

Alternative Fee Arrangements

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I. ALTERNATIVE TO WHAT?

What do paper copies, fax machines and powdered wigs have in common? Depending on who you talk to, each is an anachronism in the legal industry, either dead or dying. But what about the “billable hour”? Unlike powdered wigs, the billable hour – where work done on client files is tracked using six-minute increments and billed to clients later – remains a core component in the workday of most Canadian lawyers. In fact, by some estimates, as much as eighty-five percent of all legal work done in Canada is still billed using this method.¹

While the legal industry can be notoriously slow to change, consumers today increasingly expect services to be delivered quickly, cheaply and seamlessly as they draw on technology-driven experiences in other industries. Legal clients are no exception. There is also evidence that demand for legal services is flat or falling at large firms, with revenue driven only by hourly rate increases.² However, this does not mean that there is less demand for legal work. In fact, corporate clients are spending more money on legal services, just not on law firms. Further, as many

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¹ Ann Macaulay, “The Billable Hour – Here to Stay?” (12 March 2014), online: *Canadian Bar Association* <cba.org> [perma.cc/HQH8-RUUU].

² Jordan Furlong, “You’re not selling what we’re buying” (30 November 2016), online (blog): *Law21* <law21.ca> [perma.cc/NCJ6-YT3X].

clients are shifting their legal work in-house, the money that is being spent on law firms now comes with conditions.³

As clients demand choice, there may be evidence that the billable hour's grip on legal services is loosening.⁴ Alternative Fee Arrangements (known as "AFAs") is the blanket term for payment arrangements outside of the billable hour. AFAs range anywhere from fixed fees for a particular service like a real estate transaction to "all-you-can-eat" arrangements in which the client pays one lump sum for whatever they require.⁵ These types of arrangements have been championed in particular by large corporate legal departments as a way to more effectively work within tightening legal budgets.⁶ Creating an appropriate AFA is ultimately a business decision for lawyers and clients, who determine what type of arrangement strikes the right balance.⁷

II. IT'S ALL ABOUT VALUE

Historically, legal bills were more a matter of "professional judgment" than the bills of today. Bills were more global, detailing not only the time spent on a file, but the nature of the service, the result achieved and the amount of money at stake.⁸ In *Yule v Saskatoon (City) (No 4)*,⁹ and *Murphy v Cory*,¹⁰ the courts reviewed how legal fees and value should be assigned to legal work. Both decisions reference factors like the nature of services rendered, labour, time, value of property affected, experience required, result secured and the ability of the client to pay as relevant. However, in the 1960s, clients began demanding more precise billing statements to seek greater transparency and efficiency in the legal services they were

³ *Ibid.*

⁴ Macaulay, *supra* note 1.

⁵ Jeff Gray, "Lawyers finding new ways to get paid" (31 May 2011), online: *The Globe and Mail* <theglobeandmail.com> [perma.cc/8YNV-7M8A].

⁶ *Ibid.*

⁷ Edward Poll, "The Perfect Legal Bill" (13 February 2014), online: *Canadian Bar Association* <cba.org> [perma.cc/W3GD-ABRB].

⁸ *Ibid.*

⁹ *Yule v Saskatoon (City)*, 16 WWR 305, [1955] SJ No 65 at para 21.

¹⁰ *Murphy v Cory*, 7 OWR 363, (1906) CarswellOnt 147 at 1.

receiving.¹¹ Since this time, the billable hour has been king in all but a few select types of work.

The reality is that clients and lawyers often have conflicting priorities when it comes to legal services. Clients generally want predictability and control over the fees they are paying, whereas lawyers aim to effectively monetize their professional services and maximize profit.¹² As a result, the meaning of “value” is often in the eye of the beholder. While the billable hour can at times deliver value for both lawyer and client, it does have its limitations. The billable hour, though useful for protecting the lawyer’s time from unforeseen complexity, can often reduce efficient work as it actually incentivizes the inflating or rounding up of hours. Unsurprisingly, these concerns have found their way into the courts. In *Bank of Nova Scotia v Diemer*,¹³ an appeal of the court’s refusal to award \$255,955 in legal fees for a cattle farm receivership spanning two months was held excessive in light of counsel’s efforts and work on the file. The judge stated that there is something “inherently troubling about a billing system that pits a lawyer’s financial interest against that of its client and that has built-in incentives for inefficiency.”¹⁴ The court stressed that “value” should predominate over the hours-times-hourly rate mathematical calculation.¹⁵

