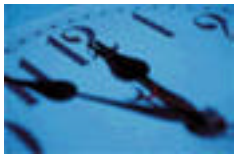
ABA Commission on Billable Hours Report

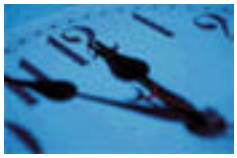
2001-2002



ABA Commission on Billable Hours Report

Defending Liberty
Pursuing Justice

2001-2002



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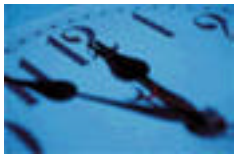

ACKNOWLEDGMENTS

We would like to thank the members, liaisons, and staff of our Commission for their unflagging dedication and hard work over this past year in crystallizing the issues, researching and drafting this report and stimulating the profession and the lay public in thinking about and beginning to discuss the issues and problems posed by the billable hour system. The Commission's continuing goal is to initiate a serious debate that will lead to innovations that address the flaws in the current standard. It is our hope that this report will begin to take us down that road.

Our work has been blessed with the interest and generous participation of Associate Supreme Court Justice Stephen Breyer, who hosted the Commission's first meeting last fall, and who has drawn attention to the many ways in which the billable hours system has diminished our profession. We thank Justice Breyer for his commitment and interest in the work of the Commission.

Finally, but perhaps most importantly, this report would not have come to fruition without the prescience and dedication of ABA President Robert Hirshon whose strongly held views on the unintended consequences of the dominance of the billable hours system prompted him to make the issue a priority of his presidency.

Commission on Billable Hours Co-Chairs
August, 2002

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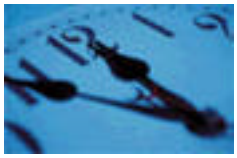

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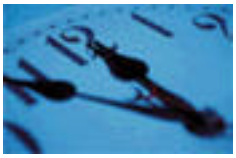


FOREWORD

Roscoe Pound wrote that the legal profession is characterized by a "spirit of public service." That spirit explains why so many lawyers respond "pro bono" to the needs of those who cannot afford to pay for legal assistance, why they participate in the work of the many government and non-government committees engaged in law reform, and why they teach to others, both inside and outside the profession, the values that have made the rule of law possible in America. Yet over the past four decades it has become increasingly difficult for many lawyers to put this spirit into practice.

The villain of the piece is what some call the "treadmill"—the continuous push to increase billable hours. As one lawyer has put it, the profession's obsession with billable hours is like "drinking water from a fire hose," and the result is that many lawyers are starting to drown. How can a practitioner undertake pro bono work, engage in law reform efforts, even attend bar association meetings, if that lawyer also must produce 2100 or more billable hours each year, say sixty-five or seventy hours in the office each week. The answer is that most cannot, and for this, both the profession and the community suffer.

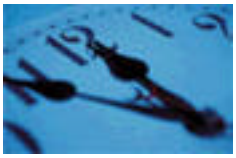
The treadmill's pressure is partly financial: law firm salaries have grown exponentially; at the same time, younger lawyers must repay law school loans that may amount to $100,000 or more. But the pressure also reflects the increased complexity and specialization of law itself, along with growing demands by clients for a precise accounting of the services for which they pay.

The Commission on Billable Hours hopes to begin to combat the problem by examining the billable hour itself. Does that kind of charge unnecessarily aggravate the pressures that threaten to confine the lawyer to the office, insulating him or her from the community? Moreover, does the billable hour contribute to or undermine a practitioner's ultimate goal—to provide clients with the best legal services possible? And to the extent billable hours are counterproductive on either or both counts, how, when, and to what extent, might it be possible to change billing methods?

I think the task is enormously important both for the lawyer and for the community. The need for the lawyer to continue to fulfill the profession's public service role is great. The ABA has estimated, for example, that nearly three fourths of those who need pro bono assistance fail to find a lawyer. Our profession has found that the law's increased complexity, reflecting the increased technological complexity of modern society, increasingly demands that lawyers devote time, not only to helping their clients benefit from the law as it is, but also to help shape the law as it ought to be. Our nation has found that lawyers must help in teaching our youth about law, about rights, about freedom, and about our government.

The Committee's technical task, then, concerns not just a better or more efficient way to run a law firm. It concerns how to create a life within the firm that permits lawyers, particularly younger lawyers, to lead lives in which there is time for family, for career, and for the community. Doing so is difficult. Yet I believe it is a challenge that cannot be declined, lest we abandon the very values that led many of us to choose this honorable profession. I am pleased indeed that this Committee has begun, in a very practical way, to address this critically important problem.

The Honorable Stephen G. Breyer
Associate Justice
Supreme Court of the United States
August, 2002



PREFACE

It has become increasingly clear that many of the legal profession's contemporary woes intersect at the billable hour. The 1960s marked the coming of age of the billable hour – an economic model that was created to address antitrust concerns with bar association fee schedules, to provide lawyers with a better handle on their own productivity and, more urgently, to address clients' demands for more information about the legal fees charged.

Today, unintended consequences of the billable hours model have permeated the profession. A recent study by the ABA shows that many young attorneys are leaving the profession due to a lack of balance in their lives. The unending drive for billable hours has had a negative effect not only on family and personal relationships, but on the public service role that lawyers traditionally have played in society. The elimination of discretionary time has taken a toll on pro bono work and our profession's ability to be involved in our communities. At the same time, professional development, workplace stimulation, mentoring and lawyer/client relationships have all suffered as a result of billable hour pressures.

The profession is paying the price. Disaffection with the practice of law is illustrated by a feeling of frustration and isolation on the part of newer lawyers who, due to time-billing pressures, are not being as well mentored as in the past. Time pressures also result in less willingness on the part of lawyers to be collegial, which only exacerbates work load since it necessitates that everything be put in writing. Not coincidentally, public respect for lawyers has been waning since the 1970s.[i] All this at a time when lawyers are less interested in climbing the corporate ladder and more interested in life balance.[ii] Many lawyers indicate that they would gladly take a substantial pay cut in exchange for a decrease in billable hours.[iii]

In this report, the Commission on Billable Hours, co-chaired by Jeffrey Liss, chief operating officer for Piper Rudnick LLP, and Anastasia Kelly, senior vice president and general counsel for Sears, Roebuck and Co., challenges the profession to look at value over cost when determining fair payment for services rendered. 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 counter-intuitive 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.

That said, the outright elimination of time billing is not a likely proposition. In fact, time billing as one aspect of price-setting for legal services is an appropriate and necessary tool in certain situations. Our profession's goal, however, should be to adopt innovate billing methods that provide an accurate measure of value to the client and, at the same time, make the practice of law more fulfilling and enjoyable.

As you prepare to examine the report, allow me to provide a brief overview of the contents. Chapter One outlines the current state of the profession and provides an analysis of the pros and cons of the billable hours system. Chapter Two provides a nuts and bolts primer on alternative billing methods, detailed case studies, an analysis of the results of the Commission's in-house and law firm questionnaires, and a financial pro forma for use by law firms interested in employing alternative billing methods on a larger scale. Recognizing that — at least for the foreseeable future — time-billing will continue to dominate, Chapter Three recommends innovative ways to avoid common pitfalls while working within the billable hours system. The final chapter outlines plans for year two of the Commission. Building upon this year's endeavors, the Commission will focus on the implementation and tracking of alternative billing pilot projects in law firms and corporate law departments.

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[i] Harris poll (2000).

[ii] American Bar Association Pulse of the Profession Report (2002).

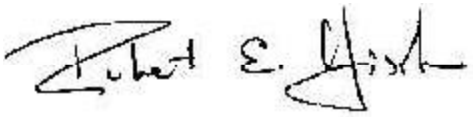
[iii] Half of the respondents to a 2001 American Lawyer survey indicted they would take a large pay cut in order to reduce billable hours.

The Commission has produced a range of additional resources to assist those interested in learning more about the issues relating to billable hours. An on-line toolkit designed to assist bar associations, law firms and law departments interested in presenting a program on billable hours and its impact on the profession, can be found at:

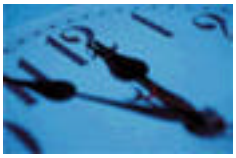
www.abanet.org/careercounsel/billable.html

The toolkit includes a selection of model programs, a PowerPoint presentation that can be customized, a speakers' bureau, talking points, a bibliography, and other resource materials. The Commission's Web Board (*see link above*) continues to house the ongoing dialogue of the myriad of issues relating to billable hours. This publication is the result of extensive research, creative thinking and in-depth interviews. While it doesn't offer a panacea for the problems inherent in the billable hours system, I believe we have begun to delve beneath the surface. In producing the report, the Commission has taken on the ambitious task of persuading traditionally risk-averse institutions to be open to new possibilities and thus help create a better future for our profession. I recognize that all of this will take a leap of faith: a willingness for lawyers and clients to reach out to each other and to embrace change.

But the time is ripe.



Robert E. Hirshon
President
American Bar Association
August, 2002



Information Gathering Methodology

The ABA Commission on Billable Hours wants to ensure all members of the legal profession, at every stage and in any workplace, have an opportunity to share their views with the Commission. This report refers frequently to information gathered from the four outreach mechanisms described in this section.

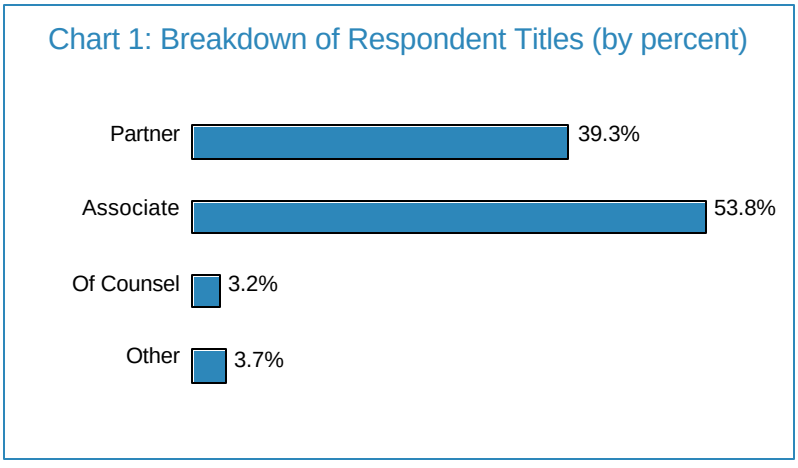
Methods Employed

- **Law Firm Questionnaire** (on-line)
  See www.abanet.org/careercounsel/archive/billablehourssurvey.html
- **In-House Counsel Questionnaire** (on-line)
  See www.abanet.org/careercounsel/archive/inhousesurvey.html
- **AmLaw 100 Questionnaire** (mailed)
  See www.abanet.org/careercounsel/billable/toolkit/amlaw.pdf
- **Web Board Dialogue** (on-line)
  See www.abanet.org/careercounsel/billable.html

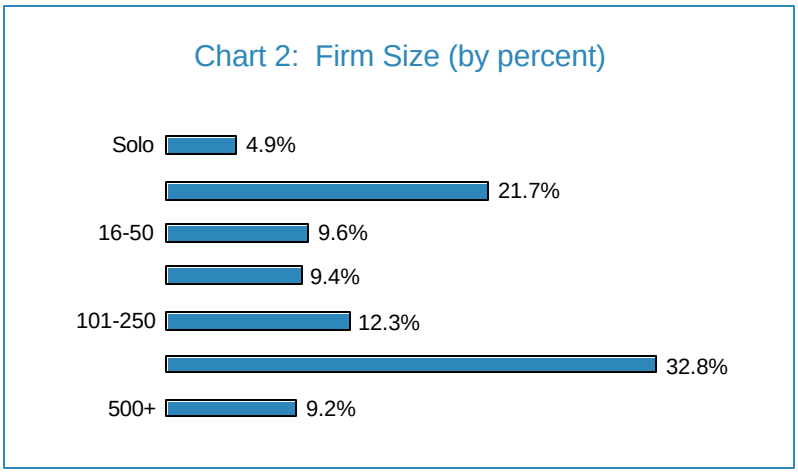
About the Law Firm Questionnaire

In January of 2002, the Commission posted on the ABA website a questionnaire for law firm lawyers to complete concerning their creditable hours, their quality of life, and their billing arrangements. This report reflects data collected through April 1, 2002. As of that date, the questionnaire generated 570 responses.

Chart 1: Breakdown of Respondent Titles (by percent)



Nearly two-thirds of the respondents worked in firms with more than 100 lawyers; one-third ranged in size from 101 to 250 lawyers. Approximately 20 percent of the respondents worked in firms with 2 to 15 lawyers.



The results of the law firm questionnaire by the ABA Commission on Billable Hours confirmed that few firms give attorneys credit for activities beyond billing, and that alternative arrangements are used infrequently, particularly the more unusual arrangements beyond flat fees and contingencies.

About the In-House Counsel Questionnaire

In January of 2002, the Commission posted on the ABA website a questionnaire for law department lawyers to complete concerning alternative billing arrangements. This report reflects data collected through April 1, 2002. As of that date, the questionnaire generated 126 responses.

The results confirm that hourly billing dominates. Moreover, few forces assessed in the questionnaire – management pressure, successful outcomes, and significant process benefits – look poised to challenge the status quo in the near term.

About the AmLaw 100 Questionnaire

We mailed a questionnaire to the 100 largest law firms in America, which inquired as to their evaluation and compensation systems, as well as their use of alternative billing arrangements. Nineteen firms responded.

Although the sample size was smaller than anticipated, the results of the questionnaire may provide a useful first cut at better understanding current billing practices at these law firms.

About the Web Board Dialogue

A web board is an on-line mechanism that allows widespread participation, giving users the ability to share comments and concerns with the Commission and other colleagues. The Commission also uses the board as a way to identify additional best practices that could be featured in its current and future reports.

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[1] Note that 54 percent of these respondents were associates. This may skew data on whether their firm uses alternative billing practices (i.e., associates may not know that information on a firm-wide basis due to their experience and exposure levels).

The Billable Hours Dialogue web board has 18 Conference Topics which are used to thread discussion. Those topics are:

I. Purpose
II. About the Commission[2]
III. Definition of the Billable Hour[3]
IV. Effect on Professional Development
V. Effect on Pro Bono Work[4]
VI. Best Practices: Alternatives that Work
VII. Alternatives that Do Not Work[5]
VIII. Recommended 'Credit' Policies Against Billable Hours Requirements[6]
IX. Base Compensation / Hours Related Bonuses[7]
X. Quality of Life[8]
XI. Comments from In-House Counsel
XII. Comments from Non-Practicing Attorneys
XIII. Comments from Government Attorneys
XIV. Comments from Public Interest Attorneys
XV. Comments from Law Professors[9]
XVI. Comments From Law Students[10]
XVII. Other Comments[11]

The ABA Career Resource Center staff vets submissions to ensure proper placement of messages and anonymity. Since May 1, 2002, more than 50 postings have been available on-line. Observations about the web board are based on commentary posted by May 1, 2002. The web board will remain on-line as part of the Commission's On-line Toolkit.

Conclusion

The ABA Commission on Billable Hours has reached out in multiple ways to the profession to garner feedback and guidance. This report reflects that additional insight.

Please visit our toolkit at www.abanet.org/careercounsel/billable.html to add your comments and read other attorneys' remarks.

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[2] We established the Purpose and About the Commission Conference Topics to give users the background work of the Commission and who was involved.

[3] The Definition of the Billable Hour Conference asks users to define hours in their workplaces, and elicited some solo practitioner input.

[4] The Effect on Professional Development and Effect on Pro Bono Work Conference Topics ask users to describe how billable hour pressures impact their ability to grow professionally and perform volunteer legal work.

[5] Under Best Practices: Alternatives that Work and Alternatives that Do Not Work, we open the virtual floor to the discussion of which alternative billing methods spelled success and which were a recipe for disaster.

[6] Recommended 'Credit' Policies Against Billable Hours Requirements asks users to recommend other activities for which firms and corporate law departments should reward attorneys.

[7] Base Compensation/Hours Related Bonuses inquired about the elements of reward systems and how they should be structured.

[8] Under the umbrella of Quality of Life, we opened the discussion to how the billable hour impacts an attorney's life in the office and beyond.

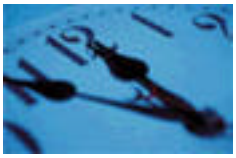
[9] Under these Conference Topics, we asked how lawyers in sectors other than private practice experienced the impact of billable hours, whether in their dealings with outside counsel, and/or their own decision to go in-house, leave the practice, move into government, commit to a non-profit, and/or teach the next generation of lawyers.

[10] Under the Comments From Law Students Conference, we sought general remarks from the future members of the legal profession.

[11] Other Comments is a Conference with no boundaries except that comments should not fall into any of the other categories.

PART ONE

STATE OF THE PROFESSION



The History of Hourly Billing

The legal profession has had a long and distinguished past. Over many centuries, lawyers found ways to charge for their services without counting billable hours. In those earlier days, lawyers considered many factors, including the difficulty of the matter, the result obtained and the value provided the client. Charges were often determined based on a review of the file at the conclusion of a matter. There was a high level of trust between lawyer and client and fee disputes were rare.

The ABA's Model Rules of Professional Responsibility, that had its origin in the 1908 Canons of Ethics, includes Rule 1.5 entitled "Fees." The Rule requires that when a lawyer has not regularly represented a client, the basis or rate of the fee be communicated to the client, preferably in writing, at the beginning or within a reasonable time after commencing the representation. After stating the prohibition of illegal or excessive fees, Rule 1.5 sets out the following factors to be considered in determining a reasonable fee:

- the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal services properly.
- the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer.
- the fee customarily charged in the locality for similar legal services.
- the amount involved and the result obtained.
- the time limitations imposed by the client or by the circumstances.
- the nature and the length of the professional relationship with the client.
- the experience, reputation, and ability of the lawyer or lawyers performing the services; and
- whether the fee is fixed or contingent.

Although the amount of time involved was always a factor, it did not become the most significant factor until the 1960s. The shift to accurate timekeeping took place slowly and at different times in different places. Some lawyers started keeping time in a rough way by making unofficial handwritten notations on the inside of the file folders, in order to later remember significant portions of the work. It was not until the 1950s and 1960s that timekeeping became routine. Law firm consultants were advocating the keeping of time records by suggesting that lawyers who kept accurate time records and billed by the hour made more money. By the late 1960s most mid-sized and large firms had shifted to hourly billing.

Once firms had shifted to hourly billing, budgets were based on expected billable hours times an hourly rate less an amount for write-offs and uncollectible accounts. Under a budget based on billable hours, the best way to increase revenue was either increase the rate or increase the number of hours worked. During the 1970s and 1980s, the system based on both lawyer rates and billable hours worked. Firms set billable hour goals for their partners and associates. However, as competition among lawyers increased and the economy fluctuated, many lawyers could not increase their rates enough to cover increased expenses. As a result, the number of billable hours worked had to be increased. Firms began taking a harder line and billable hour goals became billable-hour commitments. During the 1990s, those billable hour commitments reached unreasonably high levels in many firms.

As we move into the 21st century, we look back at a forty-year trend in which the billable hour has had a dramatic impact on the practice of law. Some of the

changes have been beneficial; many have been corrosive. This Report examines in some detail the good and the bad and explores ideas for a better future. One concern, however, is that with each passing year, the lawyers who remember the practice of law before the billable hour decrease in number, and we risk losing their wisdom and perspective. In fact, the vast majority of today's practicing lawyers have known only the practice of hourly billing.

This is not really a *return to the future* issue because change will not let us go back. But, lawyers need to recognize that the profession has a past that was not based on hourly billing, and that some of the historical concepts may help to improve present billing methods. No one expects hourly billing to go away. The goal of the Commission is to help lawyers consider alternative billing methods where appropriate.

From: Commission In-House Questionnaire
Re: The Future of Hourly Billing

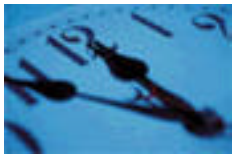
Even future lawyers are concerned about what the profession has to offer them within the constraints of the billable hour.

One law student explained:

I have previous highly technical experience in business and feel restricting my time to a set billable rate for first year associates unfairly limits me or my firm from the benefit of this expertise. The more a person's background is valued, and compensated for by one's clients, the better the profession will be understood by the public at large.

Another law student said:

As a full-time and married law student, I already feel the pressure that devotion to my studies places on my relationship with my wife. That being said, deciding which firm to work for when I graduate will not be based on salary alone. I would prefer quality of life over an initial six-figure salary. What good am I to my family, my clients, and myself if I work 20 extra hours a week for an extra $20,000-30,000 annually? I will not have time to spend the money, or see my children benefit from it. The esteem of working in a sweatshop requiring 2,100+ billable hours is not worth the detriment to my family, friends, or my sanity.



CURRENT STATE OF THE PROFESSION

The emergence of hourly rate billing has had a profound effect on the practice of law. Although there are both advantages and disadvantages to any billing method, the unintended consequences of billable hours to both lawyers and their clients are now receiving close examination. This chapter will highlight some of the problems associated with hourly billing as well as take a look at why it has survived, and has not been displaced by other methods.

The Corrosive Impact of Emphasis on Billable Hours

Simply put, the overreliance on billable hours by the legal profession:

- results in a decline of the collegiality of law firm culture and an increase in associate departures
- discourages taking on pro bono work
- does not encourage project or case planning
- provides no predictability of cost for client
- may not reflect value to the client
- penalizes the efficient and productive lawyer
- discourages communication between lawyer and client
- encourages skipping steps
- fails to discourage excessive layering and duplication of effort
- fails to promote a risk/benefit analysis
- does not reward the lawyer for productive use of technology
- puts client's interests in conflict with lawyer's interests
- client runs the risk of paying for:

  — the lawyer's incompetency or inefficiency
  — associate training
  — associate turnover
  — padding of timesheets

- results in itemized bills that tend to report mechanical functions, not value of progress
- results in lawyers competing based on hourly rates

Results in a Decline of the Collegiality of Firm Culture and an Increase in Associate Departures

For the past decade or so, law firms have been increasing billable-hour requirements in order to meet escalating costs and associate compensation requirements. Unfortunately, the increased need for billable hours has caused the pace of law practice to become frenetic and has had a negative effect on mentoring, associate training and collegiality. Lawyers no longer are being recognized primarily for the quality of their work and their talent. As a result, the quality of law firm cultures are in decline and the pressure for hours makes it impossible for many lawyers to achieve balance in their lives.[1] Generally, associate morale is low. Associate departures are increasing at a time when turnover is recognized as costly to their firms. Talented lawyers are leaving the profession.

Discourages Pro Bono Work

Another unfortunate and unintended result of the higher hourly billing requirements is a loss of available time for pro bono work. The well-meaning associate who desires to participate in pro bono work is often challenged by the attitude of law firms that value only billable work.

Does Not Encourage Project or Case Planning

Looking at individual client matters, absent a request from the client, hourly billing arrangements do not require, or even encourage, the lawyer to prepare a project plan or case plan at the beginning of a client engage

[1] See, for example, Whitley, Lisa M., Lateral Hires Up at Texas Firms in 2001, Texas Lawyer (June 4, 2002).

ment. Rather, hourly billing allows lawyers simply to start working and reporting the hours. In some circumstances, the lawyer "makes it up" as the matter proceeds. Lack of planning often leads to inefficiencies that can result in excessive billings.

