns out to be less financially rewarding than they might have originally thought. Consider the situation discussed above, in which Quinn Emanuel sought to withdraw from five pending cases because it determined that the fixed prices that Uber was paying under its preferred counsel did not meet the firm’s financial needs. Under Rule 1.16(a)(6), a lawyer can withdraw from representing a client if “the representation will result in an unreasonable financial burden on the lawyer ....”\(^{51}\) However, the ethics opinions on attorney withdrawal under this provision focus on situations in which a client has failed to pay its attorney. There does not appear to be guidance on whether a fee arrangement that was disclosed in advance, agreed to by the firm, and honored by the client would constitute an unreasonable burden – especially if the prices the client paid actually generated a profit for the firm (albeit less profit than a firm might like). As one commentator noted: “Ethically speaking, it might not be a problem to agree to be paid too little, but from a risk-management perspective, it’s a problem. Unhappy clients make malpractice claims.”\(^{52}\)

Further, firms need to keep in mind that, even if good cause for withdrawing exists, a lawyer must continue representing a client if the lawyer is ordered to do so.\(^{53}\) Therefore, if withdrawal would have an adverse material impact on the client, or unreasonably delay proceedings, a lawyer may be required to continue representing a client, even if the rate structure it agreed to turns out to be a significant financial burden.

\(^{48}\) American Ins. Assoc. v. Kentucky Bar Assoc., 917 S.W.2d 568, 572 (Ky. 1996).

\(^{49}\) Ohio Board of Commissioners on Grievances and Discipline Opinion, OH ADV. OP. 97-7, 1997 WL 782951 (Ohio Dec. 5, 1997).

\(^{50}\) Id.; see also West Virginia Lawyer Disciplinary Board Opinion 98-01 (expressing the same concern). Other jurisdictions have summarily approved the use of fixed or flat fee agreements. See, e.g., Oregon State Bar Board of Governors on Ethics Opinion No. 1991-98.

\(^{51}\) Model Rules of Professional Conduct R. 1.16(a)(6).

\(^{52}\) Strickler, supra n. 25.

\(^{53}\) Model Rules of Professional Conduct R. 1.16(c).
2. **Blended Rates Arrangements**

As noted above, blended rate AFAs are premised on a single blended rate for all timekeepers or, in some instances, a blended rate for partners and another blended rate for associates. These AFAs therefore create an incentive for lawyers to push work down to those who can perform it at a lower hourly rate. This implicates Model Rule 1.1.

Under Rule 1.1, a lawyer must “provide competent representation to a client.” The comments to this Rule set forth a list of various factors that may be considered in determining whether a lawyer is competent to handle a certain matter:

- “the relative complexity and specialized nature of the matter”;
- “the lawyer’s general experience”;
- “the lawyer’s training and experience in the field in question”; and
- “the preparation and study the lawyer is able to give the matter and whether it is feasible to refer the matter to, or associate or consult with, a lawyer of established competence in the field in question.”

In this way, Rule 1.1 limits the circumstances in which work can be “pushed down.” “The supervising attorney must ensure that all work is assigned to attorneys with sufficient skill and experience to handle the particular project.”

Claims that “inexperienced” attorneys were assigned to handle tasks beyond their abilities regularly appear in malpractice actions. Attorneys who use AFAs must keep in mind that, even if there is no private right of action for violation of disciplinary rules, the presence of an AFA may foster the impression that there was a financial incentive for the firm to assign work to attorneys that were not qualified to handle that work.

3. **Retainer Agreements / Upfront Payment of Fixed Fees**

Assuming a lawyer and client agree to a fixed fee or an upfront retainer, issues can arise concerning when that fee is “earned” and what happens if the representation terminates before the matter is concluded. The Model Rules state that “[a] lawyer may require advance payment of a fee, but is obligated to return any unearned portion.” Further, the Rule that describes a lawyer’s duties when representation has ended (Model Rule 1.16) states that, upon termination, a lawyer must “refund[] any advance payment of fee or expense that has not been earned or incurred.” Therefore, a lawyer should clearly disclose to the client when he or she considers the fixed fee “earned.”

