

LAWYERS ALERT

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Marketing Law Firm Value: **Alternative Fee Arrangements**

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There are dramatic changes occurring in the legal profession. Some changes are the result of economic pressures and others are forced upon lawyers and law firms by the clients they serve. These days, being a lawyer is less about the practice of law and, out of necessity, more about the business of law.

At the heart of these changes is a question plaguing managing partners, practice group chairs, CMOs and marketing staff, and every service provider in the law firm – “How do we define and market our value?” Many believe the answer lies in the philosophy and application of alternative fee arrangements (AFAs), a topic of much discussion, criticism, and confusion as more corporate counsel seek to hasten the elimination of the billable hour.

AFAs can be a bitter pill for many firms to swallow. Prospectively, firms will have to alter the ways in which they approach the handling of cases, but they will not be able to do so, at least not profitably, without thoroughly examining historical revenues and costs to accurately forecast fees of future cases. This process may even require new roles, responsibilities, and hierarchies within the law firm.

Once a firm successfully completes this internal due diligence, it must then incorporate AFA approaches and philosophies into its Public Reputation Management Plan. Now is the time for firms to re-think the value of the professional services they provide.

Responding to market demand

Although rarely discussed as a marketing issue, law firm billing rates have always had marketing/business development and client satisfaction consequences, but usually not until the invoice crosses the client's desk, or worse, when the firm is trying to collect its fees.¹ As attorneys who have fielded billing calls from angry clients will attest, those situations aren't the

best settings in which to promote the firm's value proposition.

Today, the issue of pricing – and law firm value in general – is one that firms face not only at the beginning of new client relationships, but also with existing clients that are weighing their options among a growing supply of legal service providers.

The topic that is at the top of any client-led agenda is a requiem for the billable hour. Hourly rate pricing has become the elephant in the room that firms don't wish to discuss, but given the perilous state of the economy, are forced to do so now.

The billable hour offers the client no certainty vis-à-vis budgets or anticipated matter costs. On its surface, it poses no hard incentives for a firm to streamline workflow efficiencies, outsource routine tasks to lower-cost service providers, or seek quick resolution or closure to a matter.

Given today's economic environment and the outlook for legal services, embracing the value points most important to the client will be the differentiators of truly successful firms in the future. These law firm value points are the fundamental drivers behind alternative fee arrangements:

- efficiency and appropriate allocation of resources;
- alignment with client risk; and
- cost of legal services relative to matter results.

Marketing and Public Reputation Management for AFAs

For firms that have a strategic marketing plan in place, integrating tactics for AFAs need not be taxing. For firms that haven't developed a marketing strategy or that haven't addressed AFAs within their strategic plan, AFAs provide the impetus to assess their value propositions and produce a plan accordingly.

The threshold question any firm needs to ask itself is, “What stance are we going to take on AFAs?” And if it

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chooses to explore the idea further, “Are we going to be conservative or aggressive?” Successful AFA adoption and implementation at any firm requires two critical ingredients – thorough preparation and a dedication to building trust.

Experts agree that a firm must do its homework before beginning any conversations with clients and prospects about AFAs, including:

- analyzing different types of matters to determine historical costs, possible alternative fee ranges, and savings opportunities;
- aligning compensation and recognition to AFA performance;
- gauging whether the firm is equipped with the personnel, vendor support, culture, and mindset;
- supplementing current knowledge systems – primarily, time and billing applications; ⁱⁱ
- dissecting the philosophies of the leading AFA firms; and
- assessing the threat to current client relationships from competitors that promote AFAs.

Once the firm is well informed and well versed in AFA methodologies and practices, executing an AFA engagement that fulfills everyone’s expectations requires commitment from both client and counsel. AFA advocates within a firm must include colleagues and firm management as the targets of their marketing efforts. And for good reason – AFAs represent a shift in the practice of law itself.

Build your AFA marketing strategy

As firms begin down the AFA path, it is critical to keep these ideals in mind during planning and implementation.