In the alternative, billing arrangements that include flat rate or contingency components require lawyers to completely reverse their thought processes at the planning stage. For the lawyer to be successful, there must be a plan at the outset that enables the lawyer to set a fee for the work that is fair to both lawyer and client. While there will always be a few cases that are so unpredictable that hourly billing is required, too often hourly billing becomes a crutch for the lawyer who is not sufficiently knowledgeable and/or productive, or is unwilling to share with the client the risk of the lawyer's own inefficiency.

Provides No Predictability of Cost for Client

Most clients want some level of predictability in their legal costs. Hourly billing does not offer any predictability for the client. It is not until the matter concludes that the client knows the ultimate cost. In too many situations, the lawyer simply sends out monthly bills without tracking or being concerned about the overall cost to the client.

May Not Reflect Value to the Client

Every legal project has an intrinsic value to the client. The value may be greater than a fee based on the total of the hours billed. Or the value may be less. More importantly, with hourly billing the client does not have the information necessary at the outset to evaluate whether to or how to pursue a matter. Hourly billing often produces a result that is unfair to either the client or the lawyer. In some cases it may not be fair to either.

Penalizes the Efficient and Productive Lawyer

Hourly billing penalizes the efficient and productive lawyer. The inefficient and less productive lawyer ends up billing more hours. Advocates for hourly billing often argue that the difference is accounted for in the hourly rates. However, in most circumstances the rate differential does not come close to accounting for the difference in experience and productivity.

Discourages Communication Between Lawyer and Client

Clients may be discouraged from communication with their lawyers because they are concerned such action will start the billing clock. They may even suggest that their lawyers eliminate spending time on routine reporting letters or telephone calls.

Encourages Skipping Steps

In situations where the pressure is on the lawyer to save money or cut costs, hourly billing may result in the lawyer cutting out necessary steps in litigation or transaction planning.

Fails to Discourage Excessive Layering and Duplication of Effort

Hourly billing does not encourage the responsible partner to limit the number of lawyers and paralegals assigned to a file. In fact, it promotes duplication of effort by not providing any incentive to limit the number of lawyers participating at a given event or to take advantage of research on the shelf.

Fails to Promote a Risk/Benefit Analysis

Hourly billing does not encourage lawyers to conduct a risk/benefit analysis with regard to determining how to proceed on matters. Without a predictable cost, a risk/benefit analysis is impossible. Hourly billing results in work being conducted that may not be necessary, or work being performed prematurely or at a cost that is not justified.

Does Not Reward the Lawyer for Productive Use of Technology

Lawyers' overhead has increased dramatically due to the need for improved technology. The new technology has allowed the lawyers to be more efficient and to produce their work in fewer hours. As a result, the profession is facing increased costs and fewer hours to bill. Simultaneously, in many markets there is a level of competition that is preventing lawyers from increasing their hourly rates to reflect the added expenses of technology. As a result, instead of seeing monetary rewards for their improved efficiency and investment in

[2] For more, please read Calloway, James A. and Robertson, Mark A., Winning Alternatives to the Billable Hour: Strategies that Work, Second Edition, Chapter 8: Technology and Billing, American Bar Association Law Practice Management Section (2002).

technology, lawyers are seeing their profit margin decrease which ironically creates additional pressure to bill more hours.

Puts Client's Interests in Conflict with Lawyer's Interests

Normally, the client's interest is to resolve a matter or complete a project efficiently and quickly. If hourly billing is utilized, the efficient and quick lawyer will earn a lower fee than an inefficient and slow lawyer. Because of this, hourly billing fails to align the interests of the lawyer and client, and under many circumstances puts their interests in conflict.

Client Runs the Risk of Paying for:

The Lawyer's Incompetency or Inefficiency

Excessive hours due to incompetence and inefficiency are likely to be billed to the client and paid, particularly if the client is unsophisticated or does not spend time scrutinizing invoices.

Associate Training

Financial challenges for law firms result in higher billable hour requirements for partners and associates. As hour requirements increase, the amount of time available for partners to interact and teach associates, as well as the time available for associates to train, decreases. Because clients end up, in effect, paying for associate "on the job" training.

Associate Turnover

When an associate leaves a firm and a new associate is assigned to a file, the client may end up paying for the hours involved in getting the new associate up to speed.

Aggressive Time Recording

Reputable lawyers do not pad their timesheets. However, high hourly requirements can put subtle pressure on lawyers to be aggressive rather than conservative in recording their time. Under those circumstances, a lawyer may be less likely to carefully evaluate the quality of the time spent. Hourly billing tends to lead to simple quantitative recordings of time without qualitative judgments being applied.[3]

Results in Itemized Bills that Tend to Report Mechanical Functions, Not Value of Progress

The recording of hours for hourly billing tends to focus the lawyer on mechanical functions rather than on accomplishments or substantive progress.

Results in Lawyers Competing Based on Hourly Rates

Unfortunately, hourly billing makes the billing rate the primary factor for clients when they shop for legal services. Lawyers are thus forced to compete by lowering their rates. As a result, the significance of the hourly rate carries too much importance. Clients may select the best rate, but that rate, for the above reasons, may not convert to the best overall cost.

Part II—Why Billable Hours are so Entrenched[4]

Most law firms bill the majority of their clients on the basis of the hours worked by lawyers and paralegals multiplied by their standard billing rates. This hourly billing method has endured virulent criticism over the past two decades. The criticisms, however, have not displaced hourly billing or even reduced its dominance as the most common form of law firm billing. If, as critics harangue, the system breeds many problems, there must be equally powerful forces supporting the status quo.

The survival of hourly billing finds support in a cluster of related circumstances. The reasons fall into economic, psychological, and organizational categories.

The Method is Simple

Law firms find it very simple to multiply hours worked by a billing rate; law departments find it simple to understand and review such bills. Alternative methods of billing inevitably introduce more complexity without

[3] ABA Comm. On Ethics and Professional Responsibility, Formal Op. 93-379 (1993).

[4] This section focuses on law firms representing law departments. A subset of these points covers the situation of a law firm representing an entity that has no in-house lawyers.

obvious benefit and, therefore, do not challenge the incumbent system.

Comfortable Standard Completely Familiar to All Sides

An obvious reason supporting billable hours is longevity – the fact that by now everyone is wholly familiar with the system. A generation of partners knows no other way to bill, such as the "services rendered" bills of the 1960s and earlier.

But these reasons beg the question of why the system has endured. The answer is, in part, rooted in psychology and physics. The fact is that, like most people, lawyers simply do not like change and the normal reaction is to resist change. Because a working system exists, a kind of inertia takes over. As a result, the billing system has remained at rest undisturbed by an outside force.

Serves When No One Can Calculate Value of a Service

Support for billing on an hourly basis rests strongly on the difficulty of determining ahead of time the value of a particular legal service. If a law firm obtains a permit for disposal of effluent, and charges the client $21,000, can either the company or the law firm state with any degree of confidence that the permit was worth $21,000? If so, over what period of time, with what discount rate, and on what business assumptions was that value determined? If a lawyer prepares a motion for summary judgment, what has that motion contributed to the company's bottom line? If a law firm labors mightily on an acquisition that falls through because the stock price plummeted, what can be the value other than the hours devoted to the work?

For law firms, the value of the same amount and quality of legal work to one client could be completely different than the value of the same work to a second client. Yet, it simplifies life to stay with the lowest common denominator – hours worked.

For the reason that most clients appreciate that legal work of any significance cannot be standardized, hourly billing prevails. Unlike "commodity work," like changing the oil on a car, mowing a lawn, or installing 500 square feet of hardwood flooring, much of the work of lawyers cannot be predicted with precision. Because clients find it so hard to assess the value of work, they fall back on the comfortable, familiar and measurable.

Part of the enduring prevalence of hourly billing results because consumers of legal services purchase them in a highly fragmented market. If clients had more knowledge about how a legal service is provided, and the likely cost range, such as is true with obstetrics services, root canals or architectural plans for home improvement, there would be a reduction in information asymmetry. The on-line bidding platforms for legal services are a step in this direction. So too is the growing prevalence of legal cost insurance, especially if the insurance companies establish standard costs for standard services. They have the scope and volume of information to make the assessments necessary to standardize services and fees. In yet a third forum, competitive bids for fixed fee work may well yield more standardization of legal costs.[5]

Lets Law Firms Make More Money

Hourly billing allows, indeed may encourage, profligate work habits. A cost-plus contract can degenerate into disregard for basic market discipline. So too can the obvious benefit of being paid for working more hours lead, directly or indirectly, to inflating the number of hours worked. Cost-plus can also override scruples about quarter-hour billing increments, which are never marked down, only up.

Associate management becomes an oxymoron. All this is to say that law firms understandably cling to a system that minimizes responsibility for efficiency and maximizes ability to earn money.

This inclination finds support in the belief that law firms have fostered an environment of "produce error-free work" and "leave no stone unturned." Law firms can also hide behind the risk of malpractice: "If we don't research everything, we might be held liable."

[5] Over time, this argument for hourly billing will weaken. Groups of law departments may share data and thereby develop a better understanding of what a plain vanilla service costs. Vendors, especially those who offer case management software that tracks outside counsel spending, may try to aggregate such data. Surveys by consultants and trade groups could feed this growing body of shared knowledge.

Alleviates Tension-Causing Oversight by Inside Counsel

Many lawyers in law departments have little reason to question hourly bills, and also have sound personal reasons for continuing that arrangement. It is a fact of life that outside counsel relieve pressure on inside lawyers. That pressure can be the pressure of knowing the law, delivering the bad news, making a tough decision, slaving over the weekend, traveling extensively, or simply shouldering the load. Why would a mid-level law department lawyer want to bite the hand that serves her? True, pressure for cost control may come from the top of the company and reach as far as the general counsel, but it is very hard to translate cost control goals into actions that personally benefit the lawyer in the trenches. For those on the firing line, it is most convenient if law departments do not require budgeting or estimating value, but only look at hours worked. Because most people are adverse to confrontation, they are reluctant to ask or answer difficult questions about the value of work. A statement that "we worked six hours on this" is harder to challenge than "this was worth $1,500 to you." Neither side wants to give the other unilateral responsibility for determining the value of a service.

Ironically, when clients challenge the amount of a bill, they are often implicitly or explicitly basing their challenge on a perception of value. "This should not have taken so much time," means that the cost seems higher than the value obtained.

Law departments are as much at fault as law firms for perpetuating hourly billing. Law department lawyers do not need to think hard about the parameters of an assignment or the value of its results if they only look at hours clocked. Bills submitted on an hourly basis allow in-house counsel the equivalent of the line item veto. They can focus on the small end of the telescope and question the hours spent at a deposition, rather than think about the larger contribution to their company of the law firm's services.

Minimizes Transaction Costs for Both Sides in Engagements

Transaction costs increase when clients and law firms deviate from hourly billing. The most efficient basis for an assignment is for the law firm to record its time and bill it; much less efficient is an arrangement in which both parties must agree in advance on some basis for the billing other than hourly billing. Thus, transaction costs diminish at the start of a matter when the law firm begins clocking hours and also at the end of a matter, when the bill can be easily reviewed.

To be sure, someone in the company that retains the law firm can estimate the value of the firm's prospective work, but that foray into the unknown (a) takes time and effort on both sides, (b) requires agreement, and (c) opens up the estimators on both sides to later criticism. Who will look back and say that $25,000 was the value to the company of filing the application before the Federal Energy Regulatory Commission? If each time a company retains a firm both the company and the law firm must agree to the value of the work, the effort may not seem worth it.

Hourly billing removes accountability from both the purchaser and the seller of legal service for assessing value "It is what it is, sorry." Other methods of valuing services require someone to make judgments.

Both clients and firms want the other to move first. As savvy negotiators, both law departments and law firms want the other to expend the effort required to propose terms first. This permits the other side to either accept good terms or reject unfavorable terms. Partnering, a much confused term in the legal industry, is at least an attempt to increase trust between law departments and law firms. To the extent partnering brings firms and departments closer, increases how much they talk to each other about economic arrangements, and enhances trust, partnering will increase the likelihood that a law department and a firm can broach, then reach agreement on, billing innovations.

Increases Management Tools Within Law Firms and Departments

Tracking and billing time by hours aid lawyers in running their businesses. For example:

- Partners in law firms can give assignments with more precision and clarity when they can estimate for an associate how many hours a task should take. If a partner says, "Why don't you research this for five or six hours and let me know what you get?," they give more guidance as to the work effort and investment than if they said, "Work on this until you reach some value level." Ironically, the more pressure on associates to bill hours, the more important it is for partners to define tasks in terms of hours of work.

- Law firms recognize the ease with which a partner can write-off a number of hours. The partner may conclude that the task should have taken the associate only eight hours to complete, not twelve, and write off the difference. If the partner has to value the work product with a specific dollar number, it becomes harder to write-off and delete the extra dollars.

- It is easier to show the billable hours of an associate than the value delivered. With billable hours, the value delivered is the fee collected. The argument is that if the client paid for it, the client deemed the value sufficient to justify the cost.

- When law firms plan ahead for staffing and hiring needs, they can think in terms of full-time-equivalent lawyers, which is another way of calculating potential billable hours.

- When law firms increase the hourly-billing rate across the board for each class year, it protects the partners from making decisions about relative abilities of the associates. This mechanism is also a built-in income booster if all other factors stay the same. That is, with the same amount of work, higher billing rates will bring in more income. Law firms undoubtedly like the idea of a periodic increase in their billing rates. It would be much harder every year to justify that the value of their work for clients has increased.

- Hours billed are under the control of associates and partners; collections from clients depends on billing practices and the payment policies of clients.

- Tracking work by the hour permits the calculation of many more metrics. If a law firm works only on fees collected, it cannot calculate realization rate, or blended billing rates, or hours per associate, or set minimum standards of performance, e.g. 2,100 hours per year. Hours worked provides a *lingua franca* in the legal marketplace.

- The system perpetuates the lack of emphasis on project management in law firms.

- The number of hours logged by a lawyer becomes a proxy for quality of work and competence of the lawyer. Law firms tend to accept the Darwinian notion that assignments flow to the more capable associates or partners, so the busy lawyers – those with 2,000 or more hours – must be the better lawyers.

- June Eichbaum, a partner of Heidrick & Struggles in New York, pointed out in the white paper "Lateral Partner Satisfaction Survey" that hourly billing commodifies lawyers' work. An hour is a fungible measurement and those who produce an hour of work are more likely to be seen as interchangeable. Yet this is ultimately what many law firms are all about: they are providers of specialized temporary help, selling work at piecemeal rates for as long as possible. Do we want to say "for as long as possible?" Thus the prevailing measurement system – hourly billing – complements the model of the industry.

No one would quarrel with using hours as one aspect of setting prices for legal services. After all, the ABA guidelines for ethical billing expressly permit that. Doing so, however, raises the question of whether law firms should establish different billing rates for the same lawyer for different tasks.

Works Regardless of Volume or Type of Services

Whatever the legal service, and howsoever much there is of it, hourly billing can apply. By contrast, alternatives to hourly billing are easier to implement when there is a sufficient volume of work coming from a law department. A small company, without any lawyers inside, tends to know even less about the value of a service or what is involved in this service. What these companies can understand is that a certain amount of labor went into producing the document submitted or advice given. Where legal work is sporadic, it is more difficult to assess the value of that legal work. Also, where volume is lacking, law firms cannot spread the risk of improperly estimating over enough matters so that the total portfolio risk is acceptable to them.

Law firms, being conservative entities, welcome the risk-adverse arrangement of hourly billing. They willingly engage in fixed fee work if the volume is large enough, but for episodic work, they are concerned that the risk of loss is higher than the opportunity for gain. People making decisions are usually adverse to risk. Smaller law firms have even fewer resources to absorb variable risk than do larger law firms, so they may be more reluctant to venture into alternative billing.

Fits with Lawyers' Risk Aversion

Business clients and law departments themselves, if they pay a law firm on some basis other than hourly rates, may fear the risk of paying a windfall more than they fear the extravagance of hourly billing. Most law departments charge the greater portion of outside counsel costs through to the operating or staff unit that incurred the costs. At the very least, in-house counsel can say "the law firm worked all those thousands of hours" and it takes an astute critic to point out where those hours perhaps were unnecessarily put in. On the other side of the bill, law firms see the glass half empty if they evaluate sipping from alternative billing methods.

Allows Law Departments to Bask in the Comparison of Their Costs Per Hour

Law departments often compare their internal costs of operation, expressed as a cost per lawyer hour, to the blended rate of outside counsel. It is a simple matter to divide the budget of a law department – excluding outside counsel fees and patent maintenance fees – by the number of hours that the department's lawyers performed chargeable work. The in-house cost-per-lawyer hour ranges from $100 to $175 an hour.[6] By contrast, the bills of outside counsel, divided by the number of hours logged by lawyers on the bills, comes in much higher, on the order of $195 to $250 an hour with large law firms.[7]

Conclusion

The reality is that hourly billing survives, indeed reigns supreme. Its prominence has withstood much criticism and waves of management initiatives, such as bill auditing, task-based billing, Legal Electronic Data Exchange Standard, Activity Based Costing, Total Quality Management, partnering, and knowledge management, all of which failed to change this deep-seated style.

The dominance of hourly billing rests on interlocking and reinforcing pressures: simplicity, familiarity, profitability, efficiency, and amiability. Of these forces, simplicity and profitability are most prominent, followed by psychological issues of amiability and efficiency. These forces have led to the ubiquity of hourly billing and its embedded familiarity, and the difficulty of implementing alternative arrangements.

From: Commission In-House Questionnaire
Re: Current State of the Profession

The In-House Questionnaire asked respondents what percentage of their 2001 outside counsel expenses were based on hourly rates multiplied by hours worked.

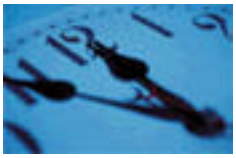
36% of the respondents calculated more than 91 percent of their bills using the traditional method. Additionally, **18%** determined 81-90 percent of their bills on that basis.

Thus, most bills from law firms are calculated using the traditional hourly system.

[6] Morrison, Rees W., Law Department Benchmarks: Myths, Metrics, and Management, Glasser LegalWorks, Second Edition (2001).
[7] See Id.

PART TWO

ALTERNATIVE BILLING METHODS



Overview and Introduction

When Commission members sailed out to tackle the hydra that is the billable hours economic model, they were pleased to learn that many of their colleagues were already working to tame the beast and that still others were willing to join in the fray, and simply needed guidance.

In this chapter, we will explore alternative methods of billing, considering what it takes to get comfortable with them, from both a law firm and client perspective, as well as models to guide interested parties through the process.

For example, in this chapter, the Commission presents ideas about how to price and deliver legal services on an alternative basis. It includes a financial pro forma, which sets forth three financial models, complete with examples. The Commission's suggestions are intentionally varied, it being understood that while no single model fits all practices, each model has the common goal of eliminating the incentives for inefficiency that permeate the billable hours model, and instead emphasizing effectiveness, efficiency and the value of the services rendered. We conclude with three snapshots: one of a forum that assists clients in locating legal counsel that will bill them on a flat fee basis, a general counsel that sought outside counsel in this way, and a law firm that bills approximately 90 percent of its fees on an alternative basis.

From: Commission AmLaw 100 Questionnaire
Re: Large Firms Using Alternative Methods

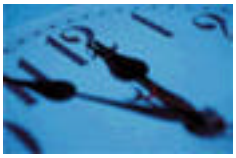
79% used partial or whole contingent fees
74% used flat fees
42% used result-based premiums
11% used retainers
11% used stock in exchange for fees

In this chapter, the Commission intertwines the results from its informational outreach, which is testimony to the profession's willingness to embrace change, but also its hesitancy on how best to proceed. The in-house counsel results are particularly insightful, as they observe that outside counsel is the biggest roadblock to implementing alternative billing arrangements.

From: Commission In-House Questionnaire
Re: Alternative Fees: Frequency of Use

Smaller law departments turn to alternative methods with greater frequency than do larger law departments.[1] For example, in law departments of two to 15 lawyers, almost two out of three respondents indicated that they had used some form of alternative billing. This may indicate that smaller departments are less entrenched in tradition, or that they are under more pressure to control costs, that they work more commonly with law firms of the size that will entertain variations from hourly billing. It is also possible that respondents from larger law departments simply do not know whether someone within their department is using alternatives to hourly billing. It also is possible that larger law departments tend to use larger law firms, which may be more committed to conventional hourly billing methods.

[1] Consider also the testimony of a Commission Web Board respondent, who said that as a solo, s/he was able to be more flexible and experimental than most firms, and is thus more open to trying alternative billing methods at a clients' request.



ALTERNATIVES THAT WORK

Based on our information gathering, we have found the following methods favorable to the profession. However, the best method may vary, depending on the size of the law firm or department, and the category of the matter.

Fixed or Flat Fees

According to the Commission's Law Firm Questionnaire, the most frequently used alternative fee arrangement in firms of all sizes was fixed or flat fees. Fifty-five percent of respondents said their firms had used the method in the last year.

Between 54 percent and 63 percent of firms with between 2 to 50 lawyers have used this alternative in the past three months, nearly double the percentage of larger firms, which had a 30-38 percent usage rate. *See Chart 1: Breakdown of firms that used fixed/flat fees in the past 12 months (by size).*

Chart 1

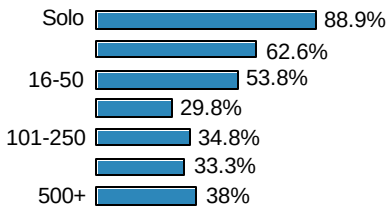
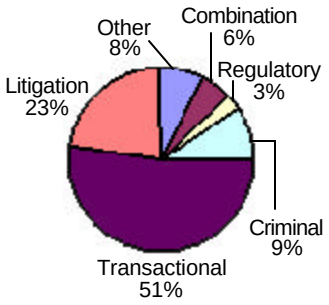


Chart 2



Irrespective of size, firms use fixed or flat fees far more often for transactional work than for litigation, indicating that firms are still in the relatively nascent stages of enjoying the benefits of flat fees. Firms may find it difficult to segment their litigation into discreet pieces for which flat fees can be recovered (for instance, a flat fee for drafting a complaint or a motion). *See Chart 2: Category of matter in which respondents have used fixed/flat fees for in the past 12 months (by type).*

The Commission's In-House Questionnaire revealed that in 2001, 72 percent of respondents' offices had a fixed/flat fee arrangement with outside counsel. However, 61 percent also said that such arrangements only accounted for between 1-10 percent of their legal fees.

On the Commission Web Board, *flat and fixed fees* made for their own debate. One attorney explained that his firm developed a projection system for delivering legal services to the same clients on a repetitive basis in the consumer bankruptcy area. The firm now offers clients a "fixed menu of services," which are flat fee options for defined services or total cases.

