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THE ATTACK ON TRADITIONAL BILLING PRACTICES

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I. INTRODUCTION

The traditional hourly billing method is under attack from market forces, technological advances, and, most importantly, clients. The sophisticated clients of today are becoming unwilling to defer to their attorneys the complete control of their cases and, along with it, control of their legal expenses. With corporate downsizing, cutbacks, and the attempt to make the workplace more efficient, clients want to have some measure of control regarding the direction and cost of their legal services, especially as it concerns defense litigation. Clients may not know exactly what type of legal billing they want, but they know exactly what they do not want—a billing method that gives the attorney the ability to determine the costs with no added incentive for the attorney to be efficient with the clients' resources. Overall, clients want to pay a fair price for a reasonable amount of quality service. The question centers around what is, for each client, fair and reasonable.

The traditional hourly billing method has worked fairly well for a number of years. But now, with the technology available to reduce the number of hours required to perform a task, the greater number of attorneys in the market place, and the overall public perception that attorneys have the ability to take advantage of the unwary, other methods of billing are under increasing consideration. Currently, there seems to be no one method that will work for all clients and all cases. Although many attorneys recognize the need for change, no one is quite sure what the change should be. The purpose of this article is to discuss the competing interests of clients and attorneys, and to suggest ways to implement new technologies with alternate billing methods that benefit both the lawyer and the client.

II. THE HISTORY OF THE BILLABLE HOUR

The billable hour method did not become popular until the mid-1960s, when the American Bar Association released the results of a study entitled *The*

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1958 Lawyer and His 1938 Dollar, which claimed that lawyers who recorded time expended per client and used that information to formulate their legal fees actually made more money than lawyers who did not.[1] Previously, lawyers used a variety of value-based billing methods, such as fixed,[2] contingent, percentage, or value[3] billing.[4] The adoption of the billable hour had several advantages in addition to increased revenues. With data on how they were actually expending their time and effort, attorneys were able to determine the most profitable areas of their practices and make adjustments accordingly by increasing fees, becoming more efficient, abandoning unprofitable services, or concentrating on particularly profitable areas of practice.[5] Initially, lawyers kept their time by client, not because they intended to bill the client for each hour, but for the purpose of later determining a fair and proper fee.[6] Eventually, however, recording time led to the adoption of fees based solely on hourly rates rather than as an adjustment to the forms of billing already in place.

The transition from charging a fixed rate to charging clients by billable hour was relatively easy for several reasons. First, at that time there was actually much more work than there were lawyers to do the work; thus there was no incentive for attorneys to be inefficient or to "churn" files.[7] Second, from a business standpoint, measuring the hours of work that a lawyer put into a task was an objective way to measure the amount a client should owe.[8] At the initial stages of the transition to hourly billing, hourly rates were determined by figuring the amount of overhead an attorney could expect to pay over the course of the year, adding in the amount the attorney expected to make in salary per year, and dividing that sum by the number of hours the attorney intended to work during the year.[9] The end number represented the hourly rate that attorney must charge each client.

The transition to the billable hour was hastened by the United States

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1. *See* William Kummel, Note, *A Market Approach to Law Firm Economics: A New Model for Pricing, Billing, Compensation and Ownership in Corporate Legal Services,* 1996 COLUM. BUS. L. REV. 379, 385 n.16.

2. A fixed-fee or task-based billing breaks large projects into smaller components, such as depositions or document production, and charges a fixed fee for each task.

3. Value billing is a subjective method that considers the complexity of the matter, the experience and reputation of the attorney, and the results to be achieved, as well as the time and labor involved.

4. *See* F. Leary Davis, *Back to the Future: The Buyer's Market and the Need for Law Firm Leadership, Creativity and Innovation,* 16 CAMPBELL L. REV. 147 (1994).

5. *See id.* at 158.

6. *See id.*

7. *See id.* at 159.

8. *See id.*

9. *See id.* at 158.