Go to your best clients first

AFA modeling cannot happen in a vacuum; rather, it is accomplished through direct experimentation and refinement. The optimal place to begin is with the firm’s best clients. In this safe harbor, attorney-client business relationships are more secure, with more open communication.

Put your communications game plan together

Once you’ve beta-tested your AFA models and outlined the process, you need to determine the messages and means by which you will promote your AFA proficiency.

First, the firm needs to add an AFA piece to its internal business development training and coaching curriculum. Attorneys responsible for test cases with best clients

should be enlisted to prepare or at least contribute to presentations to other attorneys, developing a brief “elevator pitch” for staff attorneys, and preparing an internal handbook and a checklist for attorneys and billing/accounting staff to evaluate new AFA opportunities prior to a formal engagement.

The main thrust here is to have attorneys comprehend the business implications of AFAs for the client, the firm, and themselves. It is imperative that AFAs are endorsed by firm leadership as a strategic decision, and not painted as a sales gimmick.

Next, consider revising the formal documents that clients will see first – proposals and engagement letters. Proposals to provide legal services, including responses to RFPs, are unquestionably marketing tools, and as such, need to identify and acknowledge clients’ needs while thoughtfully and adroitly explaining how the firm will alleviate that pain.

AFAs are inherently relationship-oriented and are extremely well suited as a discussion topic in a proposal. They require the firm to match the value of its services to the specific client and matter.

Once the firm succeeds in communicating its value with a proposal and other business development activities, the engagement letter should keep the momentum going and provide a written roadmap for the ensuing relationship. Along these same lines, firms must consider how to design or revise content for other written and electronic communications.

Develop an AFA Public Reputation Management Plan

A law firm’s Public Reputation encompasses all of its promotional work to build, manage, and sustain its outward image and foster growth. For an AFA-specific Public Reputation Management Plan, a firm may opt to deploy a few tactics at first, and then augment them and add more going forward. The good news is, once the firm goes through the steps to assemble a communications plan (described above), much of the hard work of developing an insular AFA Public Reputation Management Strategy is already done.

Final Thoughts

Without question, AFAs will change the legal profession. Interestingly, some experts predict a new set of roles within the law firm responsible not only for ascertaining the economic feasibility of fixed-fee and other AFA engagements, but also for managing the teams doing the work under those structures. Pricing specialists and project managers will have increased importance

as AFAs replace the billable hour and become the new billing standard, and they will be tasked with selecting and overseeing internal and external resources, helping to guide cost-efficient strategies, and ensuring matter profitability.ⁱⁱⁱ

As with any shift in the marketplace, those that see opportunity rather than hardship stand to reap the benefits, and the law firm that recognizes AFAs as a means to differentiate itself will outdistance the competition. §

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ⁱ Raymond, Nate, "In Rare Move, Debevoise Sues Client Over \$6 Million in Unpaid Bills," *New York Law Journal*, December 9, 2009

ⁱⁱ Three Geeks and a Law Blog, "The Evolution of AFAs: Law Firm Side," September 25, 2009, <http://www.geeklawblog.com>.

ⁱⁱⁱ Sirkin, Mark, Ph.D., *New Roles in the Law Firm of the Future*, Hildebrandt Consulting, November 16, 2009, <http://www.hildebrandt.com>. See also Three Geeks and a Law Blog, "The Evolution of AFAs: Law Firm Side."

Convergence:

Thinking About the 21st Century and How it Will Unfold for Law Firms Over the Coming Decade

Robert Millard

The year 2010 finds us in the final year of the first decade of the third millennium – in the western calendar at any rate. One thing is abundantly clear: the future is not what it used to be. If there ever was a time when one could rely heavily on forecasts in crafting strategy, then that time is past. Today's leaders of law firms need to be able to juggle simultaneously three seemingly incompatible goals:

1. to define and execute a strategy in order to sustain and maximize the value that the firm delivers to its owners into the future, based on the capabilities and resources that it has and that it can reasonably achieve or realize;
2. to ensure that the firm is agile, robust and resilient enough not only to withstand unexpected and unforeseen changes in the market but to capitalize upon them; and
3. to deliver sufficient short-term profitability to be able to meet owner expectations and compete effectively for talent.