However, another attorney countered that "Flat fees in litigation have proven to be counterproductive to settlement and unfairly burden the court system." Although hourly billing may at times be burdensome to clients, flat fees do not incentivize clients to consider litigation costs when looking at settlement proposals.

Another respondent suggested a special category of fixed fees, dubbed *fixed fees in stages*, may be the answer for litigation matters. The attorney attested that her/his firm has successfully used flat fees for transactional work and has been experimenting with incremental flat fee hybrids for litigation stages. The lawyer said the key to creating meaningful fixed/flat fees in litigation is to set them based on stage instead of per project. For example, charging $x for interrogatories, $y for pretrial motions, and $z for summary judgment motions would provide clients with "some degree of certainty as to the total litigation expense, an incentive to settle or at least consider settlement, and an incentive for law firms to become more efficient (and reward those firms who in fact are efficient)."

An in-house attorney further stated, "Lawyers should be at least as capable to set fixed fees for most engagements as auditors, construction contractors and even car mechanics are. All of these other jobs have substantial risks of cost overruns due to unexpected difficulties."

Discounting

Perhaps the easiest variation on straight billable hours is a discount on hourly rates. This method was the most frequently cited method by law department respondents, cited by more than a third of them. Although hourly billing is very common, discounts on those rates are relatively uncommon. Slightly more than half the departments said that 20 percent or less of their hourly bills have been shaved by a discount.

This finding may indicate that departments that do not often use outside counsel lack the leverage to insist on discounts. It may also bear witness to the sentiment that discounts on hourly rates prove to be ineffective for cost control. Though a law firm may discount the hourly rates charged, the number of hours worked may rise proportionately. Third, many people recognize that hourly rate discounts, which are generally applied across the board to everybody, are not necessarily effective at improving efficiency. The work of some lawyers perhaps should be discounted heavily, whereas the work of other lawyers perhaps should receive premiums.

From the Commission Web Board comes a related suggestion: give flat fee *discounts* to high volume referral clients. The attorney explained that at his firm, "Clients are rewarded for loyalty in referring a volume of cases, and we are able to develop economies of scale which allow us to handle matters profitably but at a reduced cost." His firm tracks overhead and identifies variable costs, and reviews fee agreements annually to allow for changes in overhead and controlling case law and statutes. "Clients enjoy predictable fees and we are able to bundle services to make representation cost effective to deliver."

Blended Billing Rate

The *blended billing rate,* which allows firms to bill a set hourly rate regardless of who is doing the work, found favor with a fair amount of law departments and law firms. Almost one out of every two in-house respondents and between a fifth and a third of their private practice counterparts said they used the blended rate method in the past twelve months. Fourteen percent of in-house respondents said that between 11-20 percent of their bills are calculated on this basis.

The data also showed that blended rates are used in far greater ratios for litigation than transaction matters (two and three to one).

From: Commission In-House Questionnaire
Re: Operational Impact of Accepting Bills Based Substantially on an Alternative Basis

Q: If your department committed to accepting bills for a substantial portion of its work on a basis other than hourly rates, how much of an impact would the change have on internal department operations?

32% felt that such a change would not impact their internal department operations. We presume those operations would include bill review, evaluations of outside counsel, budgeting management of matters, and reporting to internal clients.

39% said it would make "some" difference,

14% said it would be significant,

2% said it would require departmental revamping, and

13% were unsure of its impact.

Contingent Fee

Thirty-six percent of in-house respondents used contingent fees in 2001.

Some variations of contingent fees include outcome-based billing and a base fee plus a success fee, as explained on the Commission Web Board:

A once-claims manager for a major insurance carrier suggested the use of *outcome-based billing*, a rewards-based system grounded on budgetary compliance and case results. His current company is establishing preferred defense counsel networks for its clients.

Building on that, an attorney practicing in Japan suggested a *base fee topped with a success fee* structure.

In Japan, lawyers traditionally charge "a base fee to finance the case, and a final fee based on the success of the endeavor." There, "practicing attorneys would suffer greatly under the hourly billing system." The attorney further suggested that in cases "such as market access negotiations, [attorneys should] work against a budget at modest rates with a well-defined success fee based on results." In this manner, an attorney can cover costs and focus not on the time spent, but on the results, which is where clients focus.

Hybrid

Twenty-four percent of in-house counsel have used some mixture of alternative arrangements (*hybrid*), while less than 20 percent of the law firm respondents answered questions about hybrid fees, which included the *flat fee plus hourly* and the *hourly rate plus contingenc*y. Of the hybrid possibilities, the most popular in the firms was the *flat fee plus hourly rate* approach (ranging from 22 percent to 67% percent of the 35 respondents); with respect to the hourly rate plus contingency approach, less than 5 percent of respondents worked in firms with more than a hundred lawyers, less than 10 percent of respondents worked in firms with between 16 to 100 lawyers, and less than 20 percent of respondents worked in firms with fewer than 16 lawyers.

On the Commission Web Board, one solo attorney suggested that colleagues offer different fee structures depending on the matter. For example, he generally uses a *hybrid approach*, which consists of *base fixed fee plus expenses plus a contingent fee*. For matters like real estate closings and truly uncontested divorces he resorts to a *fixed fee*.

Other Methods

A law firm billing by *retrospective fees based on value, unit fees and relative fees based on value*, or taking *equity*, would be in a minority.[1] The rare use of these methods are also reflected in law department feedback, as only 8-9 percent have experience with them, and they comprise less than 20 percent of those departments' legal fees.

One Commission Web Board respondent is upfront about charging a reasonable value. He tells clients:

> That I do not charge by the hour but seek to charge for what I believe to be the reasonable value of the services. I also remind clients that if they are not satisfied with my charges based on the nature of the work performed, they obviously do not have to return with a repeat assignment. Most are quite happy to have their fees based on the reasonable value of the results achieved.

[1] As these are lesser-known alternatives, perhaps confusion over what was meant by the terms *unit fees* and *relative fees based on value* prevented people from recognizing them as methods they have used.

From: Commission Web Board
Re: Obstacles to Alternative Arrangements

Regardless of who or what is to blame for our infrequent use of alternative billing methods, we must work towards acceptance.

Attitudes of Outside Counsel

Success varies among in-house attorneys at getting outside counsel to use alternative billing strategies. Although in-house respondents seem open to it, one respondent noted that it is the attitudes outside counsel have towards alternatives that prevent such arrangements. "My attempts to date to use alternative billing have been dismal. Even using bidding to engage firms for representation has not resulted in lower billing rates." The attorney said the uncertainty of litigation has led firms to stand by billable hours and abandon budget plans, particularly in an industry that does not have repeated litigation. S/he recommended blended and discounted rates for clients in similar situations, but said even these methods do not eliminate the use of billable hours.

Attitudes of Clients

However, a longtime practicing outside counsel compellingly responded that clients are also responsible for the lack of alternative billing methods:

I have a difficult time getting a sophisticated client, like a general counsel, to agree to anything other than an hourly rate basis for our fees. I think that is because we do not have the relationship with those types of clients that we had with most of our clients in the old days. The new breed is concerned that our idea of a success element or a discounting element in a fee will not be his or her idea. In other words, there is a lack of trust.

Beyond that, web board respondents noted additional obstacles that we must overcome as we wean ourselves from total reliance on the billable hour.

Judicial Acceptance

One obstacle is earning judicial acceptance. "Courts have problems with my refusal to fill out time sheets or account for my work based on hours because they are so accustomed to having lawyers justify their fees based on time rather than results," one reasonable rate user explained. Although the attorney has never been questioned about her/his rates, s/he attributes that to age and experience. "Charging by the hour encourages needless and slow work, and I am necessarily pleased that my refusal to bill by the hour has never proved to be an impediment."

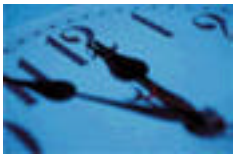
Fear of the Unknown

Also, consider the resistance to change because it forces us into the unknown. One respondent said that although "No one likes the billable hour and the results it produces, [it is] too often [that] negotiations over alternatives leave one of the parties concerned that they are paying (or losing) more than they should." The attorney said this concern stems from lack of detailed information about average cost of various stages of litigation. "Pooling such data from insurers, corporations and firms through a third party such as the ABA might be one step."

Ethics and Other Constraints

A further obstacle is the "can't do it attitude." One respondent believes the billable hour system cannot change much in defense litigation because premiums and contingencies are not only uncommon, but at times unethical. "Alternatives only work when the firm can make as much or more for efficient practices and good results, as they can with hourly billing, while being protected when cases grow due to practices of the other side, or facts not discoverable when initial budgets are set."

Furthermore, he said, although "corporate clients say they will consider alternatives, [they] are moving in the opposite direction of managed care—pressure on rates, auditing of hours. Insured cases are even worse."



Considering Price and Delivery Possibilities

Virtually everything contained in this overview applies to alternative billing methods, whether the alternative system focuses on specific tasks, an entire matter or an entire portfolio (for example, all of a company's antitrust, labor and/or environmental work).

Developing alternative approaches to calculating the cost of legal services is not simply a matter of pricing. No matter what approach is used, lawyers should be careful not simply to draft agreements for services and/or implement some slightly modified billing system and believe they have succeeded in "alternative pricing." *A successful alternative billing program requires a re-evaluation as to how the work will be managed and delivered.* Among the initial questions that might be asked are the following:

(1) What works and what needs improvement with the way we currently handle legal services?
(2) Where specifically have things not gone well in the past, and why?
(3) What different approaches, in both pricing and delivery, are likely to work better?

Seeking A Better Way To Price and Deliver Legal Services – an Overview

Song Of The Prophets/Profits

If the prophets could come forward on this topic, they would likely say: It's an outrage that legal services are handled the way they are today.

Consider an analogy of an outside supplier that provides brake linings to a major auto company. Imagine the foolishness if each lining were separately measured and fabricated, then sent to the auto company, where a large in-house team was needed to review and correct the work of the outside supplier with respect to each individually designed lining. Worse, imagine the foolishness if the company were charged *by the supplier* an hourly rate for all the time the supplier spent learning from the inside team why each lining was wrong, plus all the time then spent by the supplier to correct the mistakes the supplier made in the first place. Yet that is how most legal services in the U.S. are priced and delivered today. In any other part of a company, anyone handling outside services in this manner would be fired summarily.

Put another way, lawyers make a fairly nice salary relative to the rest of the workforce. So how can they possibly say, whether in-house or outside, and especially after a few years of experience, that they still cannot decide ahead of time what a given legal project should cost?

Goals

- When contemplating alternative pricing and delivery, the following might be considered as possible goals:
- Assure that the legal needs of the client are met, with successful outcomes.
- Achieve and even exceed the client's budget goals while assuring strong economic and other returns for the law firm.
- Assure high client satisfaction with the quality of product and manner of service.
- Provide preventive services, including developing alternative methodologies to solving legal problems.
- Enhance professional development opportunities for

both inside and outside lawyers.

- Align the incentives to support the objectives.

Alternative Pricing And Delivery Approaches

Much has been written about alternative pricing and delivery techniques, including several books and articles published by the American Bar Association (ABA) and the American Corporate Counsel Association (ACCA). Some of the more frequently suggested approaches include:

- Fixed (or budgeted) price by task, matter or portfolio.
- Contingency fee per task, matter or portfolio.
- Other bonus arrangements (such as an annual or end-of-project allocation from a bonus pool, based on predetermined objectives and/or subjective assessment factors).
- Risk corridors (such as used in health care pricing).
- Full Time Equivalent (FTE) allocations (such as used by corporations for virtually all internal functions).
- Work units (a concept of charging a pre-determined number of "units" for a given task, no matter how many actual hours it takes).
- Outsourcing/partnering of a certain category of work (such as all intellectual property or antitrust work), using fixed or budgeted pricing per matter or portfolio.

Determining Price

When thinking about how to price a project, it is important for both the client and the firm to discuss pricing. And the starting point for the discussion can be the simple question: How much should this cost? Note that, when buying a hamburger at a fast food restaurant, or a refrigerator at an appliance store, you're never told no one knows what the product will cost. The price is posted. In the case of much more complex transactions, such as building a skyscraper or an aircraft carrier, even though there are many factors out of the control of the builder, the parties still predict the cost, or at least agree upon a methodology for establishing in advance the likely cost, plus a process for handling any unexpected changes.

Here are some questions a law firm or law department might consider when estimating a price for future work:

- *What has it cost the firm and/or the client to do this type of work in the past?* This was one of the key reasons the ABA and ACCA developed task pricing – to allow law firms and corporate law departments the opportunity, especially after several years of collecting data, to understand what those tasks are likely to cost, including evaluating the factors likely to cause the range to be higher or lower.
- *What is the value to the client?* The answer to this question probably communicates more to the lawyers than anything else. It basically tells counsel: "This is what this project is worth to me, the buyer. Deliver a legal product at this price, or tell me what I'm missing."
- *What is the benchmark cost?* When doing benchmarking, many industries have trade groups that publish fairly precise data on what legal services cost for a typical company in that industry, often as a percent of sales, revenues or staff. Other benchmarks exist for corporations generally. Here are some factors to consider when calculating a benchmark number:
  - Direct in-house costs (salaries for attorneys and administrative staff, benefits, library, telephone, photocopy, etc.).
  - Indirect in-house costs (space, utilities, personnel services, data processing, possibly stock options, etc.).
  - Costs of non-attorney services that also are involved in addressing legal problems (e.g., workers compensation administration, human resources investigators, early intervention teams, patent prosecutors, risk management staff, compliance staff, costs of fines and judgments, etc.).
  - Costs of outside counsel (fees and disbursements, perhaps including internal corporate costs to administer).

— Defense portion of insurance premiums.

- *What is the cost estimate using an FTE approach?* Almost every company in America calculates its personnel costs in terms of "full time equivalents." Thus, if law firms or law departments are looking for an alternative to billable hours, this would seem an obvious choice. For a law firm, what percent of an attorney's time in a given day, week, month or year might be committed to a specific project? Likewise, the law department might tell a firm a given project is "worth" one-tenth of a mid-level associate's time, for one week, because that is what that task has required in the past. Assuming the firm knows its FTE costs, it has the essential information to set a price.

- *What other methodologies might be borrowed from industry (including the client's industry) when estimating costs and/or establishing incentive bonuses?*

Factors When Selecting Law Firms

Part of the process is to select the best firm for the work. The following factors can help predict which firms are likely to do well, both in bidding for the work and in the actual delivery of legal services:

- Serves a number of similar clients.

- Has high expertise in the industry and/or key substantive areas.

- Knows how to manage legal services.

- Knows how to communicate effectively.

- Has their own internal costs under control.

- Has an internal profit-sharing system that puts the incentives in the right place.

Levels Of Bidding

Law firm bids can cover varying amounts of work. Careful thought needs to be given as to which approach to use, how it will be managed and how it should be priced:

- Complete outsourcing of a task, matter or portfolio.

- Shared responsibility of in-house and outside counsel ("partnering") by task, matter or portfolio.

- Backup service (outside counsel serve as a backup for testing ideas, etc., but "without the meter running").

- Other benefits of the delivery model—knowledge of company builds ability of firm to do more valuable work.

Adequate Information

When inside and outside counsel (and possibly the client) discuss how to price the project, it is useful to give outside counsel as much information as possible. Put another way, although most lawyers are typically wary of giving more information to the other side than absolutely necessary, in fact, there is no reason to hide the ball. Indeed, no one benefits if the law firm, because of insufficient information, makes a wrong bid, either high or low.

Among other things, the following information is often useful to share with a firm proposing to handle a project on some alternative basis:

- Current and past in-house and outside costs of handling similar projects.

- Detailed summary of what was done, and what problems arose, in similar tasks, matters or portfolios in the past.

- Total funds available. This is one of the most important pieces of information to give the law firm, yet is usually withheld. What does the client think it should pay for this project? If the client has a pre-existing budget, how much has been allocated for the project, including legal work? Whose profit or budget center is being charged for doing the legal work, and who must approve any cost changes?

- Potential problems that may arise—work stoppage, disputes with supplier, etc., that the client may be aware of that could impact the cost of legal services.

Contract For Services

When agreeing upon an alternative method to price and deliver services, many lawyers tend to convert what should be a simple business

negotiation. It need not be. Too many lawyers have forgotten that a simple business letter is often the best form of contract. In fact, a well written, two-page business letter (possibly with some exhibits) is usually more than adequate to spell out how alternative legal services will be handled. Here are some of the items that might be covered in the letter or exhibits:

- Definition of services.
  - Basic coverage.
  - Extraordinary circumstances.
- Personnel and other resources.
- Support services and disbursements, if any.
- Periodic evaluations; what will be measured.
- Conflicts.
- Payment.
- Term of engagement.
- Contingencies, if any, such as incentive bonuses, risk corridors, etc.
- Future changes or rebidding.
- Transition steps in the event of termination.

Savings From the Three E's

Lawyers often say the only thing they have to sell is hours. Nothing could be further from the truth, and our predecessors (that is, the general counsels and law firm leaders of 30 years ago and earlier) knew better. The real value of a good lawyer lies in the lawyer's skill set, expertise, wisdom, ability to manage, ability to bring people together, and ability to find and implement solutions. So, when thinking about how to price and structure alternative services, remember that the real savings are not going to come from contractual language (those are just words), but rather an ability to manage the three E's:

- Expertise
  - This factor, particularly important in highly technical areas, is actually the most important factor overall. What lawyers have to sell isn't hours. It is expertise, and the sooner this concept is re-affirmed, the easier it will be to establish alternative pricing and delivery and, more important, the sooner all sides will realize how much better the alternatives can be.
  - Counsel who handle similar matters for many clients, and interact with government agencies and other specialists on a regular basis, will have a much higher level of efficiency and certainty, including in areas where "there is no answer."
  - When considering expertise, remember that inside counsel have a great deal of exposure, especially in substantive areas that comprise the client's core businesses. They also are expert in understanding how different legal issues relate to the client.
- Elasticity
  - In substantive areas, it is important to be able to move resources from one specialty or project to another, depending on where issues exist at any given time.
  - There are also important cost savings that come from being able to assign attorneys who have varying levels of experience at different times.
  - An alternative pricing and delivery system can provide elasticity with respect to a company's legal budget overall (i.e., the ability to shrink or expand the amount of legal resources the company can afford at any given time).
- Economics
  - Annual increases in salary and overhead accrete over time.
  - An alternative pricing and delivery system has important strengths if it is able to spread overhead and other costs over a large client base, to shift levels of experience assigned to a task, matter or portfolio, and to expand career paths.
  - Fixed pricing and contingency arrangements

provide an especially important incentive for the law firm to monitor projects and properly manage and allocate resources.

Monitoring The Project Once Underway

Once an alternative project is underway, both the law department and the law firm might still use hours, but if they do, they should be used as a management tool, which is how hours originally were intended to be used, and *not* as an absolute determinant of value and final price. Work units, FTE reports or similar alternatives also can be used.

In managing the project, it is important that all parties agree on what the cost is likely to be, absent extraordinary events. That total amount, however, should be broken down into a budget, with sufficient detail to essentially map out the project, but not with so much detail (which lawyers unfortunately gravitate to) that it isn't workable and in fact is never used.

Equally important, there needs to be a system that tracks costs in real time. In light of technology resources, there is no reason a matter's costs cannot be tracked *daily*. If the responsible partner and the responsible in-house attorney received regular reports on how much resources have been allocated to designated functions or matters, they could quickly identify areas where too much effort is being expended and/or where there are cost overruns. Yet most firms operate on a system that evolved over a half century ago: get your time sheets in by the end of the month; take another month sorting out billing errors, send a bill to the client by the third, fourth or even fifth month after completion of the work, and receive payment six or more months after the completion. Not only is this a poor system for the law firm's cash flow, it is a disaster in terms of managing legal resources. As pointed out earlier, if any other part of a company worked with its suppliers in this manner, everyone involved would be fired.

Obviously, once data exists on a real time basis, lawyers need to compare the actual cost with the budget. Whether that is done weekly or monthly, the most important purpose is to support a dialogue among inside and outside counsel as well as the client: Are we on track? Is this the legal product the client wants? If we're running over budget, why? And what can be done to get us back on track? Or, do we all agree that we need to change the allocation of resources?

An important part of this exercise is to have agreement from the outset, usually in the business letter agreement or exhibits, with respect to actions to be taken when budgets are exceeded, and how to determine when to act. For example, the test might be whether more than X hours, work units, or FTE percentages are spent, notwithstanding what was planned at the outset. Or the test might be whether the total cost of the project exceeds a fixed dollar amount. There may be other ways to define "extraordinary" items.

Improving Interactions Among In-House Counsel, Outside Counsel and the Internal Clients

Communication among the parties is essential to keep the project within budget and, equally important, to meet and exceed client expectations. Holding regular project status meetings, as is done in most other parts of industry, is one approach. These meetings should have at least two parts: (1) substantiatively, how are things going? and (2) are we within budget and, if not, what needs to be done?

Measuring Outcomes

Lawyers, by training, are heavily focused on process. Most business professionals in industry, on the other hand, focus on outcomes. Thus, one of the most important elements in designing an alternative pricing and delivery system is to change the mindset to one that emphasizes outcomes, and in a measurable way. What will naturally follow from this approach will be development procedures for achieving the outcomes. But in terms of implementing alternative approaches to legal services, the ability to measure outcomes is what counts, *not* process.

Among the elements that might be measured are the following:

- Success in individual tasks and matters.
- Client satisfaction (interviews, written surveys, etc.).
- Comparison to industry benchmarks.
- Comparison to past costs for comparable work.
- Comparison to targets and stretch goals.
- Impact on the client's reputation, market value, etc.

- Annual evaluation of strengths and weaknesses, possibly using methods employed in annual evaluations of personnel by the law firm or the client or both.

Fixed Pricing

Much has been written, including in an earlier section of this report, to establish that pricing based solely on billable hours rewards inefficiency, puts little or no premium on expertise and know-how, and provides no incentive for keeping the client out of trouble and/or solving problems (or closing deals, etc.) quickly and effectively.

By going to some form of fixed or budgeted price, the law firm now has the incentive both to manage its resources and to deploy those resources for highly effective outcomes. Indeed, that is one of the most important operational benefits of in-house counsel (to say nothing of their expertise, knowledge of the industry, knowledge of the client, etc.). An in-house lawyer has only a certain number of hours in the day and thus has to balance many competing pressures. The in-house lawyer also has to decide, hopefully in rational ways, where time is best spent, and what specifically should be done to maximize the benefit of that time. Any alternative billing and delivery system should incorporate similar incentives for outside counsel.

Working On-Site

An important dynamic to consider in any alternative system is whether the law firm attorneys can spend at least part of their time working on-site at the client's place of business. Of course, the outside attorneys need to maintain their professional independence, but law firm attorneys who stay in their skyscrapers often think providing effective legal services is writing lots of documents (and now, e-mail). It is so much more effective for outside counsel to be on-site with the client for some period of time, interacting face to face.

By being on-site at least some of the time, counsel can not only solve problems but also observe why problems have arisen in the past, and thus suggest better business practices to keep the client out of trouble going forward (or help the client more readily close business transactions, or resolve regulatory questions, etc.). And if the pricing is done correctly at the outset, both the client and the law firm should benefit very substantially by legal services that are priced and delivered more effectively. Put another way, the law firm should be rewarded for helping the client better achieve its goals with less but far more effective legal input.