III. IMPROVING THE BUSINESS OF LAW

Legal work can, at times, be highly unpredictable given the uncertainty and lack of control over the process. As a result, one of the main challenges for firms moving away from the billable hour is figuring out, based on experience, the cost of a particular legal service. From a business perspective, knowing one’s bottom line is critical to crafting effective AFAs. Some firms are even using analytics to assess how services can be more effectively delivered.¹⁶ This approach involves compiling

¹¹ Poll, *supra* note 7.

¹² Shari L Klevens, “The ethics of alternative fee arrangements” (31 August 2016), online: *Dentons Insights* <dentons.com> [perma.cc/UTF4-GUE8].

¹³ *Bank of Nova Scotia v Diemer*, 2014 ONCA 851 [*Diemer*].

¹⁴ *Ibid* at para 36.

¹⁵ *Ibid* at para 45.

¹⁶ James Careless, “Analytics Can Make Your Firm More Profitable and More Competitive” (21 September 2017), online: *Canadian Bar Association* <cba.org>

comprehensive information about how a firm operates in order to analyze the data to find ways to operate more efficiently and profitably.¹⁷ AFAs can be a useful way of responding to these analytics because they offer a more tailored approach for designing business models better suited to the needs of both the lawyer and the client.

AFAs have a number of advantages such as the mitigation of unpredictable costs, more accurately meeting client expectations, providing a “pipeline” to other legal services a client might need and building long-term client relationships.¹⁸ Some disadvantages are that AFAs may not be appropriate for complex cases without a predictable scope, administrative costs to develop new models may be needed, and the client’s burden to provide more information up-front.¹⁹ Edward Poll describes the “perfect bill” as reasonable and clear, demonstrating value, detailed, convenient and timely.²⁰ AFAs provide useful tools to better align lawyer and client interests and to get a little bit closer to perfection.

Currently, most AFAs arise following client requests. In order to create an effective AFA, the lawyer and client should have an accurate understanding of each other’s expectations and needs as well as the type of file. Meeting in person to discuss is almost always advisable in order to ensure the resulting AFA is tailored to the relationship and situation.²¹ For instance, regular conversations are also a good idea to keep the fee and delivery model aligned with the overall goal. Interestingly, large institutional clients may even solicit legal work with AFA pay structures through formal bid-tender processes from multiple, competing law firms as a means of controlling costs.

An increasing number of law firms are even investing in concepts like Legal Project Management (LPM) to improve efficiency and quality in their business. LPM focuses on organizing and developing ways in which

[perma.cc/T5ZF-XKYM].

¹⁷ *Ibid.*

¹⁸ “Study Paper on Financing Litigation” BCLI Study Paper No. 9 (October 2017) at 171-172, online (pdf): *British Columbia Law Institute* <bcli.org> [perma.cc/9BLX-9BJ8].

¹⁹ *Ibid* at 173-175.

²⁰ Poll, *supra* note 7.

²¹ Toby Brown, “AFA Advice for Clients” (14 September 2012), online (blog): *3 Geeks and a Law Blog* <geeklawblog.com> [perma.cc/52ZD-LWHG].

files develop and can potentially be a powerful tool when combined with AFAs.²²

Below are some common forms of AFAs. The names ascribed to each are not universal, and elements from many AFAs are often borrowed to create tailored solutions to suit the lawyer's needs, the client and the case.

