Competitive Legal Pricing:

The Rise of the Alternative Fee Arrangement and Determining the "Right" Pricing Agreement

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I. Introduction

The "billable hour"; it has been the most common method of billing by lawyers for decades. But like any industry, clients continue to demand more value for their dollar, and more predictability on the bottom line. The billable hour, once believed by law firms to be the billing method that best maximizes revenue and tracks productivity, has been challenged in recent years. Clients are requesting, and innovative law firms are now offering alternative fee arrangements in exchange for legal services.

There is no universal definition for an alternative fee arrangement ("AFA") but they are generally described as an alternative method for clients to pay for legal services, which may or may not include a modified hourly billing model.[1]

[1] British Columbia Law Institute, "*Study Paper on Financing Litigation*" (2017)

According to Jerome Crawford and Erika L. Davis of the Michigan Bar Journal, the AFA is all about value:

> 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.[2]

II. AFAs v. the "billable hour"

The concept of the AFA is not new. Although the majority of North American law firms have historically relied on the billable hour for billing their services, alternative billing methods have been around for some time. In the 1960's the billable hour became the primary method for billing in the United States as a result of publications such as "*The 1958 Lawyer and His 1938 Dollar Law Firm*", a study by the American Bar Association, which touted the hourly fee as a means to maximize revenue and to evaluate efficiencies within firms.[3] However, after the economic recession of 2008, law firms were under increasing pressure to adopt AFAs as clients pushed back on the billable hour method and demanded more value for their dollar spent.[4]

Although the use of AFAs is increasing, most lawyers in Canada continue to use the billable hour as their preferred method of billing. According to *Canadian Lawyer's 2019 Legal Fees Survey*, 88.56 per cent of the 336 respondents surveyed continue to use the billable hour.[5] This is in contrast to 62.71 per cent of respondents who use flat rates and 33.56 per cent who rely upon contingency fees.[6]

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[2] Michigan Bar Journal, *Show me the Bill: Alternatives to the Hourly Rate,* (2017) Online: <http://www.michbar.org/file/barjournal/article/documents/pdf4article3144.pdf>
[3] McDowell, David, *Alternative Fee Arrangements: A Primer,* (2014), Online: <https://rcdmlaw.com/wp-content/uploads/2014/05/afa.pdf>
[4] Melnitzer, Julius, "Alternative … Billable Hours, (2018) Lexpert Magazine: Online: <https://www.lexpert.ca/article/alternative-billable-hours/>
[5] Bruineman, Marg, *Steady Optimism – 2019 Legal Fees Survey* (Canadian Bar Association, 2019) Online: <https://www.canadianlawyermag.com/surveys-reports/legal-fees/steady-optimism-2019-legal-fees-survey/276027>
[6] *Ibid*. Of the respondents, 51.69 per cent indicated they worked in firms with four or fewer lawyers, 29.39 per cent in firms with five to 25 lawyers and 8.11 per cent worked with 26 to 50 lawyers.

a) Advantages of AFAs:

There are several general benefits that AFAs offer the lawyer and client over the billable hour. For a lawyer, AFAs may be appropriate to cover a task, service, or particular offering in which he or she is well versed and can control the time spent and process flow; for example, if the lawyer is efficient in a particular service or offering and able to pinpoint expected costs. Although billable hours provide a simple and familiar means of calculating fees, they ignore whether the lawyer's work actually furthers the clients' interests. The billable hour is safe, reliable, and consistent, but AFAs are increasing in popularity among lawyers and firms who understand that their clients are seeking value and predictability.

For these reasons, if a lawyer/firm can effectively integrate AFAs into their practice, they can offer a competitive advantage to clients over lawyers/firms that continue to only use the billable hour method. As stated by Robert Tapper, Q.C. of Tapper Cuddy in Winnipeg, "I think that hourly billing is the rewarding of the inefficient and the slow and clients are starting to understand that in some cases and are looking for more alternatives."[7]

In addition to value and predictability, lawyers are looking to get away from the tyranny of the billable hour. "Billing by the hour wears on lawyers," said national managing partner at Bennett Jones LLP in Calgary. "They feel the pressure. Often lawyers argue that they'd like to get away from this hourly rate environment because they feel so much pressure to account for all their time and to maximize the efficiency they get out of their time. They feel they can't relax, they can't sit back, they have to keep producing during the course of the hours they're charging for."[8]

For the client, AFAs make sense for matters that have an easily determined scope, such as corporate filings and estate planning. An AFA may provide the client with more peace of mind, knowing with more certainty what the final cost will be, and as opposed to the billable hour, knowing that the lawyer is not being rewarded for inefficient work.