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54 Id. R. 1.1.
55 Id. R. 1.1. cmt. (1).
56 Friedman and Freed, supra n. 30, at p.13 (emphasis added).
57 Model Rules of Professional Conduct R. 1.5 cmt. (4).
58 Id. R. 1.16(d).
Notwithstanding the clarity of this disclosure, the enforceability of any agreement to treat fees as “earned” will depend on the reasonableness of the fee in light of the factors set forth in Model Rule 1.5. To the extent a lawyer seeks to implement an arrangement where a fee is deemed earned at a specific time, the lawyer should consult the rules in his or her jurisdiction, as some jurisdictions are suspect of fees that are deemed fully earned upon retention.\(^{59}\)

### 4. **Reverse Contingent Fees**

As discussed in Section III.A., a reverse contingency fee is one in which an attorney is asked to dispose of a case (through settlement or judgment) for an amount less than the amount sought by the plaintiff. The attorney is paid a fee which hinges on the difference between the amount paid to the plaintiff and the amount originally claimed by the plaintiff. This type of AFA can present different ethical issues depending on the type of arrangement and the jurisdiction involved. In *Wunschel Law Firm, P.C. v. Clabaugh*,\(^{60}\) the Iowa Supreme Court addressed whether it should approve of “contingent attorney fee contracts for the defense of unliquidated tort damage claims in which the fee is fixed as a percentage of the difference between the amount prayed for in the petition and the amount actually awarded.” Adopting an opinion of the Ethics Committee of the Iowa State Bar Association (which was based on the Iowa Code of Professional Responsibility), the court held that an unliquidated tort damage claim was purely speculative and that a fee agreement based on a speculative amount was void as against public policy.\(^{61}\) In fact, the ethics opinion which the court adopted stated that the committee’s decision would be the same “even if the actual amount of the prayer [was] written into the contingent fee contract (as in the case at bar) so that the fee would not increase if the prayer [was] increased.”\(^{62}\)

The ABA seems to have taken a different view. In April of 1993, the ABA’s Standing Committee on Ethics and Professional Responsibility issued an opinion on reverse contingent fees.\(^{63}\) The ABA’s opinion determined that when “reasonably determinable civil damages between private parties are at issue … there is no basis in public policy for prohibiting a fee arrangement based on the amount save a defendant, so long as the reasonableness and informed consent requirements of Rule 1.5 are satisfied.”\(^{64}\) Nonetheless, the ABA’s opinion stated that a reverse contingent fee could not be speculative, but must be based on the reasonably ascertainable savings to the client. The opinion also noted that a comment to Rule 1.5 makes clear that “when there is a doubt whether a contingent fee is consistent with the

\(^{59}\) *See In re Mance*, 980 A.2d 1196 (D.C. 2009) (a flat fees is not earned upon receipt but upon the performance of legal services); Prof’l Ethics Committee for the State Bar of Texas Op. No. 611, at 3 (Sept. 2011) (“A legal fee relating to future services is a non-refundable retained at the time received only if the fee in its entirety is a reasonable fee to secure the availability of the lawyer’s future services and compensate the lawyer for the preclusion of other employment that results from the acceptance of employment by the client.”) (emphasis in original).

\(^{60}\) 291 N.W.2d 331 (Iowa 1980).

\(^{61}\) Id. at 337.

\(^{62}\) Id.

\(^{63}\) ABA Formal Opinion 93-373.

\(^{64}\) Id.
client’s best interests, the lawyer should offer the client alternative bases for the fee and explain their implications.65

VIII. IN-HOUSE COUNSEL PERSPECTIVE ON ALTERNATIVE FEE ARRANGEMENTS

Given the increased focus by most general counsels (and their finance officers) on reducing outside legal costs, companies are becoming more open to any form of fee arrangement that can provide them with (i) greater certainty in budgets for outside legal spend generally but particularly for routine matters, (ii) greater assurances that law firms are focused on improving efficiencies in providing legal services, and (iii) the opportunity to build strong relationships with specific firms who understand the company’s business and are willing to share in risks with the company. While there surely are clients that seek only a low cost solution, most experienced general counsels and their in-house teams understand the realities of the time required to provide quality legal work and are willing to pay law firms fairly for such work. However, the days of an open checkbook from which to pay those fees has passed, and clients now are requiring more certainty about the costs of the work provided. With growing pressure to provide realistic legal budgets for the company, and work within those budgets, general counsels seek fee arrangements that provide for as much cost certainty as can reasonably be obtained.