Management Concepts

Management concepts that should be built into an alternative structure for legal services include the following:

- For the law firm
  - Manage finite resources – and thereby act like in-house lawyers.
  - Be proactive – anticipate and solve problems quickly and for the long-term.
  - Communicate regularly and effectively with the general counsel and internal clients.
- For the general counsel and other inside counsel
  - Manage both in-house and outside counsel as a single team.
  - Focus on legal exposures of the organization as a whole, and manage the legal budget to get the highest and best use from all available resources.
- For internal clients
  - Share in legal decision-making.
  - Be more focused on where legal services can best be used, versus other resources that can address the same needs more cheaply and with longer-lasting benefits.
  - Be more aggressive in seeking and implementing preventive techniques.

Unitary Legal Office – A True Partnership

For those who are ready to combine more efficiently the in-house and law firm resources, here are some concepts to consider:

- Combine law firm and in-house attorneys into a single team without regard to who is the employer.

- Eliminate unneeded intermediaries when working with internal clients and handling matters. No double-teaming at meetings or handling tasks. This concept alone could reduce costs by a third or more.

- Have inside and outside counsel participate jointly in weekly, monthly or quarterly staff meetings and possibly an annual retreat.

- Eliminate complex and often meaningless bills, especially where fixed pricing, combined with internal continuity and knowledge of the client and industry, is at the core of the relationship.

- Put the emphasis on expertise and outcomes. Provide ongoing education of both law firm and in-house counsel as to what is taking place:
  - For the client.
  - In the industry.
  - In substantive areas.

- Emphasize proactive client education and other preventive law techniques.

In The End, There Is No Single Right Way To Do It

- Pick one of several approaches that meets the needs of your organization.

- Then, do it well.

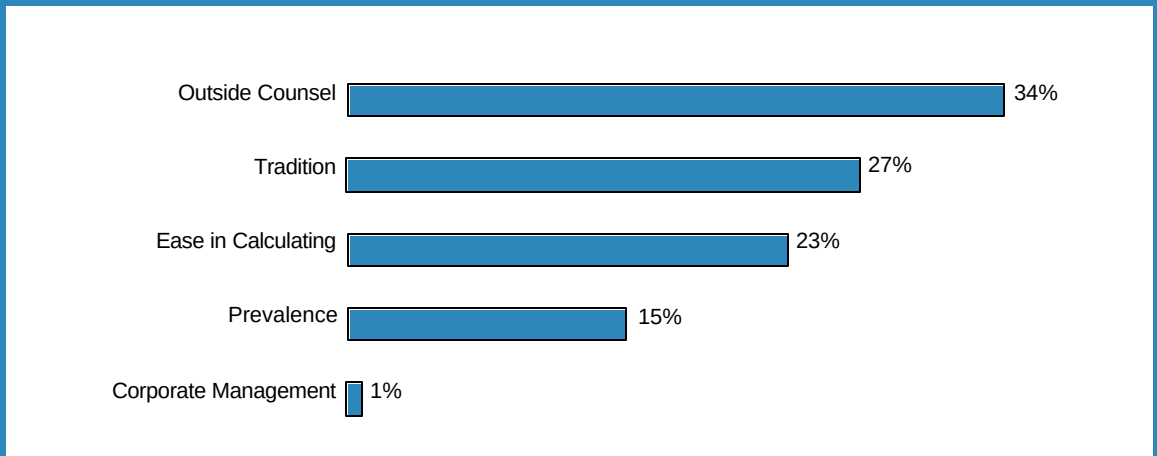
- Be ready to identify problems and be ready with solutions, including a willingness to start all over again!

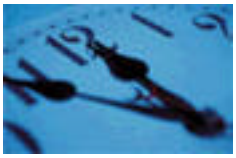
From: Commission In-House Questionnaire
Re: Impact of Accepting Alternative Billing from Outside Counsel

Q: What discourages you or your outside counsel from entering into retention arrangements based on something other than hourly rates?

This chart shows the distribution in answers for five possible hindrances. The biggest obstacle is outside counsel. The next most common obstacle was tradition, cited by 27 percent of the respondents, followed closely by the complexities of calculating an alternative method of billing. No internal management forces guard the way. The final point, prevalence, probably indicates sheer familiarity with hourly billing.

Factors Discouraging Retention Arrangements Based on a Method Other than Hourly Rates





Alternative Based Fee Budget Models

One challenge law firms face when encouraging partners to consider revenue generation on a basis other than hourly rate is the firm revenue budget. Generally, these budgets are developed on predictable hours and rates because they focus on the known abundance of billable hours, thus bearing little relationship to client demands or value of services rendered.

Billable-hour-driven budgeting also means that the firm's profitability is limited by what they can achieve with the profitability levers. The revenue equation is driven by the combination of rates, hours and realization. There are market limits on the rates, physical limits on the hours and, in a billable hour driven billing environment, practical limits on realization. Individual attorneys also feel the negative effects. Facing pressure to increase hours and/or increase effective rates, their "contribution" is generally measured by the number of their billable hours. Their "productivity" is equated to performance against the firm's standard for hours, with little attention paid to their actual generated revenue or value to clients.

If a firm is truly to encourage movement away from billable hours as a means of fee generation, the firm must also move away from billable hours as the primary measure of individual performance.

Alternative Revenue Budgeting Approaches

There are many alternatives to the billable hour, including hybrids, that law firms can utilize to accommodate and encourage revenue generation. Below are three general budgeting approaches in brief, followed by a fuller description and example of each. Firms should tailor these approaches to meet their unique needs. Note that in larger firms, implementation is often most successful when decided at the practice group level and taken up by the group to the firm level.

(1) Approach 1: Line Item Budgeting
Expand revenue budget to include revenue generated from alternative billing arrangements, by client, by practice, and/or by product.

(2) Approach 2: Individual Revenue Targets
Develop revenue targets for each lawyer (based on personal effort). Measure against achievement of target rather than billable hours logged.

(3) Approach 3: Profit Margin
Build up from the firm's expense structure (including a "salary" number for partners) and then determine the desired profit margin for the firm. The result is the required revenue, which must then be tested against demand.

This method requires expanding the firm's revenue budget to specifically include revenue generated from alternative billing arrangements, by client, by practice, and/or by product. This approach serves to focus the firm on the types of revenue sources and fee arrangements it has, and helps measure the firm's success in expanding these alternative revenue sources over time. Interestingly, many firms can only roughly estimate fee percentages charged on a basis other than hourly rate because revenue tracking is driven by billable hours.

First, identify the categories of fees that make sense for your firm, and use these as the basis for your firm's revenue budget. Examples include:

- **Retainers and special fee arrangements** – some firms have annual fee agreements with certain clients. These are easily identified and included as a separate line item in the revenue budget.

- **Product revenue** – this includes revenue generated from flat fee services. For example, an IP firm that charges a flat fee for certain aspects of patent or trademark prosecution services can estimate the number of these services that will be provided times the price per services. Firms that are creating web-based services by subscription could also estimate revenues for these products.

- **Ongoing matters** – in most firms an often-significant portion of the revenue comes from clients for whom the firm provides regular services. Estimates can be made of the expected revenues from these clients or matters even if they are billed on an hourly rate basis.

- **Billable hour services** – revenue generated by traditional billable hour services, based on projected demand for these services.

The firm must then estimate the resources required to provide these services. This can be tricky as you do not want to simply back into billable hours. One alternative is to estimate full time equivalents (FTE). For example, you may know that in order to provide a certain set of products it will require .5 of a partner, 2 associates and 2 paralegals. This can be built up to determine the overall resources required to generate the projected revenue budget.

It can also be useful to cross check the revenue budget against the firm's supply of services. This requires doing a traditional hours-based budget and comparing that to the projected demand for services. The "supply budget" less the "demand budget," if a deficit, indicates the amount of work that will need to be generated to create the supply for the expected number of lawyers. If it is in excess of the supply budget, it indicates a need for additional resources.

Expenses are then budgeted in the traditional way, but should factor in plans to align "supply" and "demand."

Approach 1: Example
Line Item Budgeting Model

Revenue		
Retainers and special fee arrangements	2,000,000	
Products	1,000,000	
Client specific	3,500,000	
Billable hour services	7,000,000	
Total Revenue		13,500,000
Expenses		
Associate Salaries	2,700,000	
Staff Salaries	1,200,000	
Other Compensation Expenses	400,000	
Operating expenses	4,400,000	
Total Expenses		8,700,000
Profit		4,800,000
Profit per Partner (10 partners)		**480,000**

This method requires the development of revenue targets for each lawyer/timekeeper. These revenue targets will vary by person. Development of the revenue targets are based on a combination of hours-driven revenue and a timekeeper's participation in work on a basis other than hourly rate.

For some timekeepers, the revenue budget will be based largely on their billable hour efforts if the nature of their practice is billable hour driven. For other timekeepers, who are involved in fixed fee or other alternate fee projects, there may be no billable hour component to their revenue target. For example, if the firm has a fixed fee project of $800,000 for the budget period that will require .5 of a partner, 2 associates and 1 paralegal, each person involved would be allocated a portion of the $800,000 as their target, or a portion of their target. As the revenue is received it is allocated to those timekeepers in proportion to their contribution. In this approach, monthly utilization reports would be based on achievement of revenue targets rather than billable hours.

There are many benefits to this approach. First, it accommodates a mix of fee arrangements and does not penalize people who are efficient on fixed fee projects (and who may generate equal revenue with less effort than someone billing on an hours basis). Second, it de-emphasizes billable hours as the primary measure of performance. Third, it gets lawyers more invested in the management of the matters. Because the measurement is related to fee collection rather than only hours (the "realization rate"), lawyers on the matter will be more involved in managing the matter effectively, such as reducing write-offs and billing and collecting on a timely basis. Fourth, it encourages people to think about pricing. If the target is $500,000, a timekeeper can get there in any number of ways and with various levels of effort. The mix is, to some degree, up to the lawyer.

Approach 2: Example
Individual Revenue Targets Budgeting Model

Partners	**Targets**	**Total**
Partner 1-3	725,000	2,175,000
Partner 4-5	675,000	1,350,000
Partner 6-8	625,000	1,875,000
Partner 9-10	550,000	1,100,000
Associates		
Associate 1-3	425,000	1,275,000
Associate 4-6	400,000	1,200,000
Associate 7-9	350,000	1,050,000
Associate 10-12	325,000	975,000
Associate 13-15	300,000	900,000
Associate 16-18	250,000	750,000
Paralegals and Other Revenue Generators		
Paralegal 1-3	150,000	450,000
Paralegal 4-6	120,000	360,000

Total Revenue	13,460,000
Associate Salaries	2,700,000
Staff Salaries	1,200,000
Other Compensation Expenses	400,000
Operating Expenses	4,400,000
Total Expenses	8,700,000
Profit	4,760,000
Profit per Partner (10 partners)	**476,000**

Approach 3: Profit Margin

Build up from the firm's expense structure (including a "salary" number for partners) and then determine the desired profit margin for the firm. The result is the required revenue, which must then be tested against demand for services. Once the firm has set the required revenue, the practice groups can determine how they will generate that revenue. Obviously this will be an iterative process as both the required revenue and demand estimates need to be aligned. This methodology is also very effective at the practice or client/matter level.

A key concept in this methodology is separating the salary component of a partner's overall compensation with the return on, or profit on, the business. The salary component can be a controversial figure. The "notional salary" is generally a fixed number below the average earnings per partner. Some firms set 2 or 3 notional salary levels that are aligned with compensation levels.

To some extent this methodology needs to be combined with aspects of the first two approaches to balance the external demands with internal profitability goals.

Approach 3: Example
Profit Margin Revenue Budgeting Model

Expenses		
Partner Salaries	2,500,000	
100 partners at $250,000		
Associate Salaries	2,700,000	
Staff Salaries	1,200,000	
Other Compensation		
Expenses	400,000	
Operating expenses	4,400,000	
Total Expenses		11,200,000
Profit Margin		4,800,000
Based on 20%		
Profit		
Partner Salary	2,500,000	
Profit Margin	2,240,000	
Total Profit		4,740,000
Profit per Partner (10 partners)		**474,000**

From: Commission Web Board
Re: Reasons to Use Alternatives

One Web Board respondent recommended transitioning to *realization on rates* for a number of reasons. He said, "That change in emphasis has made a huge difference in the law firms I work with because they are focused on effectiveness and efficiency, not logging hours. With effectiveness and efficiency the quality of life is better and more time may be contributed to pro bono efforts of the bar."

ALTERNATIVE SNAPSHOT #1

On-line bidding service focused on flat fee billing arrangements

eLawForum, like other on-line legal service bidding vehicles, helps companies outsource significant parts of their legal budgets to selected outside counsel. However, as of early-2002, its leadership added a twist—bids must be based on a flat fee (non-hourly) basis.

"We have decided, based on our experiences from early 2000, that the way this thing has to work is to get completely off the hourly rate. We are no longer accepting assignments of hourly rates." David Roll, a director of eLawForum, explained.

The company now focuses on bringing together clients and attorneys that agree to flat fees or some variant. Roll said eLawForum "experimented with all kinds of fee arrangements, but concluded early in the year [February 2002] that efficiency and savings [for companies come from] a flat-fee basis, and that law firms should accept some of the risk." As for the success of limiting business to those willing to bid for alternative-only fee arrangements, "Only time will tell. I can't believe you will get anything but quality work." Thus far, Roll says the results have been "amazing."

Pricing for Services

eLawForum's own fee structure also has changed. In the past, it was based on two percent of the contract deal per match. Now, fees are based on a percentage of the savings a company (client) realizes. Clients assess how much a legal service has cost them in the past, and they put out a bid. eLawForum takes a percentage of the savings below the estimated cost.

Bidder Origins

eLawForum focuses on attracting individual attorneys. "Litigators in [a particular] area believe they can do it faster and better than anyone else, and they are willing to take the risk." Bidders generally go to the management of their firms and persuade them that they should assume the risk, and take that chance.

eLawForum draws bidders from its database and input from the company interested in participating; however, the company selects the bidders. Lawyers and law firms can register with eLawForum as potential bidders, and are then added to the

Motivating companies to request alternative billing arrangements from outside counsel

"When we talk to a company we say, 'Look, every other department in the company is using competition to acquire goods and services. Most departments solicit bids before deciding where to get their services, and the process is highly competitive. There is no reason why legal services cannot also be bought using competitive principles. There is no reason why lawyers and legal services cannot be purchased on a flat fee basis. Why allow law firms to put all the risk on you?'"

¾ David Roll, eLawForum Director

company's database. The company also draws information from candidates from their prior submitted bids.

The Bidding Process

According to the eLawForum website, www.elawforum.com, companies (clients) post a request for proposal (RFP) on-line. "The RFP describes the legal work and expertise the client is seeking from the law firm," it explains. Only law firms selected by the company are invited to respond to the RFP. The firms can be incumbent or non-incumbent, but they must register with eLawForum to participate. Generally, Roll says, between 15 and 20 firms are invited to bid on a deal.

Participating companies are not required to take the lowest bid, but eLawForum has one basic requirement: after the bidding starts, parties cannot go outside the bidding process. "Companies and law firms that sign up to use us are required to follow our bidding rules," Roll said. "This requirement is a tough one, because the exchange of information during the bidding process is comprehensive, and the parties sometimes try to deal with each other outside the eLawForum process."

Obstacles

There is also an acceptance curve for alternative fee schedules. Although 62 percent of CLOs are not satisfied with the value of the services they are getting from their outside counsel,[1] and are, according to Roll, thus open to trying new things, "Some companies still resist going off the hourly rate."

About eLawForum

Although as of July, 2002, there were 1,464 registered law firms (including 75% of the AmLaw 100 and NLJ 250) representing every state and continent, as well as 176 corporations registered, eLawForum focuses more on the number of competitions it runs, which, as of July, 2002, exceeded 80.

As the company evolves, however, the number of deals per month will decrease because the stakes are higher. "Early on, we were running small deals on an hourly rate basis," Roll said. Now, "we have higher end, bigger deals, packaging lots of legal work together, and aggregating demand."

[1] American Corporate Counsel Association (ACCA) and Altman Weil, Inc., *2nd Annual Chief Legal Officer Survey: The Opinions of Chief Legal Officers on Issues of Importance (2001).*

Benefits of Using On-line Legal Fee Bidding Services Requiring Alternative Fee Arrangements

To Companies
The average price paid after an eLawForum bidding session is 30% less than the same legal work solicited by traditional means, according to Roll. The service helps corporate clients manage corporate legal costs. It is a vehicle to bring up alternative fee arrangements with existing law firms. It allows them to share the risk with the firms.

To Firms
The winning law firm has the satisfaction of knowing it has a fixed revenue from the project. The firm can focus on efficiency instead of the clock.

To the Legal Profession
eLawForum's effort will lead firms to shift their focus, from number of hours billed to quality of work product. "Firm associates ought to be evaluated on their efficiency and effectiveness in solving problems and getting rid of cases," expressed Roll, former chair and managing partner of Steptoe & Johnson.

ALTERNATIVE SNAPSHOT #2

How one general counsel changed legal billing protocol

Nationwide Insurance, a large Columbus, Ohio based insurance company recently employed eLawForum to facilitate the bidding process for a three-year, flat-fee arrangement to manage a set of its cases. Nationwide, ranked 136 on the Fortune 500 list, solicited proposals to manage these cases for a set amount of dollars on an annual basis. The several-million-dollar fee will cover everything affiliated with the matters, including travel and expert fees.

"This is not peanuts; this is a big deal," said David Roll, a member of eLawForum's Board of Directors, noting that some AmLaw 100 firms were among those that participated. "It was an astonishingly successful bidding process."

Pat Hatler, Nationwide's General Counsel, said the organization sought alternative fee based arrangements because, "we wanted to manage the cost, and build an ongoing relationship with someone that could manage the caseload."

Idea Evolution

The idea evolved from "Right Place, Right Time" syndrome. "eLawForum had given us a sales pitch some months ago, and I had been thinking for some time about which matters we could consider," Hatler explained. "Suddenly, the lightbulb went on."

Such an arrangement "allows for some certainty for the law firms, as well as for ourselves," Hatler explained. Additionally, "For the right kind of work, it really is helpful to think about the work as a block of work," Hatler described.

Despite these benefits, Hatler explained that the feat "is easy to say and hard to do." As with all cases, there remains ambiguity—some settle, and some go to trial. Related cases may crop up. And there were fears to overcome within the company.

Overcoming the Fear of Change

One fear Hatler anticipated was that some leaders at the insurance company would be nervous about the possibility of switching law firms. "Some people were less concerned about managing the money, but more about making the change." Luckily, she said, it was less of an issue than anticipated, which may be in part due to Hatler's personal experience and the research done by the 90-person general counsel's office.

Hatler herself has multiple successful agreements under her belt: She has used such arrangements for immigration, employee dispute work, and insurance claims cases. Specifically, she has worked on flat fee per matter agreements, which entail exclusive rights to all work in a particular area (high volume, relatively small cases); discount agreements; and agreements with built in contingencies for positive outcomes.

The general counsel's office did a lot of investigating throughout the process-including on whether or not to use a facilitator for the process.

Considering Forums

Initially, "We were thinking about doing this apart from eLawForum," Hatler explained, for it is possible without an online forum. However, gathering information from interested firms while trying to manage a legal process is a lot to be responsible for. She explained, "It is a substantial undertaking. There's a real value in having someone do that for you," particularly someone else that knows the procedure.

Therefore, Nationwide tested out eLawForum by using it to bid out two smaller matters. The bidding processes ran well in both instances, and the company decided to go ahead and consider the provider for the bigger deal.

Pre Bidding Process

As for preparing and engaging in the bidding process, "It required some real effort," Hatler said. Before starting the bidding process, Hatler's team of 90 in-house attorneys spent a fair amount of time looking into the cases. Granted, she said, the time was well spent.

She wanted to ensure the risk was shared well with the firm selected. "We didn't want to have a winner and a loser," she said. Her research assured her company and bidding firms that changes in volume and development of the cases wouldn't create a hardship on either side.

Thus, she attributes her good feelings toward the process to the fact that it increased the company's understanding of the matters and considered multiple approaches. Participating in a bidding process "Made us think about the strategic approach we wanted to bring to these cases, she said. "We had to really understand the nature of these cases and to think about them in a different way."

Pros and Cons

The department also considered the drawbacks of an alternative billing arrangement before taking the plunge into a large alternative fee arrangement.

"Our primary concern was that we not sacrifice quality for fee management," she explained. "Therefore, we were fairly careful about the firms we were willing to talk to about the project."

Firm Selection

Hatler and her team brainstormed appropriate criteria for the firms, which included:

- Experience in the subject matter
- Experience in class actions
- Capacity to manage the size and number of cases
- Capacity to handle local counsel relationships
- Experience in similar relationships

Of those firms ultimately agreeing to participate, Hatler was pleased to discover that two had significant experience in such alternative fee-based arrangements.

Bidder Profiles

Next, Nationwide and eLawForum worked to find out which of the firms meeting this criteria would be interested in participating. "There were a few very large national firms that weren't willing to participate. We expected that," Hatler explained. However, there were also "a few fairly large firms we use that we though wouldn't participate, but did."

Nationwide ultimately met with four finalist firms, and Hatler noted, "Most of the firms we talked to, we had some relationship with, and some sort of discount relationship."

Information Sharing

Another area Hatler's department worked on was finding a balance between sanitizing information for confidentiality and giving enough for firms to get a clear picture of what the deal would entail.

"One concern was that nobody got unfair access to confidential matters," Hatler said. "We didn't want to disclose more information than would be appropriate, but we obviously needed [to pass along] enough to let them know what they were getting into."

The Process

Next, the company solicited proposals from firms. The proposals had to include:

- Their proposal for annual flat fee
- Their proposal for what to do about volume fluctuations.

The second requirement was primarily a safeguard. "We want to make adjustments if fluctuations occur," Hatler said.

Overall, "This was a neat exercise," Hatler said. She thought it was interesting to set out the parameters, and have the firms participate in some of the problem solving.

Selecting a Firm

As applications rolled in, eLawForum sent to the company the full application and a synthesized version for the company's general counsel office to analyze the responses. Although the company had the full set of responses and could refer to them, Hatler commented, "It was helpful to have someone like eLawForum synthesize the information."

Results

After a few weeks of information sharing, Nationwide received bids from a number of firms. At the time, Roll quipped, "If they accept [the] lower end of the bids, [the savings] will be dramatic."

For Hatler the results were "quite interesting." Flat fee proposals, she explained, "ranged quite dramatically in cost." Although at times, billable hours may be the right way to provide legal services, "My take away from all of this is that the hourly rate can impede the law firms from the most efficient way of delivering their service."

As to the solutions for case fluctuation, "We received good insight from the small group of law firms," Hatler said. "The range of responses we got emphasized to me that firms really do think about and manage their firms differently."

Aftermath

Nationwide announced a match in June, 2002 and began the three-year relationship on July 1, 2002.