Never before has this been more difficult, nor the way forward so uncertain. Change has always been with us. It is not change but our reaction to it that defines its effect on our firms. This holds as true today as then. Different today, even from the 20th Century in which most of us developed our world-view, is the

pace and scope and the level of complexity of the change. As we emerge from the worst recession in (for most) living memory, the realignments taking place in the world seem akin to an earthquake. In its aftermath, assumptions upon which we have based the business models of our firms lie in ruins. Almost as a knee-jerk to drive performance harder, many compensation systems are being overhauled radically. Client relationships are evolving rapidly as client demands reach new heights and fees come under pressure at exactly the time that many kinds of matters become more complex and sophisticated. Other kinds of matters, previously profitable, have become commodities or even disappeared. Alternative fee arrangements are nearing a tipping point that makes the survival of the billable hour as the primary billing model most unlikely over a five to ten year timeframe. Firms that have never before thought of globalization in the context of their own business models are being challenged by this reality too. How will all this unfold over the next few years? What does a prudent law firm managing partner or executive director need to do? What should be discarded? What should be kept unchanged?

In this turbulent 21st Century, it is critical for many law firm leaders to rethink radically their roles in their firms, and especially how they and their firms approach strategy. A clear

sense of direction is imperative. As in the popular CBS TV series *Survivor*, strategy is a matter of “outplaying” and “outlasting” (and yes, sometimes even “outwitting”) one’s competitors for as long as the firm is in business. It is critical for today’s leaders to get really good at “thinking strategically,” every single day. Strategy is no longer something that can be adequately dealt with as a periodic event. It must become an ongoing process in the firm. It is also everybody’s responsibility, rather than something that can be left to an individual or a committee.

This article is intended to provoke law firm leaders into challenging the way that they think about strategy and the future of their firms, by exploring some of the changes that are taking place in the world and how they might unfold, especially in western law firms.

Shifting global economic and socio-political landscapes

With hindsight, it is clear that the current global crisis did not emerge solely from the housing bubble that developed in the USA and some European countries. It built up over decades. We need to consider how the world will be different in coming years, once this crisis subsides, before we can begin to think about how our strategies need to adapt.

It is clear that the global economic and socio-political landscape has changed fundamentally since 2005. The dynamics that have changed may be relatively subtle and unapparent at present, but are likely to manifest themselves more obviously in coming years.

New business models for law practice ownership and management

As law firms worldwide experiment with new business models, some seemingly attractive initiatives will fail and may even drag firms down with them. If others do yield real advantage, they will evolve and spread through the market. They will then join the other vectors that are causing the way that legal services are delivered to clients to evolve away from the business models to which we are accustomed.

Some new business practices that firms are already discussing and in some cases executing include:

- making “C-level” non-lawyer executives into shareholders, so fundamentally altering the relationship between lawyers and “non-lawyers” in most firms;
- the development of multi-disciplinary practices to provide a wider range of services to clients;
- securing equity finance either through listing on a stock exchange or through private equity, to fund growth either geographically or through recruitment incentives to attract talent; and

- exit strategies for existing owners wishing to capitalize their investments.

Exponential advances in technology

There are two schools of thought about the ultimate impact of technology on law firm management. The first holds that technology will never be more than a support tool for lawyers. The second holds that technology will fundamentally displace lawyers from many of the services that they currently provide. The first view is myopic; technology has moved far beyond being just a means of producing documents faster, managing the firm’s finances more effectively, storing and improving access to data, and communicating faster. The trend towards fundamental transformation is inexorable... and exponential.