IV. FLAT/FIXED FEES

"Flat" or "fixed" fee arrangements are one of the most common types of AFAs. Fixed fees are also the simplest form of AFA. This arrangement involves the lawyer quoting the final cost of a particular service from the outset. Advantages are predictability for the client and that clients without significant financial resources may be more comfortable with engaging representation. This type of arrangement can prevent "over-lawyering," which occurs when too many lawyers work on the same file with different levels of quality and efficiency.²³ Disadvantages are that the lawyer or firm assumes all the risk, and that if the end result is achieved with less effort than expected, the client may feel the lawyer was overpaid.²⁴ Fixed fees can be offered for a single engagement or can be offered as part of a menu of items for which a fixed price is charged as new services or steps in a file are taken.²⁵

In general, routine or "commodity" work such as mortgage defaults or trademarks applications are most conducive to flat fees because costs are easier to predict.²⁶ Fixed fees can encourage the use of technology to streamline the delivery of services. An example would be in mortgage defaults, where some firms have developed automated systems allowing banking clients to exchange data with the firm to prepare foreclosure

²² JB Ruhl, "The Rise of Legal Project Management" (9 August 2017), online: *American Bar Association* <americanbar.org> [perma.cc/5W7L-ACWS]. LPM aims to develop systems for planning and tracking legal projects through proactively defining scope, plan and budget in order to deliver better legal products or services.

²³ Becky Rynor, "The Decline of the Billable Hour" (27 April 2015), online: *Canadian Bar Association* <cba.org> [perma.cc/G7AP-NPQJ].

²⁴ Macaulay, *supra* note 1.

²⁵ Jim Hassett, "The nine most common types of alternative fees" (28 September 2011), online: *LexisNexis* <lexisnexis.com> [perma.cc/92CH-EB68].

²⁶ Gray, *supra* note 5.

documentation for a fixed fee.²⁷ Some firms have taken a “productizing” approach, by which a consumer-ready product (like a website with password-protected access that offers estate planning forms for a fixed fee with the option to speak to the lawyer) is used to open the door to future value-added advice from the lawyer and thus more business.²⁸ For fixed fees to work, perhaps more than any other type of AFA, a firm must have an accurate understanding of its business in order to ensure this billing structure is profitable given the level of risk it entails for the firm.

V. CONTINGENCY

Contingency or “result-based” fees are another common form of AFA, particularly in personal injury cases. In this arrangement, the lawyer is paid according to the result achieved and payment is based on a percentage of the recovery, settlement or amount of money saved.²⁹ These types of fees can also be offered on a “quasi-contingency” basis, whereby the client pays some fee in advance regardless of the result. This allows the firm to take on a lesser risk while still retaining the possibility of greater upside for both lawyer and client.³⁰ Some advantages are that it permits clients with less financial resources to afford full representation and that both the client and lawyer can agree to the fee at the beginning of the file. Disadvantages are that the firm takes on all the risk, and if a successful result is achieved with little effort, the client may feel the lawyer was overpaid.³¹ There can also be considerable ethical concerns with contingency fees, and the law societies have been increasingly scrutinizing their fairness in order to ensure that the calculation of fees and trust accounting rules are followed.

²⁷ *Ibid.*

²⁸ Poll, *supra* note 7.

²⁹ Macaulay, *supra* note 1.

³⁰ Samantha Green & Scott Venton, “8 Tips for Building a Successful Alternative Fee Arrangement” (7 March 2016) at 2, online (pdf): *Fogler Rubinoff LLP* <foglers.com> [perma.cc/35GR-XNS2].

³¹ *Ibid.*

VI. BLENDED RATES/CAP-FEE BUDGETING/VOLUME-BASED BILLING

Blended rates, Cap-fee budgeting and Volume-based billing are arguably not AFAs *per se*, but rather twists on the billable hour model. Blended rates use an agreed upon rate for legal work to be billed to the client regardless of who within a firm works on a file. This encourages delegation and simplifies billing. The downside is that personal contribution to a file can be lost and that it may encourage the use of less experienced or efficient lawyers.³² Cap-fee budgeting takes the billable hour and places limits on the amount that can be charged for various stages of a file. This shifts some of the risks to the firm and provides clients with predictability and a sense of when expenses will occur. The budget can apply to a particular phase of a file, such as pre-trial or conducting a simple closing.³³ Volume-based billing is generally for large clients engaging counsel frequently that agree to pay for a certain number of hours a month in exchange for a discounted hourly rate. This provides the lawyer with certainty of revenue but gives the client a reduction in rates.³⁴

VII. UNBUNDLING

Unbundling, also known as a “discrete task representation” or “limited scope retainer,” is an AFA in which a lawyer provides legal services for a portion, but not all, of a client’s case.³⁵ This can include tasks like legal research, gathering facts and drafting documents.³⁶ Unbundling legal services can result in more affordable access for clients. Some jurisdictions allow paralegals to take on parts of a client’s file. This can increase the level of predictability for clients significantly and allow those who otherwise would be unable to afford representation the ability to hire

³² Macaulay, *supra* note 1.