As mentioned above, general counsels prefer fixed fees over other forms of AFAs. A fixed fee provides cost certainty for the company. Law firms should expect that once a fixed fee is agreed upon between the company and the law firm, general counsels will be disinclined to pay more than the fixed fee if the matter requires more time than anticipated by the law firm. Consequently, law firms need to be very focused on the scope of the work required and the anticipated outcome expected before setting a fixed fee. Firms that have not previously handled a type of work, or worked with a particular client, need to insure they spend time analyzing the required work, the appropriate staffing for the work, and perhaps most importantly, the information available from the client that will be needed for the work.

As many companies have yet to fully embrace fixed fees (or other AFAs), the in-house legal team may not be focused on the information the law firm will need to properly handle the matter. As an example, does the in-house lawyer know the full extent of the information required to draft an initial FDD? Or is the in-house team expecting the law firm to gather that information from the various departments in the company? Or in a litigation matter, can the in-house team gather all documents needed for discovery, or are they expecting the law firm to provide resources for that work? An in-depth conversation about the resources needed to complete the matter is essential, particularly when law firms are working with new companies or with companies that are just beginning to use a fixed fee arrangement (or other AFA).

As general counsels place more emphasis on obtaining greater value for their legal spend, law firms should anticipate more pushback on their hourly billing practices. Offering some form of AFA can alleviate this tension, and actually create a stronger working relationship with the in-house legal team. Law firms that proactively offer AFAs to their corporate clients, and take the time to explain their benefits, will develop stronger and longer relationships with the company. This approach reflects awareness by the firm of the financial constraints many companies face today regarding outside legal expenses. It also indicates the firm’s willingness to provide efficiencies in the manner in which a matter is handled, as well as share in the risks.

65 Id. (citing Model Rules of Professional Conduct R. 1.5 cmt. (3)).
associated with many types of matters. Additionally, spending the time to discuss the details of the scope of work, the way the work will be resourced, what the company needs to provide, and the company’s expected outcome of the matter will only build stronger relationships between the company and the law firm.

IX. CONCLUSION

While AFAs have only been used for the last quarter of a century, it is clear that their use is growing and will likely continue to grow as clients continue to be more cost conscious about their legal spend, and expect the value of the work provided by law firms to be more closely related to the cost of such work. AFAs have grown in use over the years from the early use of contingency fees and fixed fees to a wide variety of other fee arrangements in use today. New forms of AFAs will undoubtedly continue to arise as law firms and clients work together.

The successful use of an AFA requires time and effort by both the law firm and the client to fully understand the scope of the work required to meet the client’s ultimate objectives. Both parties must be clear on how the client defines success in each matter, and the resources and work the law firm must provide to achieve that outcome. A failure to do this work upfront, and document the mutual understanding in the engagement letter, may lead to an unprofitable arrangement for the law firm and a broken relationship with the client when the law firm attempts to recover fees for unanticipated work.

Many of the matters for which franchisor or franchisee clients retain outside counsel are suitable for AFAs. Experienced franchise lawyers should be able to structure an AFA to provide good value for the client while providing revenue to the law firm. Law firms working with new franchisors should spend additional time discussing the franchise system and intended plans for the system prior to structuring an AFA to insure that all potential issues are identified upfront and incorporated into the pricing for the AFA.

Engagement letters between law firms and clients where an AFA will be used must include specifics about the scope of the work, the expected outcome, how expenses will be handled, and how the work will be billed in addition to the terms used in standard engagement letters. Law firms must take the time to communicate with clients about the scope of work and discuss how unanticipated changes to the scope will be handled. All of this should be detailed in the engagement letter so there is no potential conflict or discord during the course of the representation.

Finally, as with everything lawyers do, there are ethical considerations to remember when working with AFAs. Prudent law firms will take the time to incorporate these ethical factors into their engagement letters and ongoing dealings with clients.

In today’s environment, using AFAs can create a win-win relationship with clients. General counsels appreciate the cost certainty, and law firms can develop long-term relationships based on their willingness to work creatively with companies to better align the value of legal services provided with their costs. As a result, use of AFAs will likely continue to grow in the future.
KATHRYN M. KOTEL

Kathryn Kotel is a retired executive and franchise counsel. Ms. Kotel was Senior Vice President, General Counsel and Head of Business Affairs for TGI Friday’s Inc. from 2009-2017. She worked for McDonald’s Corporation from 1995-2009, most recently as Vice President, U.S. General Counsel. Prior to joining McDonald’s, she was a partner in Keck, Mahin & Cate in its Franchise and Distribution Practice Group. She also served as in-house counsel for Convenient Food Mart. Ms. Kotel was a member of the ABA’s Forum on Franchising Governing Committee and its Membership Officer from 2008-2014. Ms. Kotel received her B.S. from the University of Illinois and her J.D., with distinction, from The John Marshall Law School.
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Norman Leon represents franchisors in federal and state courts and alternative dispute resolution forums throughout the United States.