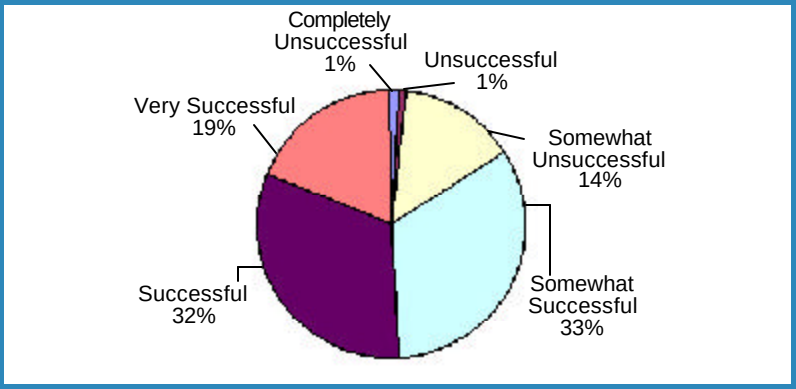
As for considering alternative billing for legal services arrangements in the future, Hatler says, "I absolutely would." And as for the input from the insurance company's leaders, as well as its selected outside counsel, "They're thrilled with what we've come up with." Rumored a hero by company management, Hatler cannot help but be pleased with the start of the new relationship.

Regardless, however, of how constructive this arrangement is, she cautions, it is "an experiment nonetheless."

"This is sort of like I've designed the rocket to get to the moon, [so] let's see if it gets the to the moon," she describes. "The interview that will matter is the interview at the end of the three years."

From: Commission In-House Questionnaire
Re: Success of Alternative Arrangements

The Commission asked in-house attorneys, "If your group has allowed billing on a basis other than hourly rates, rate the success of these other billing methods." The results are a mixed bag, in that at least half of the respondents found no or modest success. More precisely, one third of respondents said that those arrangements were "somewhat successful." On the other hand, more than 40 percent saw their efforts as either successful or very successful.



ALTERNATIVE SNAPSHOT #3

Firm thrives on alternative fee arrangements

Bartlit Beck Herman Palenchar & Scott, a boutique litigation firm based in Chicago, is no stranger to alternative fee arrangements. In fact, abandoning attorney reliance on the billable hour has been a central theme since the firm's inception eight years ago.

"When Fred Bartlit, Phil Beck, Skip Herman, and the other founding partners [of this firm] were thinking of leaving [a mega firm], one of the founding principles was that the new firm would provide better service through alternative fees," said partner Jason L. Peltz, who joined the firm two years after it was created.

The concept was foremost in their minds because such arrangements were not only novel in the legal services industry, but also because of the opportunity the new system would provide for clients.

"We felt that through inexperience people have become complacent," Peltz said. "The problem with hourly billing is that the lawyers get paid the same whether they win or lose. We thought that was a problem from the clients' perspective. The only way lawyers made more money was to bill more hours, as opposed to doing a better job. When the incentives are changed, so does the makeup of the work, and we believe so does the product for the client."

Despite the theory that such a practice is better for the client, it took many conversations with clients to get them to agree to alternative billing arrangements. "Slowly but surely, we got clients to go towards alternative fees," Peltz said. Today, the firm bills close to 90 percent of its clientele on an alternative fee basis.

"Generally, we try to have every case in the office billed on an alternative fee arrangement," explained Peltz. "We insist on it, quite frankly. But typically the client comes to us because of our reputation, not because of our alternative billing arrangements."

Client Acceptance for Budgeting Purposes

"Largely we've found that because of budgeting [needs], clients embrace it."

Generally, budgeting is one of the hardest things for general counsel to do, because firms bill by the hour. "All of a sudden, with a flat fee, they know what [the costs are] going to be every month, to the penny," Peltz said. "We've found that after a client does it in one case, they embrace it. They love it because they are able to budget."

Furthermore, "They've also enjoyed the openness and knowing they're not on the clock—there's no worry about sending an email or calling. They realize you're there for them to win the case, and it relives all those billing pressures."

The way the firm has edged its clients into such an arrangement is by talking it thorough with them. For a client new to such an arrangement, they may follow up, with a piece of correspondence highlighting the method.

Interestingly, the primary holdouts are not the firms newest clients, but "almost exclusively some of our original clients that we have worked with for decades," Peltz explained. Clients shy away from non-billable based fees primarily when "their fees are picked up by their insurance companies, as insurance companies have not yet embraced the alternative fee arrangement."

Communicate to Build Trust

The main obstacle in getting clients to agree to such arrangements is getting them to trust you, Peltz observed. "There is this enormous trust barrier the client needs to get over," Peltz said. "They have to take the initial step of trust."

Bartlit Beck has helped clients overcome their trust barrier by communicating with them—a lot.

"Starting with day one, we make it our job to make them feel comfortable with constant communication," Peltz explained. Bartlit Beck maintains a transparent office to ensure that.

"The only way clients understand what's going on is by having a transparent office," Peltz said, "because they can see the work being done, so they never question for a moment the resources that we're devoting."

Furthermore, clients love to hear the day-to-day progression and see the brainstorming stages, Peltz said. "We show them work product every single day. We copy them on every email, even internal ones."

Fee Structure

The payment arrangement between most clients and Bartlit Beck is a flat, monthly fee plus a success bonus.

"With a fixed fee, we find we have an incentive to staff the case with experienced lawyers, [who can] do the work better and faster [than inexperienced ones]," Skip Herman, managing partner at Bartlit Beck, noted. "In an hourly environment, there is an incentive to have more inexperienced lawyers on the team. Thus, in addition to its other attributes, the approach of a fixed fee with a bonus for success results in higher quality being delivered to the client as a result of having the more experienced team."

The monthly fee fluctuates, depending on the stage of the litigation. Thus, the most expensive fees are billed for trial months, followed by fees for the discovery stage, and then briefing/appellate issues.

"The fee is determined using as a proxy the amount of time we and the client think it may necessitate," Peltz said.

At Bartlit Beck, the managing partner approves all fee arrangements and amounts, but that doesn't preclude anyone, including the most junior associate, from having input.

"We like everyone in the firm to have experience in pricing cases," Peltz said. "We like to have every associate involved in that on his or her cases. We believe it's an important experience for them to see the business side of it, and to see the firm's and the client's thinking. Otherwise, they may forget to send

Advice to firms trying to move their clients toward alternative billing arrangements

1. Start slowly.
"Try [alternative fee arrangements] out with one or two matters so your lawyers can get accustomed to developing client trust," advises Peltz. Although "it's liberating once it's your routine, it's new and uncomfortable when you are starting out." The hardest part is getting over your fear of having your clients see everything you are doing before it is perfected. "It's uncomfortable to copy a client on an email where you haven't dotted every 'I' and crossed every 'T'," Peltz explains, not to mention the fear you may have that your idea might ultimately be rejected. "You really have to view the work as a work in progress—and lawyers are not accustomed to that." Over time, transparency takes the pressure off, he explains.

2. Remind clients regularly of relationship terms.
Just as lawyers are accustomed to sending out information to clients in final form, so are clients accustomed to getting everything from legal counsel in final form. In an alternative-based relationship however, "They are paying to be involved in the process," Peltz explains. "You have to reinforce that the work product a client will receive along the way is not in final form."

3. Explain to clients that your incentives are aligned.
At the beginning, clients may not be accustomed to the new arrangement and may be taken aback by the monthly invoice that does not reflect hours. "The key is to have sufficiently communicated with the client over the course of the month so that they never even question your dedication to their case," Peltz explains. "Also, it sometimes bears reminding clients that the firm's incentives are now aligned with the client's – on winning."

those emails and otherwise communicate with the client day to day."

Internal Operations

The alternative billing arrangements have an impact on quality of life at the firm as well.

"We do track our time, but not exactly with the same sort of diligence and accuracy as if we were doing it for billables. We do it to help more accurately price the next case. " Not focusing on hours has been a plus for firm attorneys. "It has increased morale because now you have people focused on results and not concerned at all about hours. Hours are irrelevant to a lawyers performance at our firm," Peltz said. "Instead, first and foremost, 'Is the client happy?' We look to our clients to help us appraise our lawyers. We also look to other people on the team, and results."

Focus on Efficiency

Also, the firm considers efficiency. "For us, it's a big, big factor," Peltz said. "Under our system, we can't afford to be inefficient. If someone is spending an inordinate amount of time on things, the firm's resources are going to be drained. [A case is] not priced to have someone inefficiently involved in it. All cases are priced [with the thought] that lawyers are going to be the most efficient around."

Furthermore, "We can provide [clients] with better service by doing the work that matters the most and not doing the work we don't think is going to lead anywhere," Peltz explained.

"[You'd] never find a case where we're putting a lot of people on to research every obscure issue," Peltz said. As for document review, the firm will focus on the documents most likely to glean important information—bee lining to summary statements, as opposed to cancelled checks.

"What that has done is allowed us to step back and say. 'Okay what are the key depositions we need to take in this case?'" Peltz described. "Whether there's 3 or 30, we'll take the ones that we believe substantively need to be taken. It's on our dime, and we have to win for the client to maintain that relationship, and quite frankly we have to win if we want to be made whole, if we want to make money."

Technology

Bartlit Beck attributes its success to some outside forces. "Because efficiency is a factor, we need great technology and top-notch people to be able to pull it off," Peltz explains.

"High use and focus on technology allows us to enter into attractive arrangements with clients," Peltz said. Attorneys review documents electronically, and make notes right into the database.

Also, the firm has also abandoned some traditional practices. "We don't write any legal memos," Peltz said. "We just don't do memos, and that's a concept completely foreign to most other firms. "

Instead, associates jump right to the actual motions. "Why have the extra step in there?" Peltz questions.

When a client asks them a question about the law, the firm will send the client a brief email which states whether the general answer is yes or no and a few reasons why that is the answer. Complete with related cases attached. Clients are welcome to call if they want to further discuss the research.

Skipping the waves of research memos to jump into the motion is yet another reason their associates have a well-rounded view of the practice.

"Our people are not writing memos. Instead, they are making substantive contributions, or writing the final product," Peltz said. "There is no pressure to have a lot of our people put in a lot of time doing document review. If they are doing that, we're losing money. Instead the pressures are to have people, as early as they are capable, to do the most substantive work in the case."

"A lot of our training is through having the experience," Peltz said. "People are thrown into it early on. In terms of training, it's on the job training with another one of our lawyers."

Bartlit Beck associates have a lot of training. "Typically, they are getting as much experience here as they can handle," Peltz said.

For example, Bartlit Beck associates are not making deposition binders, they are taking depositions. For

their first few depositions, more experienced lawyers are at their side, literally or via technology (real time web casting), making comments as they go.

Pro Bono

Bartlit Beck, which was recognized in 2000 by the Chicago Lawyers' Committee for Civil Rights Under Law for its pro bono performance, does not mandate attorneys to take part in such work. "Here people do pro bono typically because they really want to help, not because they need more experience," Peltz said. The firm encourages pro bono by making it clear that each lawyer typically may spend as much time on pro bono matters as he or she deems professionally reasonable.

CLE

As for CLE and outside training "Sky's the limit," Peltz described. "It's up to our people to find the [programs] they are interested in." The firm has no policy per se.

As for the future of the alternative billing arrangement at Bartlit Beck and beyond, "It is a new way of practicing law that places incentives where they ought to be – on winning," Peltz said.

From: Commission In-House Questionnaire
Re: Alternative Acceptance: Effective Pressure for Companies and Receptivity of Law Firms

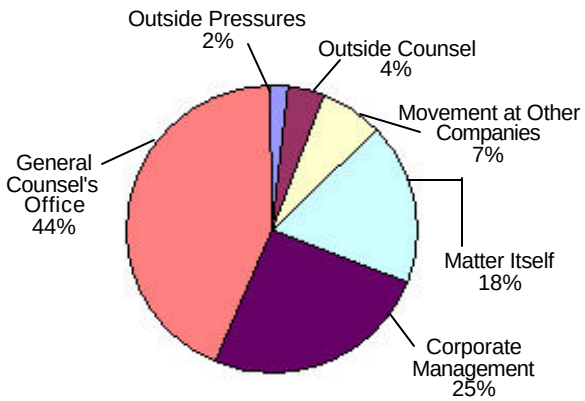
Many forces are accountable for moving companies toward alternative fee arrangements. However, the Commission inquired of in-house counsel, "Where did/would the most effective pressure come from to move your department to accept a billing system based on something other than hourly rates?"

The chart below, derived from their responses, shows that the most effective pressure comes from their own office and then from corporate manage-ment. Only four percent believe the urging of outside counsel is the most effective means.

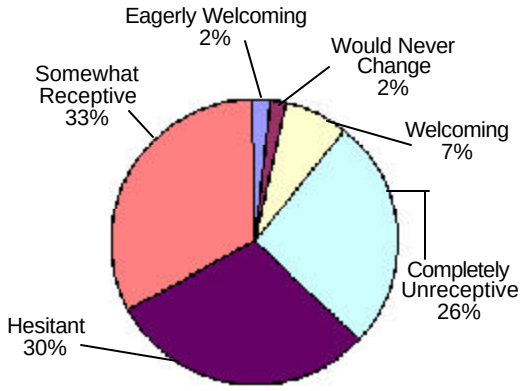
The Commission also asked in-house attorneys how receptive they believed their outside counsel is to billing on a basis other than hourly. A quarter of the respondents viewed their law firms as "completely unreceptive," or so set in their ways that they "would never change." Another third responded that the firms they retain would be "somewhat receptive," and the same percentage viewed their law firms as "hesitant."

Thus, law departments believed their law firms have a strong resistance to or reluctance to try alternatives to hourly billing.

Source of Most Effective Pressure to Accept Billing Alternatives

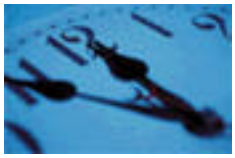


Receptivity of Outside Counsel to Billing Alternatives



PART THREE

WORKING WITHIN THE BILLABLE HOUR SYSTEM



INTRODUCTION

One issue the Commission faces is that the billable hour system has survived, notwithstanding the problems it engenders. This Chapter discusses how to better structure the billable environment so as to make living "within the billable hour" more palatable. From suggesting best practices and training tips, as well as a model policy, this Chapter addresses issues stemming from hourly billing.

Setting Hourly Requirements

The most serious current problem associated with the billable hour is that most lawyers think that there are too many of them. At the same time, pressures to generate more revenue continue to increase. The generous salaries paid to new associates by law firms, especially large firms, as well as other rising costs, create incentives to raise the number of hours that associates (and partners) are required or urged to bill.

Rising billable hour requirements can only serve to increase the growing number of complaints about burnout and about dissatisfaction with the practice of law. Our Commission has taken a critical look at the lives of associates within large firms to determine ways to respond to the current unhappiness.

From: Commission AmLaw 100 and Firm Questionnaires
Re: By the Numbers

22: number of the 570 law firm respondents that do not have a minimum hour requirement.

7: number of the 19 AmLaw 100 respondents that do not have a minimum hour requirement.

At the more general level, one issue is whether a minimum billable hour requirement is a good idea. Several problems are associated with mandatory hourly minimums. Some argue that minimum requirements, especially when they are hard to attain, shift the focus of the new lawyer's work from doing the job and deriving satisfaction from that endeavor to a preoccupation, even an obsession, with logging the number of hours required for retention, promotion, and bonuses.

Moreover, putting the responsibility upon the associate to find or create enough work to satisfy the requirement subtly shifts the burden of deciding what work is necessary and appropriate from the supervising partners or senior associates to the most inexperienced lawyers in the firm. In a perfect world, everyone would have enough work, to meet their goals and everyone would also bill the required hours appropriately. But in the real world, with required hours, many associates recognize that they must do whatever is necessary to satisfy the hourly requirement.

Further, the combination of required hourly minimums and the shift of responsibility can lead to questionable billing practices, ranging from logging hours for doing unnecessary research to outright padding of hours. These are not imaginary fears; researchers report numerous instances of overbilling, many involving exaggerated hourly entries.[1]

The problems noted above have led some firms to resist setting hourly minimums for associates. These firms rely on administrative oversight to equalize work among associates, and report that their systems increase morale among associates, and that the policies also serve as an assurance to clients that their lawyers have no incentives to do useless work or to pad hours. In these firms, the theory goes, with no minimum hourly requirements,

[1] See Rhode, Deborah, In the Interests of Justice, Oxford Press, pp. 168-183 (2001) for a sketch of some current abuses.

excess billing by associates is curtailed by self-restraint, as there are fewer rewards for overbilling.

Many, perhaps most, firms continue to believe in minimum hourly requirements. In support of this approach, some offer the view that associates should bear the responsibility for arranging their work lives by making sure that they are available for work whenever they have time on their hands. Minimums are one way to do this. Minimums may also function to equalize hours among associates. Where there are no minimums, the most favored associates could receive the heaviest assignments, resulting in uneven workload. Further, economic reasons support this approach. If all of the associates are meeting their requirements, billings are at an optimum level. In this scenario, if an associate overbills for whatever reason, billing partners can eliminate excess hours before bills are sent. Thus, the theory in support of minimum requirements is that problems generated by the billable hour system can be caught and corrected before bills are sent.[2]

Training and Padding

A second topic of interest is the degree to which formal training on billing practices exists and if so, whether it results in lower amounts of overbilling. Seventy-nine percent of the responding AmLaw 100 firms reported conducting some training for associates in billing and keeping time, but this formal training was largely confined to associate orientation. Furthermore, there are some new associates that have received no formal instruction in billing except information on the minimum part of the hour (one-tenth, one sixth, one quarter, etc.) to log on their billing sheets, instruction on their minimum hourly requirements for retention and bonuses, and whether pro bono or other hours get credited toward the hourly minimums.[3]

From: Commission AmLaw 100 Questionnaire
Re: Training

With few exceptions, formal training does not appear ongoing or extend beyond orientation.

Representative comments:

"As part of the orientation process, associates are shown a videotape which contains suggestions for accurate timekeeping. The video suggests keeping contemporaneous time records, timely submissions of time sheets, narrative requirements, etc."

"We have more problems with training associates to record and enter their time than with the quality of the time entry so we focus our efforts in that area, e.g. automatic email announcements for delinquent timesheets and automatic reductions in bonuses for sustained tardiness in submitting timesheets."

On the other hand, we are aware, for example, of the increased scrutiny by clients of firms' billing practices, of billing audits by outside consultants, and billing codes promulgated by some large corporations spelling out limits on research, on staffing, and on costs.

Varying Billable Requirements by Experience

A third interesting question is whether a billable hour requirement ought not to be varied depending on a lawyer's experience. For example, some argue that first year lawyers ought not to have a billable hour minimum applied. Others opine that when any new associate joins the firm, a period of time (say a year or two) should elapse before the minimums become mandatory. The advantages of such a course could be several: removing the pressure of minimums allows for activities such as training, pro bono work and mentoring to occur and to be taken seriously as part of a lawyer's life rather than to be seen and internalized as secondary to billing.

Calculating Bonuses

The topic of bonuses is a fourth arena of concern. Bonuses are the subject of much anecdotal comment, and it appears that there are drawbacks to whichever method of calculating bonuses is adopted. For example, lock step bonuses, given in equal amounts to every member of an associate class, may generate resentment toward those who have been perceived as underperformers either in value of work or in number of hours logged. Advantages might be that such a system could encourage team spirit and discourage competitive behavior. When bonuses are based upon hours logged, on the other hand, some worry about encouraging overbilling, and excessive competition among associates. Associates

[2] But this does impact the realization rate.

[3] Interviews with 25 new associates in large New York law firms, supervised by Professor Dennis Curtis, a Commission Member. Despite the small size of interviewees, only 3 or 4 reported receiving any formal training at all. The rest relied on peers to tell them about firm practices.

themselves may resent a firm for measuring the quality of work and value by hours rather than by content and quality.

Caring about Pro Bono

A fifth concern is how to encompass pro bono activities within the billable hour system. We have learned that pro bono activities have become harder for associates to do, given the recent increases in required hours. In addition, some firms add an hourly requirement for activities such as client development and firm administration. Within these and other constraints, how can firms both encourage and support pro bono work by their associates? Should pro bono hours be counted toward mandatory minimum billable hours? This would encourage pro bono work but reduce "real" billables. Should there be a limit on "countable" pro bono hours? Should pro bono hours be counted at less than 1:1 ratio toward mandatory minimums? Should pro bono hours be counted at all?

Using these issues as a guide, we will move forward to discuss relevant findings from our law firm questionnaire, AmLaw 100 outreach, and web board. Our purpose, in this chapter, is to show that if the billable hour system is structured appropriately, not only can an attorney survive in it, s/he may also thrive in it.

From: Commission AmLaw 100 Questionnaire
Re: Compensation and Bonuses (Associates and Partners)

Associates

A minority of firms in the sample determined pre-bonus associate compensation independently of the billable hours calculus. At most, base salary for associates is linked to hitting a threshold billable hours target. Bonuses for associates are most often tied to hitting certain billable hours targets above the base amount, generally 2000 to 2100 hours annually.

Of the responding firms:

79% use billable hours to determine associate base compensation.

84% use billable hours to determine associate bonuses.

32% offer a "merit" bonus, which is not determined by billable hours.

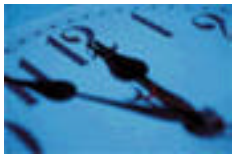
32% consider pro bono hours in determining associate salary and bonuses.

Nearly all firms responding to the survey indicated that they employ methods of evaluating associates in categories *in addition* to the amount of hours billed. Other factors commonly noted were quality of performance, business development, contribution to firm management/internal projects, and pro bono hours.

Partners

Most firms described billable hours as one of many components determining partner compensation, without specifying the relative weight of these additional components, which included:

Rainmaking 89%
Firm Management Contribution 89%
Practice Development 79%
Attorney Recruitment 74%
Civic/Community Activities, Pro Bono 42%



BEST PRACTICES

This section is designed to start a conversation and compilation, and is intended to be an evolving document. That is, it is intended to compile "best practices" ideas for avoiding some of the most damaging aspects of bill-able hour requirements, through both compensation and evaluation systems in law firms.

Best Practices in Associate and Partner Compensation and Evaluation to Avoid Some of the Most Damaging Aspects of Billable Hour Requirements

The Worst

We start with a "worst practice." Any compensation system that rigidly ties compensation to billable hours a worst practice, because it elevates hours over all, and creates an unavoidable incentive to record hours at all costs. The imperative of rewarding productivity — often measured in billable hours — is recognized, and we do not mean to ignore that imperative. But there must be flexibility and nuance in any system.

Thus a system that ties compensation — whether salary or bonus — directly to billable hours with no flexibility and no reflection, for example, of the quality of the work, is a "worst practice."