b) Disadvantages of AFAs:

The successful implementation of AFAs relies on the predictability of time and effort spent on a particular file. The obvious drawback to AFAs is that they are difficult to implement in practice,

[7] Macauley, Ann, *The Billable Hour – Here to Stay* (The Canadian Bar Association, 2014) Online: <https://www.cba.org/Publications-Resources/CBA-Practice-Link/solo/2014/The-Billable-Hour%E2%80%94Here-to-Stay>
[8] *Ibid*

especially in complex litigation files. As a matter increases in complexity, so too does the difficulty in estimating fees at the outset. Accordingly litigators are often reluctant to implement AFAs into their practice as the estimation of fees at the outset creates another layer of risk and uncertainty that must be absorbed.

Another drawback is the administration costs associated with integrating AFAs into a firm's practice. As the billable hour method is easy to administer, lawyers and firms are understandably comfortable with using the arrangement with their clients. With AFAs, significant resources must go into accurately estimating the fees for each individual client file. As such, administrative systems have to be developed to ensure that cost overruns do not occur as a result of misjudging estimated costs.

III. Types of AFAs

AFAs vary greatly in their structure. The following is a breakdown of each of the common AFAs, along with where they are optimally used, and the commonly accepted pros and cons of each:[9]

- **Blended rate** – Time is billed equally on an agreed-upon rate, no matter who in the firm works on the file.

  Pros: Encourages work delegation; simplifies billing; easy to negotiate and administer.

  Cons: Hides personal contribution; can result in use of less experienced or less efficient lawyers.

  Optimal Usage: This type of fee arrangement is best used when 1) the client is concerned about the average hourly rate of the lawyers involved in the file; 2) the lawyers expected to work on the file can be easily determined; 3) the work is routine and repeated; 4) the legal work being done is not advisory work.

- **Fixed or flat fee** – The lawyer provides a specific service for a set price.

  Pros: Encourages efficiency; easy to negotiate; encourages delegation;

[9] *Ibid*

Cons: The law firm assumes cost overruns on the file if the firm misjudges costs; can result in use of less experienced lawyers.

Optimal Usage: This type of fee arrangement is best used when 1) the scope of the work can be effectively determined in advance with minor variations expected; 2) the lawyer has completed similar work for the same (or similar) client; 3) the work is repetitive or predictable; 4) the client wants cost certainty and predictability.

Note: It is important to remember that for a fixed or flat fee arrangement it is crucial that the lawyer fully defines the scope of the engagement at the outset, clearly defining what the services are (and are not) in the agreement. This type of arrangement also requires the lawyer to obtain approvals from the client in the event the agreed upon scope of work changes. This type of arrangement is not suited for files that are difficult to accurately estimate the length of time or complexity of the work involved.

- **Result-based or contingency fee** – The lawyer is paid according to results achieved. Payment is based on a percentage of the recovery, settlement or amount of money saved.

  Pros: Allows clients with little money to obtain legal representation; both client and lawyer determine the fee from the outset.

  Cons: The law firm assumes all the risk; if a successful result is reached with little effort, the client may feel the lawyer was overpaid.

  Optimal Usage: This type of arrangement is appropriate when 1) the lawyer's/firm's contribution is key to the client's success; 2) a favorable result is achievable; 3) the client wants to reward the lawyer/firm with a premium for sharing the risk; 4) the arrangement can be seen as open and equitable by both lawyer/firm and client.

  Note: "Success" must be clearly defined at the outset. Also, a contingency arrangement must be in accordance with the specific rules in the *Rules of the Law Society of Saskatchewan*, 1991 relating to contingency fee arrangements (discussed below).

- **Limited scope retainer** (also called discrete task representation or unbundling) – The lawyer is hired to do certain tasks within the full-service package, which are agreed upon in advance by both lawyer and client, including legal research, gathering facts and drafting documents.

  Pros: offers legal services to clients who can't necessarily afford full legal representation; makes it clear up front what tasks the lawyer will perform and what will be charged.

  Cons: puts more responsibility on the client to understand what needs to be done.

  Optimal Usage: This type of arrangement is appropriate when 1) the legal matter can be easily categorized into specific tasks; 2) the matter is not highly complex.

  Note: A limited scope retainer must be in accordance with the specific provisions in the *Code of Professional Conduct*, 2012 relating to limited scope retainers (discussed below).