With proven internet speeds already exceeding the equivalent of 60 DVDs per second, bandwidth is not likely to be a limitation for much longer. Data security is also already at a point where advancing this as an unavoidable limitation is a little dubious.

Computers continue to double in power every 18 to 24 months at no increase in cost, a trend that has held for half a century and is described in the so-called Moores Law.

Enormously increased bandwidth will also go a long way to addressing the preference of clients to deal with humans rather than machines. Holographic video-conferencing tools such as Cisco’s ‘Telepresence’ are early indicators of how this trend might unfold. Automatic translation will give people the ability to communicate in whatever language they choose. Web 2.0 tools such as social networking are making it far easier for people to communicate and platforms like Legal OnRamp are at the cutting edge of this in the legal profession.

The pace of change in legal services has been traditionally (and often proudly) described as “glacial.” Technology could radically change that. But governance practices in most law firms are not suited to dealing with disruptive change. Again, this offers as many opportunities as threats for those firms with strategic acuity and the ability to develop the resilience and agility to thrive on such change.

Emergence of a global market for legal services

Frankly, it would be surprising if a single global market for a wide range of legal services did not develop over the coming five to ten years at most. Protectionist jurisdictional barriers may persist stubbornly in some markets, but for the most part they will have been inexorably eroded by the market’s ability to source goods and services anywhere in the world through the Internet. Markets abhor artificial barriers. They circumvent them whenever this is of economic benefit and achievable. Legal services are not immune from this.

World Trade Organization initiatives against unfair trade practices and trade barriers in services are also a pressure that has hardly even begun to exert itself. We have seen over the past decades how trade barriers in products have been steadily eroded. Why not too in services, including legal services? International standardization of legal terminology and commercial legislation, too, will accelerate this.

Convergence

The point, when considering these vectors impacting the legal profession, is that they cannot be viewed in isolation of each other. In order even to begin to understand their implications for law firm strategy and management in the next few years, one has to consider what their combined impact is likely to be, acting in concert with each other.

This concept, called “convergence,” is an essential element of making strategic sense of the future. Yet legal practitioners often ignore it because it is, in practice, so difficult and imprecise to apply. The result is that strategy is crafted on the basis of superficial and often incorrect deductions.

It is senseless to ask what the impact of alternative business structures in England and Wales might have on law firm management practices, without asking what their impact might be when considered together with exponential growth in technology, emergence of a global market in legal services and the changes in the global economic and socio-political landscape, all acting simultaneously and in concert. This leads to a far more complex discussion but,

almost inevitably, to a different set of conclusions from when the issues are considered in isolation.

Conclusion

The purpose of this article has been not so much to try to provide a forecast of what the future legal profession will be like, as to discuss a few key drivers and provide a framework for how law firm leaders need to think about them and, more importantly, how they impact their strategy. I hope that the point is made that it is dangerous to think too simplistically about these drivers, or (especially) to try to think about them in isolation of their interrelated impacts on each other. Most importantly, I hope the point has been driven home that these are issues that firms ignore at their peril.

Balancing all these long-term issues with the intense demands of challenging economic priorities is perhaps the most difficult task for law firm leaders today. In my experience, the only way is to create a culture where strategic conversations are a constant undercurrent, and where important information is readily communicated within the firm, to those that need to know it. §

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New Guidance on the Tax Implications of Intercorporate Management Fees

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Intercorporate management fees are used commonly to facilitate the transfer of losses within corporate groups or to gain access to additional small business deductions. However, there are risks to using such management fees. Most significantly, they are often challenged and denied by the Canada Revenue Agency where the fees were not incurred to earn income and were not reasonable in the circumstances. The denial of the deduction could lead to a one-sided adjustment, as the recipient corporation may still be required to include the fee in income.

Two recent Tax Court cases have focused on the deductibility of management fees between related companies. These cases

provide useful guidelines in assessing the reasonableness of management fees. In addition, they serve as a reminder to ensure there is a legal obligation to pay management fees, and that adequate documentation is in place to support the fee.