Norman has represented franchisors in actions and proceedings involving, among others, claims for encroachment, breach of contract, breach of the implied covenant of good faith and fair dealing, fraud, consumer fraud, tortious interference with contract, unfair trade practices, breach of fiduciary duty, disclosure compliance, and violation of Little FTC Acts and state and federal antitrust laws. Norman also has extensive experience dealing with franchisee terminations and the enforcement of post-termination covenants, and regularly prosecutes motions for temporary restraining orders and preliminary injunctions.

EXPERIENCE

Selected Decisions
- Awuah v. Coverall North America, Inc., 703 F.3d 36 (1st Cir. 2012)
- Zeidler v. A&W Restaurants, Inc., 2007 WL 528921 (7th Cir. 2007)
- Zeidler v. A & W Restaurants, Inc., 301 F.3d 572 (7th Cir. 2002)
- KKW Enterprises, Inc. v. Gloria Jean’s Gourmet Coffees Franchising Corp., 184 F.3d 42 (1st Cir. 1999)
- Ace Hardware Corp. v. Advanced Caregivers, LLC, 2012 WL 5197942 (N.D. Ill. 2012)
- 7-Eleven, Inc. v. Spear, 2011 WL 2516579 (N.D. Ill. 2011)
New York City passes new wage and hour restrictions on fast food and retail industry employers – action steps, 12 Jun 2017

“Labor/Employment Law Collides with Franchise Law…Holy Cow! Where Are We Going?,” IFA Legal Symposium, Chicago (May 3-5, 2015)

United States Court of Appeals for the Seventh Circuit
United States Court of Appeals for the Ninth Circuit
United States Court of Appeals for the First Circuit
United States Court of Appeals for the Fourth Circuit
United States District Court for the Southern District of New York
United States District Court for the Eastern District of New York
United States District Court for the Northern District of Illinois
United States District Court for the District of Colorado
United States District Court for the Northern District of Indiana
United States District Court for the Western District of Michigan

American Bar Association
ABA Forum on Franchising

Chambers USA, has recognized Norman as “a talented trial lawyer with a focus on disputes in the franchising arena” who is “praised by market sources for his strategic abilities.” “Clients praise him for being ‘efficient in terms of time and billing, and low-maintenance from a client perspective.’” He ”makes you feel like you are his number one priority,” stated one client.

Norman was named a Best Lawyer for 2014 in Chicago’s Best Lawyers magazine, and has been selected for inclusion in The International Who's Who of Franchise Lawyers, which described him as "one of the best franchisor litigators in the country." He has been listed in The Best Lawyers in America every year since 2006, has repeatedly been designated an Illinois Super Lawyer as the result of research projects conducted jointly by Law & Politics and Chicago magazines, and has been recognized by his peers as a Leading Lawyer in Franchise and Distributorship law.

Norman is one of a select group of lawyers in the US named to the 2014 BTI Client Service All-Star Team for Law Firms, which recognizes lawyers who deliver "the best client service" to Fortune 1000 clients.

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Vanessa Szajnoga currently serves as the General Counsel of Liberty Tax Service and has held the position since December 2015. She previously served as Assistant Vice President, Legal for Liberty Tax Service, a position she had held since January 2015. Ms. Szajnoga also serves on the American Bar Association, Forum Committee on Franchising, Corporate Counsel Committee.

Ms. Szajnoga began her career at Liberty in 2005, as litigation counsel, representing the Company and managing litigation matters in federal and local courts throughout the United States and Canada. She became the leader of the Transactional Legal Department in 2012. Along with her legal work, Ms. Szajnoga has played a role in the company's Culture Committee, which is tasked with creating a welcoming and nurturing work environment. The committee's work has helped Liberty's corporate office gain recognition in 2014 as one of the Best Places to Work in Virginia.

Ms. Szajnoga, born and raised in Brooklyn, New York, holds a Bachelor of Science degree from Wagner College and J.D. from The College of William and Mary, Marshall Wythe Law School. She lives in Virginia Beach with her three children.