- **Task-based billing** – Categorizes fees according to the type of work performed. Information is grouped according to pre-defined phases and tasks with the associated costs. A coding system makes it easier to track costs, compare costs for different activities, improve budgeting, and create standard software processes to facilitate the review and reconciliation of the account.

  Pros: easy to administer; provides the client with a degree of certainty of what the case will cost; codes can provide a database to project future project costs**.**

  Cons: lawyers must be able to estimate costs accurately.

  Optimal Usage: This type of fee arrangement is best used when 1) the scope of the work can be effectively determined in advance with minor variations expected; 2) the lawyer has completed similar work for the same (or similar) client; 3) the work is repetitive or predictable; 4) the client wants cost certainty and predictability.

  Note: It may be of value to include a safety-valve clause in a task-based billing arrangement that ameliorates hardship as a result of unforeseen circumstances.

- **Retainer Agreement** – The lawyer enters into an arrangement with the client whereby the client agrees to pay a set sum over a particular time period in return for the provision of

specific legal services during that period. For example, a client agrees to pay $10,000 per month for a one year period to handle all work of a certain type during that period.

Pros: This type of arrangement provides the client with cost certainty and is easy to administer. It also encourages the lawyer to be efficient and creative in achieving objectives.

Cons: Under this type of arrangement, the value that a client receives may vary month to month. It can also be difficult to estimate the time required for the services provided in the agreement.

Optimal Use: This type of arrangement is appropriate when 1) there is a large volume of work and fluctuations can be distributed over the retainer; 2) the requirements or type of work have sufficient commonality and can be clearly identified and articulated in advance; 3) the client prioritizes cost certainty and predictability; 4) there are available benchmarks to estimate the value of each particular service under the agreement.

Note: A retainer agreement must be in accordance with the specific rules in the *Rules of the Law Society of Saskatchewan*, 1991 relating to retainer arrangements (discussed below).

- **Capped fee** – The client pays an agreed-upon maximum fee.

  Pros: good for law firms that can leverage efficiencies and expertise for high-volume, routine work; clients are happy being able to predict costs.

  Cons: Can hurt firm if something unforeseen happens or if it misjudges costs.

  Optimal Usage: This type of fee arrangement works best when 1) the work can be accurately scoped in advance; 2) the work is similar to previous work completed for the client, with little variance expected.

- **Risk Collar (Cuff)** – The client retains the lawyer/firm to provide an identified service or services for a set price with an agreed upon buffer or contingency fee. By way of example, for a fee of $1,000 for a transaction with a collar of 10%:

  - Client will pay $1,000 for work between $900 – $1,100

- If under $900, the lawyer and client share in the savings (i.e. if costs = $800, the lawyer and client split the $100 in savings)
- If over 1,100, the lawyer and client share the cost (i.e. if costs = $1,200, the lawyer and the client split the cost of the $100 overrun)

Pros: This type of arrangement is more flexible than a straight fixed fee arrangement and encourages the lawyer/firm to be more efficient. It establishes a "zone of certainty" around the budgeted fee and allows for the sharing of savings and risks.

Cons: This type of arrangement provides lower cost predictability than a fixed fee arrangement. It provides incentive for the lawyer/firm to achieve the lower collar ($900 in the example).

Optimal use: This type of fee arrangement may be appropriate when 1) the client wants cost certainty and predictability; 2) the matter can be reasonably scoped in advance with minor variances; 3) the client is interested in a fixed fee, but the parties cannot scope the work accurately enough to determine the fixed fee.

IV. AFAs under Saskatchewan's *Code* and *Rules*

It is important to keep in mind that if you incorporate AFAs into your practice, you must be mindful of and adhere to the Law Society of Saskatchewan`s *Code of Professional Conduct*, 2012 (the "*Code*") and the *Rules of the Law Society of Saskatchewan*, 1991 (the "*Rules*").

Section 3.6 of the *Code* requires that "a lawyer must not charge or accept a fee or disbursement, including interest, unless it is fair and reasonable and has been disclosed in a timely fashion." The Law Society has identified several factors that will be considered in the determination of what is fair and reasonable. These are:

a) the time and effort required and spent;

b) the difficulty of the matter and the importance of the matter to the client;

c) whether special skill or service has been required and provided;

d) the results obtained;

e) fees authorized by statute or regulation;

f) special circumstances, such as the postponement of payment, uncertainty of reward, or urgency;

g) the likelihood, if made known to the client, that acceptance of the retainer will result in the lawyer's inability to accept other employment;

h) any relevant agreement between the lawyer and the client;

i) the experience and ability of the lawyer;

j) any estimate or range of fees given by the lawyer; and

k) the client's prior consent to the fee.