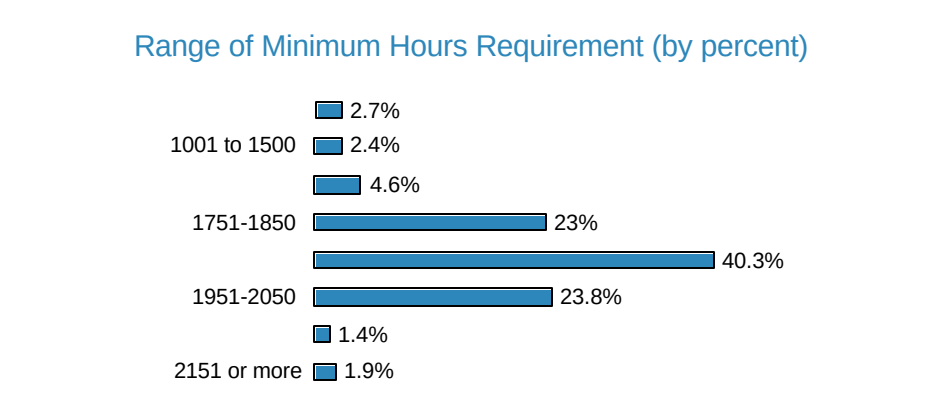
Weighted Productivity

One firm's effort to deal with this issue is the following: productivity is weighted as an important factor in salary and bonus determinations. However, it is always coupled with quality evaluation factors. Thus, an associate who records hours at level x qualifies for a salary increase or bonus. However, a matrix is used, factoring in the associate's overall numerical quality rating (on a 1-5 scale) as well. The result is that if an associate's quality rating is low, he or she can receive no increase or bonus, regardless of productivity level. Similarly, the amount of increase or bonus for those who qualify is tied not only to output — billable hours — but rating, so that an associate with a 4 rating and 2000 hours qualifies for increase or bonus X, while an associate with a 5 rating and 2000 hours qualifies for increase of bonus X + Y.

From: Commission AmLaw 100 and Law Firm Questionnaires
Re: Minimum Hours Requirement

The larger the firm, the more likely the minimum number of required billable hours fell on the high end of the range.

80% of the respondents' firms have a requirement between 1,750 and 2,050 hours.



Ceiling on hours

Another best practice, to discourage associates from simply compiling more hours for more money, is to place a ceiling on the number of hours, over which no additional compensation in salary or bonus will be paid regardless of how high the hours. This is important if the firm desires to provide incentives for the lawyer to "leave time" for pro bono and other non-billable activities, particularly if the compensation system is designed to provide rewards for those other activities as well. Simply put, the associate interested in maximizing compensation and bonus who knows there is a "limit" on how much bonus money he or she can earn through sheer hours can take his or her foot off the pedal at the ceiling limit — or, also focus his or her efforts on earning a "pro bono" bonus as well (see item 5 below).

Credit for Pro Bono

The problem of "credit" for pro bono hours counting toward billable hour requirements and salary determinations has received much attention. Among the many sound practices developed to deal with this issue are the following:

- Full credit for assigned pro bono hours toward minimum billable hour requirements.
- Full credit for assigned pro bono hours toward qualifying for salary increases or bonuses based on productivity.
- Credit for pro bono hours for the purposes described above up to certain levels, e.g., the Law Firm Pro Bono Challenge (©, The Pro Bono Institute) (up to 3% of billable time).

Bonus for Pro Bono

One firm has set up a separate bonus program for pro bono activities — that is, in addition to bonuses based largely on productivity (but also tied to quality ratings), this firm has a separate bonus program for excellence in pro bono activities.

Model Citizens

The same firm has a bonus program for Model Citizens, designed to reward distinguished service to the firm, with no regard to billable hours levels.

Focus on Quality

Regardless of the ameliorative measures chosen, an essential best practice is that the firm's compensation policy emphasize clearly the importance of quality work over quantity and the absolute requirement of integrity — including promptness — in recording hours.

From: Commission Web Board
Re: Quality of Life

Under the umbrella "Quality of Life," the Commission asked for input on how the billable hour impacts an attorney's life in the office and beyond.

One web board respondent questioned whether they selected the right profession. Another said those "fortunate" enough to enjoy the firm life feel "crunched by the billable hour quotas that tie them to their offices until ungodly hours each night, rob them of their weekends trying to finish up work at home, and severely strain most of their family/social relationships (except with other lawyers who can also relate to their situation)."

An in-house attorney added that it is no wonder associates leave firms regularly to try other practice arenas and/or leave the practice altogether. "Associates look at the partners who are billing the same as the associates and are expected to also do business development, mentoring, community service, etc. on top of that (for no credit) and say, 'why would I want to be a partner?' Since their quality of life becomes worse on making partner, most leave before they are eligible to be considered."

Another attorney pointed out that the highlight of his 50+-year career as a lawyer, "was to have practiced law when it was a profession and not a business."

From: Commission AmLaw 100 and Law Firm Questionnaires
Re: Creditable hours

Credits of Various Activities Against Firm Billable/Creditable Hour Requirements

Eighty nine percent of firms responding to the Commission's AmLaw 100 questionnaire allowed activities beyond chargeable client work to count toward annual creditable hours.

The law firm survey inquired as to whether respondents' firms permitted credit for activities beyond billables to be counted toward the number of billable/creditable hours. Not surprisingly, very few firms credit time spent on non-billable activity against billable hour requirements.

With the exception of time spent on pro bono activities, between 1 percent and 2 percent of the respondents' firms credited time spent on such activities against billable hours requirements. The following activities are ranked in order of percentage of respondents receiving no credit for the activity:

- Mentoring (72% said no credit given)[1]
- Bar association activities (60% said no credit given)
- CLE (59% said no credit given)
- In-firm training (59% said no credit given)
- Business development (53% said no credit given)
- Pro bono (37% said no credit given)

The Effect of Not Allowing Credit

In follow up, the Commission asked law firm questionnaire respondents whether their firms' approaches to billable hours had the effect of reducing their participation in:

- CLE
- Pro bono
- Mentoring
- Business development
- Bar association activities
- Leisure activities
- Outside interests

The responses indicate that 30 to 40 percent of lawyers practicing in firms with 16 or more lawyers believe that their firm's approach to billable hours completely or significantly reduced their participation in CLE, mentoring, and business development. The adverse impact is slightly higher for pro bono (indicating perhaps that lawyers would like a still more liberal approach to credit for time spent on pro bono) and bar activities, and even higher for leisure activities and outside interests (no surprise with respect to the latter two).

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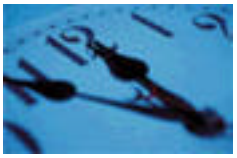
[1] One Commission Web Board respondent advocated credit for mentoring at the firms because without such credit, attorneys are discouraged from spending time and devoting attention to junior lawyers.



Model Law Firm Policy

The Commission has created a Model Firm Policy Regarding Billable Hours, which can be adapted to fit the needs of law firms across the country. For such a policy to be successfully implemented, firms must develop a concomitant training program for all their attorneys, and incorporate such training into an orientation program for attorneys who join the firm at a later date. This is yet another way firms can create a better environment as they continue to work within the billable hour.

One of the oft-expressed laments about the billable hours system — and, particularly, onerous billable hour requirements — is the fact that too heavy a billable hour load has the inevitable effect of crowding out other important non-billable activities of benefit to the lawyer's firm, the profession, and/or the community. The model policy outlined below recommends an appropriate mix of creditable hours, one that ensures a level of billable and non-billable activity to serve not only the interests of an acceptable level of productivity given the firm's reasonable profitability aspirations, but also other important objectives.

The Model Law Firm Policy Regarding Billable Hours

A significant portion of the firm's work for paying clients is priced pursuant to the billable hours system. The firm is open to and pursues alternative pricing arrangements with its clients, because we believe it is important to develop varied approaches to pricing that enhance the overall goals of the profession, beyond mere profitability considerations. Nevertheless, because the billable hour system remains a significant staple of the firm's pricing system, it is important to set forth policies pertaining to that system as it applies to the firm's lawyers.

A. Recording Time

1. Integrity

Above all else, it is an absolute requirement and condition of continued employment that lawyers be scrupulously honest in recording time. That means that lawyers must carefully keep track of the nature and amount of time spent on individual matters. No deliberate inflation of the amount of time expended, or the nature of the work done, will be tolerated. Violators will be terminated.

2. Prompt Recording of Time

Consistent with point 1 above, the only way to ensure integrity and accuracy is to keep careful records and to record and submit time on a daily basis. Lawyers are expected to compile their notes and submit their time at the end of each work day or, at the latest, the next morning. Lawyers who attempt to "reconstruct" their time from memory and stray notes at the end of the week or month cannot possibly be accurate, which means that either the client or the firm will be treated unfairly, through inaccurate recording.

3. Provide Meaningful Detail

In recording and describing time, lawyers should put themselves in the position of the client receiving the bill, and ask "Does this give me the detail I need to evaluate the quality and quantity of the services provided?" Thus, sufficient detail must be provided. In the absence of further instructions from the client (see item 4 below), meaningful but not exhaustive detail should be included. Thus, a 4.35-hour entry which says merely, "Research", or "Legal Research" or "Research Summary Judgment Brief" is insufficient. A more appropriate entry would be

"Research statute of limitations issue under Alabama and New Jersey law for summary judgment motion". Note also that lawyers should not "bundle" descriptions, e.g., "research; conference call; and draft memo on X case."

4. Be Sure to Observe Client Requirements

Some clients have very specific requirements for time-recording. The billing partner will inform you of those requirements. Be sure to follow them, so that entries do not have to be "reconstructed" or revised when the draft bill is issued.

B. Hours Expectations/Model "Diet"

The firm expects its lawyers to render quality service commensurate with each lawyer's experience level. That is the first and most important "expectation."

With respect to expectations as to hours, the firm chooses to set no hard-and-fast minimum levels. Again, we expect that our lawyers are here because they are energized about the practice, eager to serve our clients, eager to enjoy the life of the firm, eager to serve the higher ideals of the profession, including through pro bono work, and eager to learn.

At the same time, we recognize the reality that guidance as to the typical level of effort that, on average, the firm expects in order to meet its revenue and profitability goals is a useful piece of communication between the firm and its associates. To that end, we are providing below a model "diet'' or mix of work that the "typical" associate should have as a goal.[1] The firm recognizes that in any given year, the mix will vary, and it will take account of those variations in evaluating associates' level of effort.[2] For example, an associate assigned to a pro bono or client development project that requires 500 hours of effort in a given year is not likely to achieve 100% of the expected billable hour total that year. Nevertheless, the mix reflected below will be used as a tool in evaluating each associate's level of effort and determining if each associate is meeting the firm's expectations.

Finally, the mix reflected below obviously does not apply to those on partial work schedules.[3]

The model diet, reflecting typical expectations, is as follows:

1. Billable client work — 1900 hours

Our firm recognizes that this level of billable work, if achieved on average by the firm's associates, is sufficient for evaluation and compensation purposes.[4]

2. Pro bono work — 100 hours

Our firm recognizes not only the social purpose served by doing pro bono work, but also the reality that pro bono work is in some cases weighted to more junior lawyers, and that pro bono work serves training and development goals.[5]

3. Service to the Firm — 100 hours

Service to our firm – for example, in recruitment, mentoring more junior associates, serving on firm committees — is an important part of the life of the firm and the organizational development of the associate.

4. Client Development — 75 hours

Our firm is aware that associates are eager to learn about effective techniques for developing and maintaining business. Our firm also recognizes that it takes time to cultivate client relationships — the partners need to take time to teach, the associates need to devote time to learn, and all of our attorneys need to have sufficient time to assist in a full range of client development activities – e.g., articles, speeches, responses to RFPs and the like.

5. Training and Professional Development — 75 hours

The best firms, including ours, devote significant resources to training — formal in-house programs, informal training and mentoring activities, evaluation activities, occasional attendance at outside programs, and the like. In addition, self-training — keeping current with the literature in one's field — takes time as well. This is the

lifeblood of developing excellent lawyers. We expect our lawyers to partake fully.

6. Service to the Profession – 50 hours
Our firm encourages our lawyers to participate in bar association activities, as well as those of other professional associations. By joining committees, participating in community projects, and otherwise getting involved, our attorneys provide an important service to the profession while learning more about it.

The total number of hours reflected in this model — 2300 hours of billable and non-billable time — is significant. The model reflects an assumption that our firm's associates are willing to work hard, that the profession is demanding, but that it provides great rewards, not only monetarily but also through the challenge and stimulation of work for paying clients as well as the other activities reflected in the model. The total is, at the same time, manageable — it represents approximately 50 hours of recorded, professional time, billable and non-billable per week, allowing for vacation, holidays, etc. We do not view that as an unrealistic burden for incentivized, enthusiastic, hard-working associates who enjoy what they do. Indeed, the allocations suggested for all types of work — billable and non-billable — are designed to provide a varied set of challenges and to enhance the psychic rewards of the practice.

C. Compensation and Billable Hours

Hard work — often measured by the number of billable hours a lawyer works in a given year — must be rewarded. At the same time, the firm absolutely rejects a compensation system tied to billable hours without flexibility and without consideration of other factors, most significantly quality of work, as well as contributions through pro bono work and service to the firm. Accordingly, while our compensation system will be adjusted from time to time to reflect developments in the market, we commit to the following guiding principles in setting salary and any bonus payments to associates:

1. Hard work, typically measured through number of billable hours worked, will be recognized. However, our compensation system will never be tied directly and inflexibly to billable hours — if a billable hour threshold is used to determine any salary or bonus factor, it will be tied to quality factors as well.

2. Quality will be the most significant determination in setting salary levels, assuming reasonable expectations as to productivity are met.

3. Quality performance in pro bono and firm activities will be recognized in compensation, through base salary levels and bonuses tied directly to those factors.

[1] This model recognizes that the "typical" associate — and therefore the typical annual "diet" — is apocryphal. Every year, something unexpected happens that would make consistent achievement of these targets impossible — whether it is a five-month trial, an all-consuming, yearlong transaction, a major pro bono commitment, the drafting of a major, non-billable article or book for client development purposes, assignment of important and very time-consuming firm duties, or other developments. This model is intended as a hypothetical one, achievable on average over the course of a number of years.

[2] This model is designed to work within the billable hour system, and therefore assumes that the hypothetical associate's client work load is based essentially 100% on billable hours. The model is not intended to discourage in any way the ongoing effort to develop alternative pricing models for the profession.

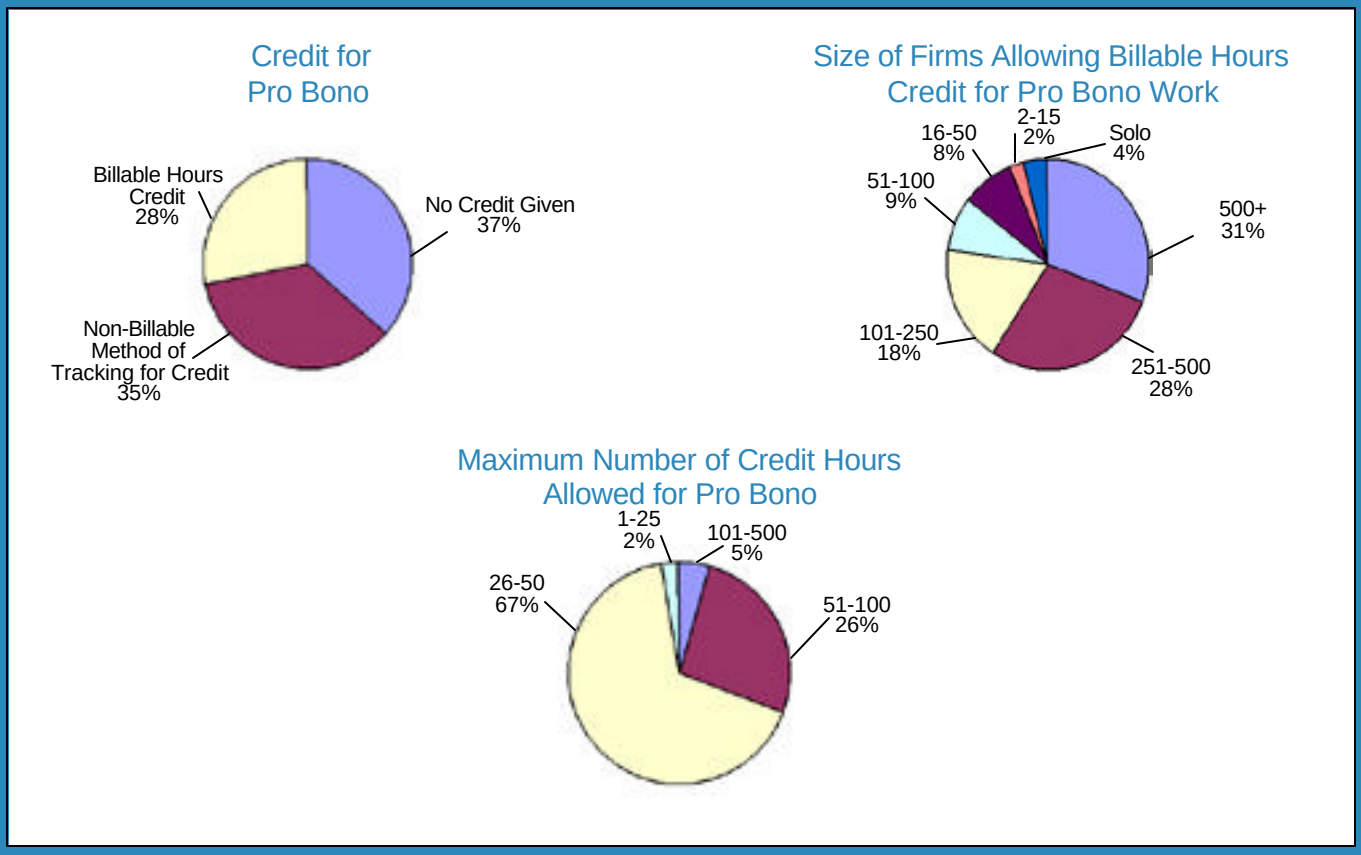
[3] Needless to say, this "diet" does not address the issue of part-time work, and there is absolutely no intention to undermine the importance of the availability of such work schedules by setting out this full-time "diet."

[4] We chose 1900 billable hours because that is typical at large firms (see the Altman Weil 2002 Survey of Law Firm Economics, which estimates the average number of hours associates worked in 2001 at a firm with 150 or more attorneys at 1860). However, we defer determining the particular level of billable work to each firm, as it is a cultural choice. We are mindful of firms' productivity needs to meet profitability aspirations and attract and retain the top talent, and believe that 1900 hours is an eminently workable billable hour requirement, which should be more than adequate to achieve reasonable aspirations at a firm A higher billable level may "crowd out" other activities, unless the expectation is that associates have no life outside the law.

[5] A requirement of 100 hours is at the top end of the Law Firm Pro Bono Challenge (©, the Pro Bono Institute) – and averages out, per lawyer, to approximately 5% of client time.

From: Commission AmLaw 100 and Law Firm Questionnaires
Re: Pro Bono

The Law Firm Questionnaire results show that 28 percent of the respondents' firms credit time spent on pro bono activities against the minimum billable hour requirement, ranging from 3.8 percent of firms that have between 2 and 15 lawyers, to 50 percent of firms with more than 500 lawyers. In fact, 79% of the firms responding to the AmLaw 100 Questionnaire indicated they provide some credit for pro bono. Note, however, that most firms had restrictions: either capping the number of pro bono hours which could be included in billable hours requirement at 50 or 100 hours, allowing only partial credit for pro bono hours, or crediting only those pro bono projects pre-approved by the firm. From the Law Firm Questionnaire, we find:



This result somewhat contradicts the belief that large firms often fail to incentivize lawyers to engage in pro bono activities. Voting with their dollars, they credit pro bono activity unlike any other identified non-billable activity. Again, the larger the firm, the more credit allowed, with 80 percent of the respondents working at firms of 500 or more attorneys allowing credit of between 26 and 100 hours, and a solid 20 percent allowing credit for more than 500 hours. On the other hand, firms ranging in size from solo practitioners to 50 lawyers uniformly do not provide credit for time spent on pro bono activities.

This observation is confirmed by the cogent response of one attorney on the Web Board:

> The billable hour system absolutely affects my participation in pro bono work. I would love to be more active than I am in pro bono activities; unfortunately these are not valued at all in smaller firms (for the most part). Therefore, something has to suffer—either my home life or my professional life—when I choose to take cases pro bono.

From: Commission Web Board
Re: Comments from Lawyers Not Working in Firms about the Impact of the Billable Hour

Respondents in sectors beyond private practice seemed to be fairly seasoned, mentioning that they "watched in horror" as the legal profession began to lean on billable hours, and are still displeased with the evolution. Some are "disgusted" because it misplaces the emphasis, moving it from results and client needs/wants to hours billed.

Others viewed billable hours as an ethical dilemma, a fantastic mechanism for outside counsel to churn clients for money. Outside counsel will "do anything for a claim representative to keep the gravy train rolling even if what the claim representative wants is not in the client's best interest." A respondent observed:

> The billable hour system has hurt the relationship between insurance carriers and its outside counsel by changing the focus of representation from what's best for the client/ insured to what's best for my billable hours.

Generally, training as to hours is different for in-house attorneys than for outside counsel. For example, one attorney said at his company, "attorneys are encouraged to spend as much or as little time as the case warrants." Outside counsel the company hires, however, have shown "frequent and egregious abuse of the billable hour system."

The in-house attorneys also commented that the billable hour has the "perverse effect of making less efficient attorneys more profitable for their law firms than more efficient ones." Although efficiency and productivity are key traits of lawyers on the client side, attorneys with outside firms are rewarded for needing "a lot of time to get a task completed properly."

> Would you allow the contractor building your house to charge you twice as much (including overhead and a full markup for profit) because the crew working on your house is slower than another crew that could have been assigned? How can accountants set fixed prices for complicated audits when lawyers can't do the same for routine contracts, leases or litigation?
>
> I believe that there are great marketing and profit opportunities for any law firm that would concentrate in hiring the most productive lawyers and have the confidence to charge fixed fees for all routine work. General Counsels and corporate managers would be very receptive to this concept.

Moreover, by rewarding inefficiency, "truly creative and efficient young attorneys are penalized by the system. The system also discourages attorneys from taking the time to do (presumably) non-billable activities, such as background research, even though such activities will be helpful for proper representation."

In-house attorneys, those in government, in public interest, in academia, and other non-practice pursuits mention that they left because they wanted to free themselves of the billable hour. Some even attribute 100 percent of their decision to leave private practice entirely to the billable hour. One wrote:

> I didn't want to have to check my watch every 6 minutes as I set about the practice of law. In public interest, while the work can be stressful in many ways, we do have more flexibility because we are not tied to the billable hour.

And finally, one respondent advocated that the profession educate people early on about the constraints of billable hours. Specifically, the attorney noted:

> I think it would have been helpful to learn in law school about the pressures of billing hours. When I entered the profession, I had no idea what a challenge it would be to satisfy my firm's billable hour requirement, while keeping my clients' costs down and still giving them the best representation possible.
>
> A large part of my practice is family law, and I often get calls from clients who are very upset. I want to be able to give them as much attention as possible, but I have to be mindful of the fine line between generating income for my firm and turning off the clock when someone needs a shoulder to cry on.