In *Nielsen Development Co. v. R.* (2009 TCC 160), the Tax Court of Canada considered the reasonableness of management fees paid between corporations owned indirectly by a husband and wife. In assessing the reasonableness of the fees, the Court considered the following factors:

1. the nature of the management services;

2. management on site;
3. the efficiency of operations in comparison to similar operations in similar markets;
4. the effort of management;
5. profitability;
6. the existence of a management contract; and
7. experience and special qualifications.

In this case, the Court held that the management fees were reasonable in the circumstances and were adequately supported by a management services contract.

In contrast, in *Entreprises Rejean Goyette Inc. v. R.* (2009 TCC 351), the Tax Court of Canada denied management fees paid between two subsidiary corporations. Here, the taxpayer was unable to prove that the management fees were in fact true management fees. There was no agreement between the companies, no corporate resolutions authorizing the provision of services, and no payment of the management fee. The only evidence was invoices between the companies that did not contain details of the services rendered. The Court held that there was no legal obligation to pay the fees and denied the deduction.

It is thus important that all management fee arrangements have a properly drafted management agreement that contains bona fide commercial terms. Supporting documentation should include the preparation of invoices on a regular basis with an adequate description of the services provided, remitting the HST portion of the invoice, issuing payments on a timely basis, and ensuring the accounting records are up to date. Most importantly, the amount of the management fee should be representative of the value of the services provided.

Where there is a key person providing services, an employment contract should also be prepared between the provider corporation and the individual in question. This will help to further solidify the basis for charging the management fee. §

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Tech Central: **LEGAL TECHNOLOGY TIDBITS**

In the last issue of *Lawyers Alert*, this *Tech Central* column touched on some recent difficulties within the legal profession in dealing with the emergence of technology in so many aspects of law practice ("Tech Central: Twittering Jurors"). A few recent cases and developments have highlighted those difficulties even further:

No more Wiki-evidence – Earlier this year, a Federal Court judge chastised Canadian immigration officers for citing, and apparently relying upon, Wikipedia entries about the origin nations of immigration applicants, as they denied their applications (see *Jahazi v. Canada*, 2010 CarswellNat 454). It was not the first time a Canadian judge had been critical of the reliability of Wiki-based evidence, but the fact that such evidence continues to show up in courtrooms indicates the degree to which Wikipedia has become the unofficial king of all research.

Facebook and MySpace compellable evidence? – This is not necessarily a novel development from a strictly evidentiary standpoint, but most social media users might be surprised to learn that their profile pages and accounts are compellable evidence in civil court matters. Recent Canadian and U.S. jurisprudence has confirmed this compellability, in some instances compelling the disclosure of "status updates" and photographs that would tend (for example) to dispute a plaintiff's claim of injury and/or disability.

Is it o.k. for judges to join Facebook? – The Ethics Committee of the Kentucky Judiciary recently issued a Formal Judicial Ethics Opinion answering with a "qualified yes" a judge's inquiry as to the propriety of his being a member of Facebook, and being "friends" with various persons who might appear before him in court. The Ethics Committee determined that such activities do not reasonably convey an air of potential bias or undue influence upon the judiciary. Judges were reminded, however, of the high standard of conduct expected of them in these public interactions. This is in contrast to a report of the Florida Supreme Court Judicial Ethics Advisory Committee, which determined that it is not acceptable for judges to "friend" lawyers who might appear before them in court. Clearly, this issue is far from settled. The Canadian Judicial Council is said to be monitoring the issue, though no formal guidelines have been drafted as yet. The reports can be found at:

<http://courts.ky.gov/NR/rdonlyres/FA22C251-1987-4AD9-999B-A326794CD62E/0/JE119.pdf>

<http://www.jud6.org/LegalCommunity/LegalPractice/opinions/jecopinions/2009/2009-20.html>

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