³³ Green & Venton, *supra* note 30 at 2.

³⁴ *Ibid.*

³⁵ “Unbundling’ of legal services”, online: *Law Society of Ontario* <Iso.ca> [perma.cc/7JW8-ZUE4] [Unbundling].

³⁶ Macaulay, *supra* note 1.

counsel for the more complex components of their case. Generally, there needs to be a document confirming the limited scope of the service to be provided.³⁷

VIII. BONUSSES

Bonuses can be woven into any billing arrangement to reward and incentivize lawyers to obtain particular objectives. A bonus is a supplementary means of compensating a lawyer that is only paid if a particular event or circumstance occurs. Bonus structures can spread risk between lawyer and client and provide clients confidence that they will not have to pay the bonus unless a desirable objective or step in a file has been achieved. Ultimately, what is an appropriate bonus depends on the context. In *Evans Sweeny Bordin LLP v Zawadzki et al*, a bonus of \$500,000 was found to be fair and reasonable because the value of the property at stake was worth about \$20 million.³⁸

IX. ETHICAL ISSUES

An overarching consideration when crafting AFAs in Canada is that all fees charged by lawyers must be “fair and reasonable” according to the Model Code of Conduct which has substantively been enacted by every jurisdiction across the country.³⁹ Some factors for assessing whether fees are fair and reasonable are: the proportion of the fee to the value of the service; relative sophistication of the lawyer and client; the amount involved and result obtained; whether the fee is fixed or contingent; and the amount of labour involved.⁴⁰ The courts are always available for a review of whether fees meet this criteria. Unfair or unreasonable fees can come in many forms, however they generally involve the value of the service provided not matching up with the amount paid. Further, an AFA

³⁷ Unbundling, *supra* note 35.

³⁸ *Evans Sweeny Bordin LLP v Zawadzki et al*, 2015 ONCA 756.

³⁹ Federation of Law Societies of Canada, *Model Code of Professional Conduct*, as amended March 14, 2017, ch 3.6 at 62, online (pdf): <flsc.ca> [perma.cc/K6WJ-P329] [Federation of Law Societies]; The Law Society of Manitoba, *Code of Professional Conduct*, effective January 1, 2011, Manitoba, ch 3.6 at 68, online (pdf): <lawsociety.mb.ca> [perma.cc/TAP5-XR5E].

⁴⁰ Federation of Law Societies, *supra* note 39 at 64.

can never alter the fundamental lawyer-client relationship, even if a client is willing to do so.⁴¹ An AFA cannot impair a client's right to end the lawyer-client relationship or create a conflict of interest. As a result, it is always advisable to reduce the terms of any AFA to writing prior to starting work on a file in order to avoid misunderstandings in the future.⁴²

X. THE FUTURE OF BILLING

The legal industry is changing. Clients are demanding options and lawyers are finding different ways to do business, from leveraging new technology to rethinking how clients are charged. Flat fees, contingency rates, blended rates and unbundling services are just some of the AFAs which present valuable options to better align client and lawyer interests in the business of law. The lawyer must, however, always ensure they possess a thorough understanding of the client's needs prior to settling on a particular AFA. This is no simple task; it involves many questions and requires communication at the beginning and throughout the lawyer-client relationship.

Is the billable hour going the way of the powdered wig in Canada? Probably not. But as business and client needs continue to evolve, modern clients will need modern lawyers willing to evolve with them. AFAs will be a key part of that evolution.

⁴¹ Klevens, *supra* note 12.

⁴² *Ibid.*