Billable Hour Snapshot

Firm works well within the billable hour

Although Robert L. Dustin, a billing partner at Schmeltzer, Aptaker & Shepard, P.C. (SA&S, P.C.), a mid-size litigation boutique, understands the "perverse incentives" tied to billable hour requirements, he believes billables are a necessary evil. "If I had a better all-around solution that worked for litigation, I would use it," he explained.

The 25-year-old firm, however, has found one way of working within the billable hour — not requiring a minimum number of them. "The only number that means anything to me are the number of hours billed and collected," Tom Esslinger, the firm's managing partner, said.

"We think we work efficiently and effectively," Dustin added. Furthermore, he believes such a practice prevents attorneys from billing unnecessary work to pad hours. "We try not to stew that," he said.

Bonus and Compensation Systems

In the past couple years, associates averaged between 1850 and 1900 billable hours. However, there are people well above and below that average, according to Esslinger.

The 47-attorney firm relies primarily on salary adjustments to reward a job well done. One-time bonuses are very rare, and all associate salaries are reviewed by the firm's shareholders. First year associate salaries hover near $75,000, but the firm's

From: Commission Web Board
Re: Base Compensation and Hours-Related Bonuses

Respondents agree that lowering the number of billable hours and raising the number of creditable hours, is the ticket to living within the billable hour.

The primary attorney in one firm explained that he implemented a low (85 hour per month) billable quota because he wants attorneys to meet goals while keeping stress under control, stay ethical (avoid padding), and have a "reasonable chance" of earning a quarterly bonus, "which is based upon hours billed and collected in excess of the 3-month average." He also sees it as a way to show support for his employees' business development efforts and legal association participation.

Another attorney said lowering the number of official billable hours and raising the number of "creditable" hours would be an option, particularly if the creditable hours include pro bono, bar association participation, CLE course attendance and business development. The attorney said that when the billable requirements are realistic, attorneys are more likely to participate in other meaningful activities. Furthermore, these and other activities are important to the firm, the profession, and society at large.

Another issue debated was whether fees collected should be considered in evaluations.

One attorney argued that fees collected and the amount of new business and/or new clients an attorney brings to the firm are something that also should be considered.

However, an associate retorted that basing pay on collected fees can be a "trap," particularly when the partners control the billing and do it at their own pace. Thus, if a partner falls behind and files that should be billed quarterly are billed once a year, it makes it hard for an associate to get a bonus. Likely, any payment from clients that comes in after the bonus period will not be considered in the bonus.

compensation system is not lock step. "I don't understand, but for ease, why firms do lock step compensation," Esslinger said.

Evaluation Considerations

The firm evaluates partners and associates "holistically," based upon total contribution as opposed to solely on hours. The firm rewards junior associates for the quality of work and their productivity, as well as their ability to get along. Things considered in senior associate and partner evaluations include mentoring, training and development, and assistance with the summer associate program. Partners also are evaluated on rainmaking and service, with a heavy eye toward their generated revenue. These attributes are used in evaluating not only for set compensation, but also in consideration for partnership.

Quality of Life

The culture of the firm allows attorneys to maintain quality of life. In fact, the firm has very few official policies. "Lawyers are by nature rule-beaters," Esslinger said. "If you give them the rule, they will work to beat it." Therefore, a lot of things at the firm, including flex and part time requirements, are left undocumented.

"We have some examples of part-time and flex-time attorneys through the years, including those on the partnership track," Dustin said. And, he points out, such arrangements are not limited to women. "There are a lot of very talented people out there," Esslinger said. We want to have the ability to hire them, regardless of their time constraints, he finished.

As for day-to-day, "We try to breed a culture that when the work is here, you do it and you go home," he said. "It sounds like a very simple recipe," but one most other firms reject.

Moreover, "there is no face-time requirement. We don't keep track of it," Esslinger explained. Thus, the firm has a practice of flextime, so attorneys can come in and leave on a schedule comfortable to them.

Impact on Pro Bono

The firm does not have an organized pro bono program. "We don't really have the resources to subsidize pro bono," Dustin explained. "Although we encourage attorneys to do pro bono, it should not hinder their duties to the firm," Esslinger said.

Alternative Future

Schmeltzer, Aptaker & Shepard does not plan to shy away from relying on billable hours in the near future. "If your client trusts you, there is no need for alternate billing," Esslinger explained.

Currently, less than ten percent of the billing at the firm is done alternatively. Dustin attributes this to the nature of the firm's work—mostly defense litigation—and the lack of information available about fair price.

Although the firm can create phase-based budgeting for most litigation, it has been very difficult to figure out incentives and premiums for success, he explained. "With major corporate clients, we address upfront those issues and talk about budgets. There is always a discussion about alternative billing, but no agreement," he said. "In the end, it is the client that does not want to do it," Esslinger agreed. Quality of work and result has been key to client retention.

Conclusion

Thus, working well within the billable hour is a challenge SA&S, P.C. has accepted. In order to ensure the firm's strength, it rewards effectiveness and efficiency.

Stop raising starting salaries.
By abandoning a regular salary hike, a firm no longer has justification for high billing requirements.

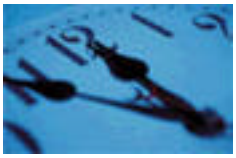
Evaluate attorneys on the quality of their work.
In the end, quality of work is what matters most to a client.

Eliminate minimum billing requirements.
This tactic will further assist a firm in shifting its focus from quantity to efficiency.

Advice to firms trying to improve their environment without abandoning the billable hour

Conclusion

A View Toward the Future



A View Toward the Future

Thank you for taking the time to read the Commission's report. On behalf of the Commission, we hope that this report has provided some insight into the reasons for the prevalence of the billable hour as well as some guidance into designed alternative approaches to valuing legal services.

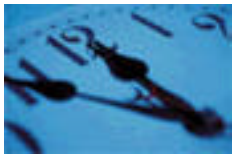
As you have read, there are no easy or clear-cut answers to developing successful alternatives to the billable hour. If there were, the legal profession would undoubtedly already have had these answers. Yet, finding successful alternatives to the yolk of the billable hour is critical to our profession. As Justice Breyer and ABA President Hirshon have stated so well, regaining quality of life in the practice of the law requires that we provide lawyers with the resources to balance the competing demands of the profession and the flexibility to reach that balance.

The practice of law is a very rewarding profession brimming with challenging work for clients; satisfying contributions to society through pro bono projects; and personal and professional growth through the experiences of a lifetime in the law. We should not lose sight of how blessed we are in our professional lives. We owe it to ourselves and the lawyers of the future to continue the Commission's valuable work in seeking to design successful alternatives to the hourly billing arrangements so that lawyers can realize the richness of their profession.

View the
ABA Commission on Billable Hours
On-line Toolkit:

www.abanet.org/careercounsel/billable.html

APPENDIX



Selected Works

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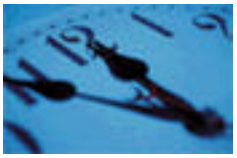
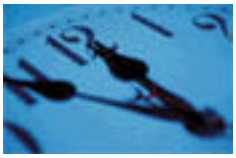
http://www.abanet.org/careercounsel/billable/toolkit/bib.html



Law Firm Questionnaire

Please Visit:

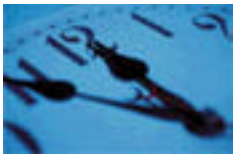
http://www.abanet.org/careercounsel/archive/billablehourssurvey.html



In-House Counsel Questionnaire

Please Visit:

http://www.abanet.org/careercounsel/archive/inhousesurvey.html



AmLaw 100 Questionnaire

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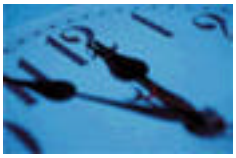
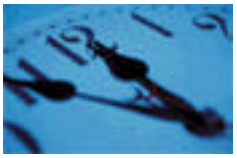
http://www.abanet.org/careercounsel/billable/toolkit/amlaw.pdf



Web Board Dialogue

Please Visit:

http://discussion.abanet.org:8080/~Billable



On-line Toolkit Contents

Please Visit:

http://www.abanet.org/careercounsel/billable/toolkit/toc.html

Cover Story

The Billable Hour Must Die

It rewards inefficiency. It makes clients suspicious. And it may be unethical.

August 2007 Issue
By Scott Turow

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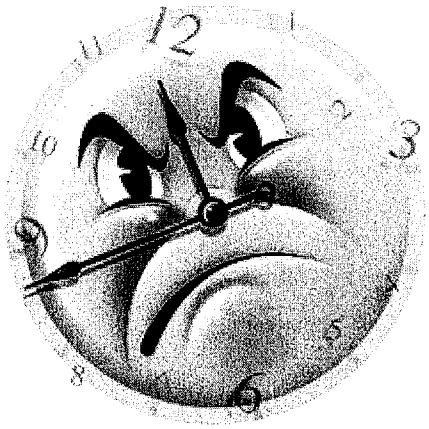

Illustration by Jeff Dionise

SIDEBAR: New Routes into the Corporate Door

Three summers ago, my wife and I were driving my two older kids to the airport. The academic year was about to resume. The younger child, my son, was returning to college; the older, my daughter, to law school.

"Say," I heard my son ask his sister in the backseat, "what do you think you'll do when you get done with law school?" My daughter expressed some uncertainty but ended up answering, "I think I'll become a litigator."

I nearly hit the brakes.

"Oh," I heard myself moan, "don't be a litigator."

My advice to my daughter had the usual effect—another demonstration of Newton's third law, the one about equal and opposite reactions, a rule that also applies to parental advice. Before the academic year was over, my daughter had enrolled in a legal clinic and tried her first and second lawsuits. It was those experiences, rather than anything she heard from me, that led her away from the courtroom.

But, candidly, I was shocked by my own reaction. Because for the last 20 years I have chosen to continue my occasional role as a litigator, despite having the option not to do so thanks to my literary career. I have always believed that I've had a charmed life as a courtroom lawyer. When I left law school, I could not imagine becoming anything other than a litigator. The courtroom was where the law was made, where the fundamental struggle to fit the law to facts took place.

The people writing contracts were, in my youthful view, not much different from consultants. Although I have learned to love and appreciate hundreds of transactional lawyers in the years since, I notice, in looking over my novels, that I have not yet had a hero who is any other kind of a lawyer but a litigator. My protagonists have been prosecutors, criminal defense lawyers, a judge, a tort lawyer, a commercial litigator—even journalists. But no deal guys or gals. In the restricted zone of my imagination, it's the litigators who are the real thing.

So why is it—given the satisfaction I've taken from being a litigator—that some piece of my heart shrieked out in opposition to the idea of my child doing the same?

CONTEMPORARY WOES

I believe what motivated my outcry, in a few words, is that I think it would be hard for someone starting today to have it as good as I have had it. The ratio of pain to pride has grown too high. And the contemporary environment has become much less congenial to aspects of the lawyering craft that deeply pleased me. We all hear the complaints from our colleagues, especially those in my age range who've been doing this now for decades. For too many litigators, our life increasingly is a highly paid serfdom—a cage of relentless hours, ruthless opponents, constant deadlines and merciless inefficiencies.

By now it's obvious that the U.S. Supreme Court's 1977 decision in *Bates v. Arizona*, which invalidated on First Amendment grounds the longtime bar on lawyer advertising, was the opening cannon shot that essentially set off the competitive war in our profession. In doing so, it did no favor to lawyers' lifestyles. The free flow of information about who is making what that soon followed—courtesy of *The American Lawyer*—ushered in the big-firm star system, in which rainmakers rule. Because they are the lawyers who can most easily set up shop elsewhere, the threat posed by that mobility in turn has cued the struggle in every firm to ensure that incomes remain high, especially at the top of the pyramid.

Not that we, in the bar, have any right to complain. The fierce competition that now characterizes the business of being a lawyer is exactly what the market requires. No matter how much we'd like it to be otherwise, lawyers can't claim any privilege to live by different rules from everybody else in our economy.

But I still believe that lawyers in general, and litigators in particular, are yet to confront the realistic limits of that competitive environment. And in this regard there is no more vicious culprit than the practice of basing our fees solely on the time spent on a matter.

Dollars times hours sounds like a formula for fairness. What could be more equitable than basing a fee on how long and hard a litigator worked to resolve a matter? But as a system, it's a prison. When you are selling your

time, there are only three ways to make more money—higher rates, longer hours and more leverage. As the years have gone on, the push has continued on all three fronts.

HOURS AMOK

Let me be clear: i don't think there is anything wrong with lawyers making money. There is a unique satisfaction in representing somebody well and being rewarded for it in a manner commensurate with the effort and skill required. I am not engaged here in a jeremiad aimed at getting litigators to join in vows of poverty, or even to agree to make less. I believe enough in the free market to know that if what we ask our clients to pay us wasn't worth it to them, they wouldn't continue to do it. My concern is with the external effects of the system we are now following.

Consider, for example, the consequences of dollars times hours for those entering the profession. When I left the government for private practice in 1986, the hours expectation for young lawyers was 1,750-1,800 hours a year in the large Chicago firms. Today it's 2,000-2,100—even 2,200 hours. And the only real outer boundary is that there are 24 hours in a day—and 168 in a week. Increasingly, if we allow time for trivialities like eating, sleeping and loving other people, it is clear, as a simple matter of arithmetic, that we are getting close to the absolute limit of how far this system can take us economically.

DIMINISHING RETURNS

More tellingly, the prospects for success for lawyers have markedly diminished over the years. Virtually all firms today make fewer partners and take a longer time to do it. And the smaller you make the eye of the needle, the more young lawyers arrive on the job as uncommitted nomads: at best, acquiring skills they'll take elsewhere; at worst, cynically trying to pile up money before the ax falls. But both states of mind alienate them somewhat from the workplace, the colleagues they work with and the clients they serve.

Worst of all, however, is that when somebody is working 2,200 hours a year, he or she has less chance to pursue the professional experiences that nourish a lawyer's soul. Lawyers of all stripes can and should offer their services for free to the needy, but I find it hard to imagine more satisfying work than pro bono litigation. That is because when you give the poor and powerless access to a just forum, there is a triumph—no matter what the outcome in a case. And the lawyer who is involved in doing that learns an invaluable lesson about the power and goodness that is inherent in being a lawyer.

I don't know many young lawyers who leave law school without dreams of becoming pro bono princes and princesses; nor is there a dream of youth that seems to die faster. In my own firm, we give young lawyers some billable credit for pro bono time and also have a full-time pro bono partner who works hard to engage the firm's lawyers in these projects.

And we are hardly alone in the profession; many other firms make similar efforts. These are noble gestures—and ones fully worth undertaking. But it's still a little like King Canute ordering the sea to roll backward. As long as it's dollars times hours times partners, we know that the tide will always rise.

Let me again make it clear that I am not calling for lawyers to band together to abandon hourly billing. The antitrust division of the Justice Department would be likely to have something to say about that, and well it should. But I am hoping that lawyers, especially litigators, will more often be bold enough to consider offering clients alternative billing arrangements. And I hope clients will be bold enough to accept them.

Many years ago now, I went shopping for a lawyer in Hollywood to represent me in the dealings I have been fortunate to have with movie and television producers in connection with my books. Naturally, I asked each of the lawyers I spoke to about his or her hourly rate. One attorney answered, "We don't bill hourly. We use the fair

fee method."

Then I asked, "Pray tell, what is that?"

"Well," he said, "we do the work, and at the end we get together and agree about what's a fair fee." This sounded to me like an invitation to jump without knowing whether there was water in the pool. "Trust me" is not a persuasive motto. A solid economic relationship ought to start out with both sides understanding the scope of the engagement.

One reason that dollars times hours continues to prevail is because it's hard to devise a fair alternative. Columbus setting out from Spain, destined, in some minds, to sail off the end of the Earth, probably had a better idea what he was headed for than either a lawyer or a client at the inception of a piece of litigation.

Whatever alternative arrangements are made have to be flexible enough to adapt to changing knowledge and the unexpected. It will take some education and experimentation on both sides. But I think we have reached the point where that is virtually required.

The widespread practice of billing by the hours exists almost in defiance of the principles that are supposed to guide our profession. Of the eight guidelines mentioned in Rule 1.5 (Fees) of the ABA Model Rules of Professional Conduct, only one speaks directly to the time spent on the legal task. Yet, despite the fact that our profession's guiding ethical rule encourages lawyers to look to other factors, dollars times hours remains the near universal standard of commercial litigation.

A SORRY SYSTEM

But at the end of the day, my greatest concern is not merely that dollars times hours is bad for the lives of lawyers—even though it demonstrably is—but that it's worse for clients, bad for the attorney-client relationship, and bad for the image of our profession. Simply put, I have never been at ease with the ethical dilemmas that the dollars-times-hours regime poses, especially for litigators. And in this regard, I think my views depart from what is commonly acknowledged (including, I hasten to add, by disciplinary authorities, who of course have not disallowed the current system).

But from the time I entered private practice to today, I have been unable to figure out how our accepted concepts of conflict of interest can possibly accommodate a system in which the lawyer's economic interests and the client's are so diametrically opposed.

Looking again to the Model Rules, Rule 1.7 provides in part that "a lawyer shall not represent a client if the representation involves a concurrent conflict of interest," which the rule defines as occurring when "there is a significant risk that the representation of one or more clients will be materially limited by ... a personal interest of the lawyer."

I ask you to ponder for just a few minutes whether that rule can really be fulfilled by hourly based fees.

It is fair to assume, of course, that sophisticated clients are fully aware of the hazards of being billed by the hour. But we all know that conflict waivers require more than fair assumptions.

When was the last time any of us actually and explicitly set forth the problems of this system for a client, the way we do with other conflicts? Who ever says to a client that my billing system on its face rewards me at your expense for slow problem-solving, duplication of effort, featherbedding the workforce and compulsiveness—not to mention fuzzy math. Does anybody ever tell a client what the rule seemingly requires?

"I want you to understand that I'm going to bill you on a basis in which the frank economic incentives favor prolonging rather than shortening the litigation for which you've hired me." The truth is that even to imagine that conversation would almost necessarily require the lawyer to be prepared to offer the client an alternative.

I understand some of the counterweights to what I've just said. There is more than a little merit to the idea that the market will reward efficient lawyers who labor to hold down their fees in the recognition that this will lead to further engagements. And of course, just like the vast, vast majority of self-respecting practitioners, I can say with conviction that I have never consciously ordered work or labored longer for the sake of increasing my bills. I think that litigators who send out bills are generally as stunned as their clients by the way time piles up.

But let's not assume this is proof the lawyer reasonably believes the representation will not be materially affected. How many times have you heard a lawyer speak mournfully of the case that settled rather than going to trial, with the resulting detrimental impact on that lawyer's economic fortunes?

More tellingly, who among us can say he or she has never accused the lawyer on the other side of "running the meter"—of doing unnecessary discovery, filing frivolous motions or foot-dragging before engaging in meaningful settlement talks—all to pad the fee. And that's not just to make excuses to the client. When we say it, we mean it.

Looking at the lawyer on the other side of the v., we can see clearly how the temptation to earn more might impact a representation. If we can see the effects of the dollars-times-hours system so clearly when we look across the courtroom, how can we be so fully confident about ourselves?

Personally, I doubt that greed is the principal motivation for the overwhelming majority in our profession, including my opponents. First and foremost, lawyers want to believe they have done their utmost for their clients—and it would be a rare attorney indeed who took much satisfaction out of thinking of himself as well-paid but incompetent or undedicated.

Like every other conflict issue, the problem is one of appearances and temptations. But how can anyone ever know exactly why certain marginal tasks were undertaken? Anybody who has ever investigated a case or prepared to try one knows there is no limit to the potential issues, avenues for investigations, questions to be researched, or variable scenarios that the courtroom might offer. Dollars times hours subtly influences lawyers not to ask themselves what's most probable. It offers scant rewards for discipline.

The more often lawyers find themselves engaged in wheel-spinning, in running out ground balls rather than focusing on the strike zone, the more isolated they feel from the principal goals of the profession, which will always be doing justice. But again, it's the effect on the lawyer-client relationship that is the principal problem.

FEE FIASCO

As a result of hourly billing, the fee collecting process has grown far more fractious. There are now law firms that specialize in disputing other firms' bills—and in-house nudniks who demand copious details and then flyspeck them.

Other clients search for means, whether it's strict litigation budgeting or task-value billing, to put a finger in the dike.

But what does it do to the environment of our profession, to our perception of ourselves and our clients' perceptions of us, that we are locked into a system in which clients are saying from the start of the relationship: I can't really trust you to be fair to me. If there is even a grain of truth to that characterization, how reasonable is it to believe that our representations have not been materially affected?

America is ambivalent about lawyers. People are impressed with our knowledge and the power that knowledge gives us, and jealous of it as well. They see us as too often self-seeking, manipulative and greedy. We all know that this is not a balanced picture. Every time I hear about a DNA exoneration on radio or TV, I wait vainly to hear what I know is the rest of the story—about the lawyers, usually an army of them, who worked for years, generally for free, to give that prisoner back his liberty. The story of the lawyer doing good because he or she is committed to doing good is not one of the narrative themes American media are fond of presenting because it's not something the public wants to hear.

But recognizing how far behind the eight ball we remain in the eyes of the public, should we really continue to engage in billing practices that even our clients, who know us best, have been telling us inspire distrust?

If I had only one wish for our profession from the proverbial genie, I would want us to move toward something better than dollars times hours. We have created a zero-sum game in which we are selling our lives, not just our time. We are fostering an environment that doesn't provide the right incentives for young lawyers to live out the ideals of the profession. And we are feeding misperceptions of our intentions as lawyers that disrupt our relationships with our clients. Somehow, people as smart and dedicated as we are can do better.

Scott Turow, the author of *Presumed Innocent* and seven other novels, is a partner in the Chicago office of the law firm Sonnenschein Nath & Rosenthal. This article is excerpted from *Raising the Bar*, a collection of essays by a variety of authors about the modern practice of law, which will be published this month by First Chair Press. For more information, go to the ABA Web store.

Sidebar

Read a related story this month, New Routes into the Corporate Door.

TEXAS LAWYER

GCs Share the Pain With Outside Counsel

Sherry Karabin
Corporate Counsel
03-02-2009

The worst economic crisis in years is forcing everyone to look for ways to save money, and general counsel are no exception. Some are cutting their internal expenses — not filling an open position, for example, or reducing the travel budget. But the main place that many GCs hope to save money is in their outside counsel spending. So they're dropping law firms, and demanding lower bills and fixed fees from the ones they keep.

"Maximizing efficiency and saving money is something many in-house departments have been trying to do for the last 20 years," says Thomas O'Neil III, general counsel at WellCare Health Plans Inc., a Tampa, Fla.-based company that provides claims processing and other administrative services. "But now the economic climate has added urgency to the goal." O'Neil says that WellCare is "in the process of reevaluating the firms that have done work for us and coming out with a roster of preferred firms, as well as new terms of retention."

Other companies also are shrinking their outside counsel lineup. Jeffrey Carr, the legal chief at FMC Technologies Inc., says that the Houston-based company will give all of its European legal work to a single firm. And Madeleine Johnson, the general counsel at Dallas-based Southwest Airlines Co., says that she too is considering "whether to consolidate outside counsel work by using fewer firms."