This is broad language which ensures that a lawyer must carefully consider what is fair and reasonable when billing a client. As the billable hour method is predicated on taking into account these factors in the determination of the billable hour rate, and is directly tied to an easily explainable metric such as time spent, there is less risk for the lawyer in violating section 3.6 of the *Code*.

As AFAs are, in some cases, not directly tied to the time spent on a file, the risk of billing a client an unfair or unreasonable amount in comparison to the effort expended or value received is substantially greater, and is one reason why many firms and lawyers are reluctant to adopt AFAs and continue to adhere to the billable hour.

As for general guidance from the Courts in regards to the billing of fees in Saskatchewan, Justice Wimmer in *Cawood v Mirza* quoted the Canadian Bar Association's commentary on the *Code of Professional Conduct*'s rule respecting fees at para 10:

> ...misunderstandings respecting fees and financial matters bring the legal profession into disrepute and reflect adversely upon the general administration of justice. The lawyer should try to avoid controversy with his client with respect to fees, and he should be ready to explain the basis for his charges (especially if the client is unsophisticated or uniformed as to the proper basis and measurements for fees). He should give the client a fair estimate of fees and disbursements, pointing out any uncertainties involved, so that the client may be able to make informed decisions. When something unusual or unforeseen occurs which may

> substantially affect the amount of the fee, the lawyer should forestall misunderstandings or disputes by explanations to his client.[10]

This commentary is a useful source of guidance for lawyers in the charging of fees, regardless of the type of fee arrangement used.

There are also provisions of the Code and Rules that pertain to specific types of AFAs, specifically retainer agreements, contingency fee arrangements and limited scope retainers.

a) Retainer Agreements

With regards to retainer agreements, Rule 1504 states

> **1504.** (1) Every retainer agreement entered into by a member shall be in writing.
>
> (2) A member who enters into a retainer agreement shall ensure that the agreement:
>
> (a) specifies in clear and unequivocal language the term of the agreement, whether or not any further fees or disbursements will be charged, what specific matters are covered by the agreement; and
>
> (b) does not mislead clients in any way with respect to the services covered by the agreement.
>
> (3) Funds received pursuant to a retainer agreement are considered trust funds as defined in Rule 900 and must be treated as such, in accordance with Part 13 of these Rules.

This is a broad provision that ensures that at the outset of the solicitor-client relationship, the client is aware of the scope of the services he/she is paying for and exactly how much he/she will be paying. In *Zipchen v Bainbridge,* the Saskatchewan Court of Appeal cited Lord Esher in *Stuart, Re,* in his discussion of whether a lawyer's fee arrangement was fair and reasonable:

> "...the Court may enforce an agreement if it appears that it is in all respects fair and reasonable. With regard to the fairness of such an agreement, it appears to me that this refers to the mode of obtaining the agreement, and that if a solicitor makes an agreement with a client who fully understands and appreciates that agreement that satisfies the requirement as to fairness. But the agreement must also be reasonable, and in determining whether it is so the matters covered by the expression "fair" cannot be re-introduced. As to this part of the

[10] 1981 CarswellSask 423, 13 Sask. R. 428

requirements of the statute, I am of opinion that the meaning is that when an agreement is challenged the solicitor must not only satisfy the Court that the agreement was absolutely fair with regard to the way in which it was obtained, but must also satisfy the Court that the terms of that agreement are reasonable..."[11]

b) Contingency Fee Agreements

As contingency fee arrangements may be drafted in a way that would cause a financial windfall for the lawyer, Courts and legislators have been particularly concerned with their regulation. As such, there are specific rules governing these arrangements. Rule 1501 states:

> **1501.** (1) Every contingent fee agreement entered into by a member shall be in writing.
>
> (2) A member who enters into a contingent fee agreement shall ensure that the agreement:
>
> (a) is fair and the member's remuneration provided for in the agreement is reasonable, under the circumstances existing at the time the contract is entered into;
>
> (b) states that any party to the agreement may apply to the Court under section 64(3) of the Act for a determination as to whether or not the agreement is fair and reasonable;
>
> (c) does not purport to exclude the member's liability for negligence;
>
> (d) does not purport to require the member's consent before a client's cause may be abandoned, discontinued or settled; or
>
> (e) does not purport to prevent the client from changing solicitors before the conclusion of the retainer.
>
> (3) Every contingent fee agreement shall be signed by each party to it, and the member shall deliver a copy of the agreement to each such party.

This provision provides the client with an assurance that if they feel the contingency fee agreement is unfair or unreasonable, the client is able to seek a remedy by way of application to the Court.

[11] 2008 SKCA 87 at para 55

Also, under section 1502 of the *Rules*, a lawyer may not enter into a contingency fee agreement for services that relate to a child custody or access matter or any other family law dispute "unless the form and content of the agreement have been approved by the court."

Prior to the codification of the above rules, Saskatchewan Courts incorporated common law equity principles into decisions that dealt with the reasonableness of contingency fee arrangements. In the case of *Speers v Hagemeister*, the Saskatchewan Court of Appeal established the following principles in regards to contingency fee arrangements:

1. fee agreements, particularly contingency agreements, must be construed as of the date they are made, not in hindsight;
2. "fair" relates to the manner in which the agreement was brought about, meaning the client fully understands and appreciates the agreement and no undue advantage is taken; and
3. "reasonable" relates to the amount payable to the solicitor, the actual work done relative to the work anticipated at the time of the agreement, the risk undertaken, and the particular circumstances of the case, however, some deference should be shown to contingency agreements recognizing that they may assist impecunious litigants to obtain the services of a lawyer.[12]

In *Deck v Rody*, the lawyer entered into a contingency fee arrangement with the plaintiff amounting to 24 per cent of a judgment including party and party costs based on a contingency fee contract for payment ranging between 20 per cent and 30 per cent of the amount recovered depending upon whether recovery was made before or after trial, or appeal.[13] This arrangement was held by Justice Macpherson (as he then was) to be fair and reasonable in the circumstances as:

1. the plaintiff was impecunious and unskilled, and
2. the plaintiff's case was difficult in the light of apparent defences relating to the plaintiff being a gratuitous passenger, the car allegedly having been stolen or used without the owner's permission, and the particular vehicle trip being "silly at best".

[12] (1974), 52 D.L.R. (3d) 109 (Sask. C.A.) [*Spears*]
[13] 1977 CarswellSask 20, [1977] 1 A.C.W.S. 125

Justice Macpherson cited the comments of Justice Hall in *Speers* in the decision:

> In my opinion, however, a Court should not be eager to find contingency agreements unreasonable. In many cases they serve a useful purpose. If they are censored too severely it may make it difficult for impecunious litigants to obtain the services of a solicitor.

Although Courts are reluctant to find a contingency agreement unreasonable, lawyers should be cognizant of the legislation and jurisprudence before entering into contingency fee agreements with their clients.

c) Limited Scope Retainers

With respect to limited scope retainers section 3.2-1A of the *Code* requires a lawyer to advise the client about the nature, extent and scope of the services the lawyer can provide before undertaking the retainer. Further, the lawyer must confirm in writing to the client as soon as practicable what services will be provided.

Commentary on section 3.2-1A provides additional guidance about the requirements of limited scope retainers:

> [1] Reducing to writing the discussions and agreement with the client about the limited scope retainer assists the lawyer and client in understanding the limitations of the service to be provided and any risks of the retainer.
>
> [2] A lawyer who is providing legal services under a limited scope retainer should be careful to avoid acting in a way that suggests that the lawyer is providing full services to the client.
>
> [3] Where the limited services being provided include an appearance before a tribunal a lawyer must be careful not to mislead the tribunal as to the scope of the retainer and should consider whether disclosure of the limited nature of the retainer is required by the rules of practice or the circumstances.
>
> [4] A lawyer who is providing legal services under a limited scope retainer should consider how communications from opposing counsel in a matter should be managed (See Rule 7.2-6A).

> [5] The rule does not apply to situations in which a lawyer is providing summary advice, for example over a telephone hotline or as duty counsel, or to initial consultations that may [not] result in the client retaining the lawyer.[14]

Section 7.2-6A governs communications between lawyers and clients where a limited scope retainer exists. Where a person is represented under a limited scope retainer, another lawyer may, without the consent of the lawyer providing the limited scope legal services, communicate with the person directly on the matter unless the lawyer has received written notice that communication falls within the scope of that retainer. In that case, the lawyer must communicate with the lawyer acting under that retainer.

V. Conclusion

Although law firms continue to rely on the billable hour due to challenges presented by AFAs (e.g. administration costs, unsuitability for complex litigation files, and the risks associated with misjudging expected costs), AFAs present several benefits over the billable hour method. If a lawyer/firm can accurately estimate fees at the outset, AFAs can present lawyers with a competitive advantage by providing their clients with more value for their dollar and more predictability on the bottom line.

[14] It appears to the authors that the word "not" is missing from the Commentary.