Firms that manage to keep their clients can't rest easy, either, since they'll be expected to submit cheaper invoices. Carr says that in December he sent a letter to FMC's firms in which he asked them to cut their bills by 10 percent on matters less than half done, and by 5 percent on matters more than half done. Carr additionally told the firms that beginning this year, they should present project budgets that are at least 10 percent lower than last year.

One way that firms can reduce their bills is by eating their own expenses, Carr says. "There are no pass-through costs," he maintains. "Our firms and vendors must act as general contractors for their scope of work so that they manage their subcontractor and vendor costs to the lowest possible level. If they fail to do so, it comes out of their profits."

Southwest's Johnson agrees. "For example, I generally don't think that outside counsel should be charging for computerized research fees on top of a lawyer's time for doing the research," she says.

Legal consultants aren't surprised by the GCs' demands. According to Jonathan Bellis at Hildebrandt, "Most law departments continued to tighten their spending belts during 2008, taking a hard look at internal staffing levels and methods for controlling law firm fees, and accelerated those efforts in the final quarter of 2008." Bellis leads the worldwide law department consulting practice at Hildebrandt, a legal consulting firm based in Somerset, N.J.

And in a November 2008 survey by Altman Weil Inc., 75 percent of general counsel said that their departments were facing budget cuts this year, with an average decrease of about 11 percent. "The solutions are often different for every organization," says Dan DiLucchio, a principal at Altman Weil, a Newtown Square, Pa.-based legal consulting firm. Some general counsel who responded to Altman Weil's survey said that they would be reducing the size of their own staffs or cutting in-house compensation. But as DiLucchio notes, "Generally, the largest portion of spending is on outside counsel," so law firms will be expected to take the biggest hits.

Even companies that claim they aren't feeling the pinch are taking action. Chris Willis, general counsel at Dallas-based Interstate Battery System of America Inc., says that his business is doing well. However, Willis adds, "We are utilizing alternative billing arrangements more than in the past, including flat-fee for file handling, and retainer agreements, primarily in the employment area."

While GCs expect their firms to bear the brunt of the cost-saving burden, they're also willing to make internal cutbacks. For example, several companies are trying to reduce their travel expenses by increasing their use of videoconferencing and Web conferencing. And businesses are also expecting their staff lawyers to work more. Two-thirds of the general counsel who responded to the Altman Weil survey said that they planned to bring more work in-house.

Some legal chiefs say they're moving more slowly in filling vacancies. At FMC, for example, Carr says that he eliminated two nonlawyer positions, "one by having one of our folks pursue opportunities elsewhere," the other by "not filling an open position and reassigning those duties to existing resources."

O'Neil also plans to exercise caution when filling any potential openings at WellCare,

saying that he will "carefully reflect on the needs of the company over the next year, and if the position is important, fill it." He adds, "In any searches that we conduct in the upcoming year, we will be sensitive to the current market realities, and strive to provide competitive compensation accordingly."

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fucile & reising | LLP

January 2007 OSB *Bar Bulletin Managing Your Practice* Column

Risky Business: Investing in Clients

By Mark J. Fucile
Fucile & Reising LLP

Investing in clients has long been a dicey prospect from both the regulatory and liability perspective. At the same time, neither the old Disciplinary Rules nor the new Rules of Professional Conduct prohibit lawyers and their firms from investing in clients—either directly or in lieu of all or part of a fee.[1] Although some of the ardor for investing in clients cooled in the wake of the "Dot Com Bust," lawyers still find investment opportunities coming their way either from their own initiative or client requests. Moreover, in many of these situations, the client is often looking to the lawyer or law firm for all of its legal counsel.

In this column, we'll look at the "Three Cs" of investing in clients from the vantage point of law firm risk management: conflicts; carrier notification; and consequences. Although this column focuses on investments in clients, the same cautionary principles apply to any business transaction with a client beyond standard commercial transactions such as having a business checking account at a bank you represent.[2] Similarly, although this column is oriented to investments being made law firms, the cautions generally apply with equal measure to investments in clients made by individual lawyers within a firm.[3]

Conflicts

Conflicts can develop at two stages when investing in clients.

The first is when the investment is made. RPC 1.8(a) frames the issue broadly: there is a conflict between the respective financial interests of the lawyer and the client every time the lawyer invests in a client. As a result, RPC 1.8(a) imposes a uniform conflict waiver standard that goes to both the substantive fairness of the transaction and the procedural disclosure the lawyer makes to the client. RPC 1.8(a) addresses these dual prerequisites by mandating for each investment that:

> "(1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;
>
> "(2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and
>
> "(3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction."

The second point at which a conflict can arise is later in the representation when the lawyer's interest in protecting the investment may run counter to the client's interests. For example, the client may ask the lawyer for advice on a

corporate restructuring that would dilute the value of the lawyer's investment. In this post-investment scenario, RPC 1.7(a)(2) requires the lawyer to obtain a conflict waiver from the client before proceeding:

> "(a) Except [when waived by the client] …, a lawyer shall not represent a client if the representation involves a current conflict of interest. A current conflict of interest exists if:
>
> *****
>
> "(2) there is a significant risk that the representation of one or more clients will be materially limited … by a personal interest of the lawyer[.]"

Both the Oregon State Bar and the American Bar Association have ethics opinions available to help navigate through and to properly document client consent when investing in clients. OSB Formal Ethics Opinion 2005-32 and ABA Formal Ethics Opinion 00-418 are available on the web at, respectively, www.osbar.org and www.abanet.org/cpr. RPCs 1.8(a) and 1.7(a)(2) are facially broader in this context than their counterparts under the former Disciplinary Rules, respectively, former DR 5-104(A) and former DR 5-101(A)(1), because they apply to all investments in firm clients whereas former DR 5-104(A) only applied to transactions where the lawyer and the client had "differing interests." Nonetheless, because the Oregon Supreme Court generally interpreted DR 5-

104(A) broadly, the Oregon cases under these former DRs should still be useful interpretive guides until we have case law applying the new rules.

Carrier Notification

In light of the risk of conflicts and attendant claims from any investment in a client, malpractice insurance carriers, including the Oregon Professional Liability Fund, may exclude such transactions from coverage unless they are notified of the investment at the time it is made.

The PLF, for example, both specifies the kind of disclosure the lawyer must make to a client and requires contemporaneous notification to the Fund.

On the former, Exclusion V.8 to the PLF's basic plan excludes coverage for claims arising from business transactions with clients falling within RPC 1.8(a) unless very detailed disclosure in a form specifically developed by the PLF (or an alternative substantially equivalent) is executed by the client. The PLF also requires that a summary of risks of lawyer-client business transactions authored by the OSB's Chief Disciplinary Counsel be provided as a part of the conflict waiver. Both forms are available on the PLF's web site at www.osbplf.org.

On the latter, Exclusion V.8 also conditions coverage on giving the PLF contemporaneous notice of the transaction in one of two forms. First, a copy of the conflict waiver must be forwarded to the PLF within 10 days after the client signs it. Second, if providing a copy of the waiver would violate RPC 1.6's confidentiality rule, the lawyer is required instead to provide the PLF with the

name of the client involved and confirmation that the required consent has been obtained within 10 days after the client signs the conflict waiver.

Particularly if you are an Oregon-based firm with an excess carrier other than the PLF, you should also consult any exclusions or other requirements mandated by your excess carrier. Multi-state firms (or lawyers licensed in more than one state) providing services to a client in more than one state should also consult the requirements and limitations in the other states involved.

Consequences

The consequences of unwaived conflicts in this area are usually severe and break along three lines: regulatory; civil liability; and enforceability.

The disciplinary reporters are filled with cases that illustrate the regulatory consequences of unwaived conflicts flowing from lawyer-client investments. They range from lawyers who handled the investment transaction involved (*see, e.g., In re Brown*, 277 Or 121, 559 P2d 884 (1977)), to lawyers who were handling other matters for the client at the time the transaction occurred (*see, e.g., In re Montgomery*, 292 Or 796, 643 P2d 338 (1982)), to lawyers who did not waive conflicts that developed later as a result of an earlier investment (*see, e.g., In re Wittemyer*, 328 Or 448, 980 P2d 148 (1999)). Although the sanction imposed in any given case is necessarily driven by the facts of that case, discipline is often on the severe end of the scale because lawyers in these situations have typically benefited financially at the expense of their clients.

The liability consequences can be no less severe. Conflicts in this setting can easily translate into claims of breach of fiduciary duty. The Oregon Supreme Court discussed the relationship between violations of the conflict rules and lawyer breach of fiduciary duty generally in *Kidney Association of Oregon v. Ferguson*, 315 Or 135, 843 P2d 442 (1992), and applied that relationship directly in the lawyer-client transaction context in *In re Brown*, 326 Or 582, 956 P2d 188 (1998). Depending on the kind of investment and the kind of client (*i.e.*, public or private), securities laws may be involved, too. Finally, an investment in a client may strip the law firm of the liability shield for assisting in the breach of a fiduciary duty that the Oregon Supreme Court created last year in *Reynolds v. Schrock*, 341 Or 338, 142 P3d 1062 (2006). *Reynolds* specifically excepted situations where the lawyer is furthering the lawyer's own interest from the liability shield. For example, a lawyer-investor in a start-up might not have the liability shield available if the lawyer provided the corporate client with advice on ousting a "whistleblowing" director where doing so constituted assisting in a breach of the client's fiduciary duty to the ousted director and also protected the lawyer's investment.

Finally, unwaived conflicts or otherwise unreasonable transactions may also imperil the investment itself. The Oregon Supreme Court noted in *Brown* that the failure to make adequate disclosure to a client may constitute fraud and fee forfeiture is an accepted remedy for breach of fiduciary duty under *Kidney*

Association. Beyond the adequacy of the conflict waiver, whether the resulting fee is reasonable is governed by both RPC 1.8(a) and the general fee-standard rule, RPC 1.5. ABA Formal Ethics Opinion 00-418 suggests that, at least when the investment transaction is complete at the point the associated legal services are rendered, the "reasonableness" of the fee should be assessed at the time of the transaction. But, there is recent authority from Washington in the form of *Holmes v. Loveless*, 122 Wn App 470, 94 P3d 338 (2004), that when the investment involves a continuing pay-out over time that the "reasonableness" requirement for an investment in lieu of a fee extends over the life of the agreement (even after the underlying legal services have been completed).

Summing Up

Investing in clients may seem like an attractive way to boost firm revenues from a static number of hours worked. In many situations, though, the risks outweigh the potential rewards.

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[1] Most ordinary fee agreements do not constitute a business transaction with a client. *Welsh v. Case*, 180 Or App 370, 382-83, 43 P3d 445 (2002). But, where a component involves an attendant venture where "the client expects that the attorney is using his or her judgment for the protection of the client," the fee arrangement constitutes a business transaction that triggers the associated professional rule and fiduciary considerations. *Id.*

[2] Cmt. 1, ABA Model Rule 1.8.

[3] *See, e.g., Roach v. Mead*, 301 Or 383, 722 P2d 1229 (1986) (holding a law partner vicariously liable for the negligence of his partner who secured a personal loan from a firm client without the disclosure required under former DR 5-104(A); *see also* RPC 1.10(a) (the "firm unit rule").

FORMAL OPINION NO. 2005-151

Fee Agreements:
Fixed Fees

Facts:

Lawyer wishes to use fixed fee agreements for certain types of services that Lawyer will perform for clients. Lawyer intends to obtain most or all of the fixed fee in advance of performing any services for the client.

Questions:

1. May Lawyer enter into fixed fee agreements with clients?

2. May Lawyer deposit prepaid fixed fees in Lawyer's general account?

3. May Lawyer keep all of the prepaid fixed fee even if the representation ends before all of the work is performed by Lawyer?

4. May Lawyer charge more than the fee fixed by the agreement when the matter unexpectedly involves more work than usual for the particular matter?

Conclusions:

1. Yes, qualified.

2. No, qualified

3. No, qualified.

4. No, qualified.

Discussion:

For purposes of this opinion, the term *fixed fee agreement* includes any fee agreement in which the lawyer's charge for specified services is a fixed dollar amount, regardless of when the lawyer is paid or how much work the lawyer must do and regardless of the name applied by the lawyer to the agreement—e.g., "flat fee," "nonrefundable retainer," "prepaid legal fee," etc.

1. *Propriety of Fixed Fee Agreements.*

Oregon RPC 1.5(a) and (b) provide:

> (a) A lawyer shall not enter into an agreement for, charge or collect an illegal or clearly excessive fee or a clearly excessive amount for expenses.
>
> (b) A fee is clearly excessive when, after a review of the facts, a lawyer of ordinary prudence would be left with a definite and firm conviction that the fee is in excess of a reasonable fee. Factors to be considered as guides in determining the reasonableness of a fee include the following:
>
> (1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;
>
> (2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;
>
> (3) the fee customarily charged in the locality for similar legal services;
>
> (4) the amount involved and the results obtained;
>
> (5) the time limitations imposed by the client or by the circumstances;
>
> (6) the nature and length of the professional relationship with the client;
>
> (7) the experience, reputation, and ability of the lawyer or lawyers performing the services; and
>
> (8) whether the fee is fixed or contingent.

The Oregon RPC do not prohibit fixed fee agreements. In addition, case law establishes that fixed fee agreements are permitted as long as they are not excessive or unreasonable. *In re Hedges*, 313 Or 618, 623–624, 836 P2d 119 (1992) ("[W]here a [nonrefundable fixed fee] arrangement is used 'the designation of the fee as nonrefundable must be made by a clear and specific written agreement between client and lawyer.'"); *In re Biggs*, 318 Or 281, 293, 864 P2d 1310 (1994). The mere fact that a fixed fee may result in a fee in excess of a reasonable hourly rate does not in itself make the fee unethical. *In re Gastineau*, 317 Or 545, 552, 857 P2d 136 (1993). On the other hand, "The disjunctive use of the word 'collect' means that the excessiveness of the fee may be determined after the services have been rendered, as well as at the time the employment began." *In re Gastineau, supra*, 317 Or at 550–551; OSB

Formal Ethics Op Nos 2005-15, 2005-69, 2005-97; *In re Sassor*, 299 Or 720, 705 P2d 736 (1985).

2. *May Prepaid Fixed Fees Be Deposited into the Lawyer's General Account?*

Oregon RPC 1.15-1(a) provides, in pertinent part:

> (a) A lawyer shall hold property of clients or third persons that is in a lawyer's possession separate from the lawyer's own property. Funds, including advances for costs and expenses and escrow and other funds held for another, shall be kept in a separate "Lawyer Trust Account" maintained in the state where the lawyer's office is situated, or elsewhere with the consent of the client or third person. Each lawyer trust account shall be an interest bearing account in a financial institution selected by the lawyer or law firm in the exercise of reasonable care. . . .

Oregon RPC 1.15-1(c) provides:

> A lawyer shall deposit into a lawyer trust account legal fees and expenses that have been paid in advance, to be withdrawn by the lawyer only as fees are earned or expenses incurred.

Ordinarily, fees are earned as work is performed. *See* OSB Formal Ethics Op No 2005-149. Without a clear written agreement between a lawyer and a client that fees paid in advance are earned on receipt, such funds must be considered client property and are, therefore, afforded the protections imposed by Oregon RPC 1.15-1. *In re Biggs, supra* (discussing *former* DR 9-101). If there is a written agreement that the fixed fee is earned on receipt, the funds belong to the lawyer and may not be put in the lawyer's client trust account. If no such agreement exists, the funds must be placed into the trust account and can only be withdrawn as earned. *See, e.g., In re Hedges, supra;* OSB Formal Ethics Op No 2005-149.

3. *Early Termination by Client and the "Nonrefundable Fee."*

A lawyer who does not complete all contemplated work will generally be unable to retain the full fixed fee. This is consistent with *In re Thomas*, 294 Or 505, 526, 659 P2d 960 (1983), in which the court stated: "It would appear that any fee that is collected for services that is not earned is clearly excessive regardless of the amount." Accordingly, even a fee designated as "nonrefundable" is subject to refund if the specified services are not performed. Thus, designation of a prepaid fixed fee as "nonrefundable" may be misleading, if not false, in violation of Oregon RPC 8.4(a)(3) (prohibiting conduct involving "dishonesty, fraud, deceit or misrepresentation that reflects adversely on the lawyer's fitness

to practice law"). Whether, or to what extent, a bad-faith termination by a client near the end of a matter requires a refund of fees paid in advance is a question beyond the scope of this opinion.

4. *Charges in Excess of Fixed Fee Agreement.*

A lawyer may not charge more than the agreed-on fee, and any fee charged in excess of the agreed-on fee is excessive as a matter of law. It follows that unless either (a) the fee agreement itself allow for changes over time[1] or (b) the fee agreement is permissibly modified pursuant to OSB Formal Ethics Op No 2005-97, the agreed-on fixed amount is all that the lawyer may collect.

Approved by Board of Governors, August 2005.

[1] For example, a fixed fee agreement might provide a fixed fee for each stage of a project rather than a fixed fee for the whole. Similarly, agreements that allow periodic adjustments to hourly fees or costs are also permissible unless illegal or otherwise unreasonable.

COMMENT: For additional information on this general topic and other related subjects, see THE ETHICAL OREGON LAWYER §§3.2, 3.14, 3.19 (Oregon CLE 2003); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS §§34, 38 (2003); and ABA Model Rule 1.5.

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September 2007 *Multnomah Lawyer Ethics Focus*

Billing Ethics, Part 1: Time-Keeping & Fee Agreements

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When we are in law school, billing is an area that gets scant, if any, attention. Yet, for lawyers in private practice, billing is a mundane but essential element of the business-side of running a law firm. Billing is also an area where disputes with clients can arise and, in that event, lawyers often face heightened scrutiny. This month and next, we'll look at two primary facets of "billing ethics." In this column, we'll review the essential ethical elements of time-keeping and fee agreements. Next month, we'll look at client trust accounts. With both, the practical consequences of problems can run the spectrum from misunderstandings with clients to regulatory discipline to claims for breach of fiduciary duty and attendant fee forfeiture. Again with both, ready guidance is available from the Oregon State Bar's ethics opinions, which are available on-line at www.osbar.org.

Time-Keeping. If you are using the still-predominant hourly-based fee system, "the" essential ethical element of time-keeping is to accurately record and report your work. OSB Formal Ethics Opinion 2005-170 makes plain that the "dishonesty rule," RPC 8.4(a)(3), applies squarely to time records. The Oregon Supreme Court has made that same point in several disciplinary cases, including *In re Miller*, 303 Or 253, 735 P2d 591(1987), where it described (at 257) this duty

as "fundamental to the attorney-client relationship." In *Miller*, the lawyer billed clients for time not worked and for expenses not incurred. He was disbarred.

Fee Agreements. Oregon law permits a wide variety of fee agreements, including hourly, contingent and "flat" fees (or combinations). Each presents discrete ethical considerations, but all fee arrangements are subject to RPC 1.5's requirement that fees not be "clearly excessive," which both the rule and the ethics opinions equate with a "reasonable" fee. RPC 1.5(b) lists the factors which, in a given representation, may be taken into account in determining whether a fee is reasonable. RPC 1.5(b)'s list, which is not exclusive, ranges from the time involved to the skill and experience of the lawyer.

Although some fee agreements, such as contingent fees for personal and property damage cases falling under ORS 20.340 and flat fees denominated as "earned upon receipt" governed by OSB Formal Ethics Opinion 2005-151 and associated court decisions, are required to be in writing, it is generally wise to have a written fee agreement in each matter or set of matters to avoid misunderstandings with clients. In particular, items such as categories of expenses to be charged, interest on past due bills, advance deposits or other security for payment should be explained. Similarly, although the RPCs do not specify a particular format for bills, we have a general duty to communicate under RPC 1.4 and, therefore, bills should contain enough detail to inform the client of the nature of the work performed for the amount charged. Further, if the lawyer

is to receive payment in a form other than money, such as stock in lieu of a fee, the special disclosure and consent requirements for lawyer-client business transactions under RPC 1.8(a) may apply.

With hourly fee agreements, the focus as discussed above in Formal Ethics Opinion 2005-170 and *Miller* is accurately recording and reporting time worked. Formal Ethics Opinion 2005-170 notes in particular that if a lawyer is billing multiple clients for simultaneous service, such as attending a deposition for two clients or reviewing a contract for one client while flying on a second client's business, the time must be divided rather than multiplied.

Contingent fees are generally permitted in a wide variety of practice settings, except for marital dissolution and attendant property division, spousal or child support determinations and criminal defense (*see* RPC 1.5(c); *see also* RPC 1.8(i)(2)). The form libraries available on-line from both the Oregon State Bar and the Professional Liability Fund (www.osbplf.org) contain model contingent fee agreements. Although as a matter of statutory law only some contingent fee agreements must be in writing, as a matter of contract law it is wise to put all contingent fee agreements in writing because regardless of the practice setting, the lawyer will be held to the arrangement negotiated with the client (*see* OSB Formal Ethics Op. 2005-15 at 33). Further, because ambiguities in fee agreements are generally construed against the lawyer (*see, e.g.,* OSB

Formal Ethics Op. 2005-124 at 329), the elements of the contingent fee should be detailed for the client.

"Flat" fees for a particular matter, set of matters or individual services are generally permitted under OSB Formal Ethics Opinions 2005-98 and 2005-151. Like their hourly and contingent fee counterparts, they remain subject to RPC 1.5(a)'s standard that they cannot result in an unreasonable/clearly excessive fee. However, as OSB Formal Ethics Opinion 2005-151 observes (at 410), "[t]he mere fact that a fixed fee may result in a fee in excess of a reasonable hourly rate does not in itself make the fee unethical." This ethics opinion (at 411), together with *In re Fadeley*, 342 Or 403, 409-11, 153 P3d 682 (2007), and *In re Balocca*, 342 Or 279, 286-90, 151 P3d 154 (2007), also find that agreements for fixed fees denominated as "nonrefundable" or "earned upon receipt" must both be in writing and must be clear on that point. The same opinion notes as well (at 411) that "[a] lawyer who does not complete all contemplated work will generally be unable to retain the full fixed fee" and *Fadeley* and *Balocca* concur.

With all fee agreements, the lawyer cannot change its terms unilaterally (*see* OSB Formal Ethics Op. 2005-97). Therefore, if the lawyer wishes to, for example, reserve the right to increase an hourly fee over the course of a matter, the lawyer should include a mechanism to do so in the original fee agreement with the client. If not, then any adjustment must be subject to an agreed amendment by the client and Formal Ethics Opinion 2005-97 notes (at 234) that

an adjustment in the lawyer's favor both "requires client consent based on an explanation of the reason for the change and its effect on the client" and "must be objectively fair." Both contingent and flat fees are also subject to these same criteria under, respectively, OSB Formal Ethics Opinion 2005-69 (contingent fees) and 2005-151 (flat fees).

Summing Up. For lawyers in private practice, time-keeping and billing are essential parts of the business-side of running a firm. At the same time, they are areas where disputes can arise with clients and, if they do, lawyers are generally subject to increased scrutiny. It pays, therefore, in both a monetary and practical sense, to devote the same care to time-keeping and billing that lawyers bring to their legal work itself.

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