Supreme Court's 1975 decision, *Goldfarb v. Virginia State Bar*,[10] which set aside a minimum fee schedule as illegal price-fixing in violation of the Sherman Antitrust Act.[11] In that case, the Fairfax County Bar Association in Virginia set a minimum price schedule for various legal services, including title examinations required before purchasing real estate, which could only be performed by a member of the Virginia State Bar. While the minimum fee schedule was ostensibly only a list of recommended minimum prices for common legal services, enforcement was provided by the Virginia State Bar, which had published reports condoning fee schedules and had issued two ethics opinions indicating that attorneys could not ethically ignore fee schedules.[12]

The complaining parties in *Goldfarb* were a married couple who were in the process of buying a home and needed a title examination prior to closing. They contacted no less than thirty-seven attorneys requesting their fees for the title examination, and none indicated that they would charge less than the rate fixed by the schedule. In fact, several indicated to the couple that they knew of no attorney who would do the work for less. The United States Supreme Court held that the State Bar, because of its policy that deviation from County Bar minimum fees might lead to disciplinary action, had voluntarily joined in private anti-competitive activity and that these activities resulted in a rigid price floor from which consumers could not escape.[13]

The *Goldfarb* case, decided in 1975 when the billable hour was steadily gaining acceptance, gave a tremendous boost to the popularity of the new method of billing clients. Without minimum fee schedules to provide guidelines, the hour-based method was an easy choice as a method to determine the worth of the service provided.

Another factor encouraging the use of the billable hour to determine fees was the practice of courts in setting and approving awards for attorneys' fees.[14] After the demise of the minimum fee schedules, the courts needed an objective method that was easy to apply in determining attorneys' fees. Hourly billing provided an administratively simple method that appeared fair to all participants.

Although simple to implement, the use of the hourly rate, unfortunately, rewards inefficiency. The more hours worked, the more fees are generated. Clients are now rebelling and demanding more efficiency; the technology now

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10. 421 U.S. 773 (1975).

11. *See id.* at 791-92. *See* 15 U.S.C. § 1 (1988) for the text of the Sherman Act disallowing price-fixing.

12. *See Goldfarb*, 421 U.S. at 777 n.5 (citing Virginia State Bar Comm. on Legal Ethics, Ops. 98, 170 (1960 &1971)).

13. *See id.* at 791-92.

14. *See* Davis, *supra* note 4, at 162.

available makes such efficiency possible.

III. NEW REALITY

Putting all of the above factors together, the climate is right for a switch from hourly billing to fixed and value rates. With the advent of advanced technology to speed up research and document production, along with the greater number of attorneys per capita,[15] hourly billing has become, simultaneously, a less attractive method for attorneys to retain profits and a less attractive arrangement for clients to manage their legal costs. Overall, in today's market, the billable hour is not as efficient as it was in the 1960s and 1970s. In many areas of the country the number of lawyers exceeds the amount of work, which has led to abuses in billing rather than reducing fees because of competition. For example, a partner at a major New York firm, who was described as "a powerful rainmaker," was disbarred when it was discovered that he falsely billed clients over $45,000.00.[16] A partner at a Chicago firm was ridiculed for claiming to have logged 6,022 billable hours in 1993, and for exceeding 6,000 billable hours in each of four consecutive years.[17]

Additionally, whereas it previously promoted increased revenues, the billable hour has now become an impediment to profits. Because of recent technology, such as online research services and desktop computers, attorneys have the capability for increased efficiency and productivity. Unfortunately, because implementing technology increases attorney costs while simultaneously reducing attorney revenues, hourly billing actively discourages these efficiencies.[18] CD-ROM and online research tools often exceed the cost of the books they replace, especially when these costs cannot be passed on to the client because of ethical constraints or clients' refusal to pay for what they perceive to be overhead. Further, while increasing costs, these tools dramatically reduce the amount of time needed to complete research projects resulting in reduced revenues for attorneys billing by the hour. This double-sided pressure on attorney revenues is an increasing problem. With the advanced

15. *See* Davis, *supra* note 4, at 162. In 1950 there were 741 persons per lawyer, whereas in 1992, there were only 318 persons per lawyer. *See* Davis, *supra* note 4, at 153.

16. *See* Ann Davis, *Ousted Rainmaker Finally Falls*, NAT'L L.J., Aug. 7, 1995, at A4.

17. *See* Karen Dillon, *6,022 Hours*, AM. L., July-Aug. 1994, at 57.

18. *See generally* Note, *Why Law Firms Cannot Afford to Maintain the Mommy Track*, 109 HARV. L. REV. 1375-76 (1996) (proposing that the billable hour encourages inefficiency and actually prevents women with family responsibilities from advancing above the glass ceiling into partnership and management positions in law firms because promotions are given based on actual time billed).

technology, attorney revenues will gradually decline under an hourly billing system unless one or more of the following three events occur:

1. Increased productivity attracts additional business;
2. Law firms downsize to eliminate unprofitable or low margin services;
3. Corporate clients agree to increased hourly rates.[19]

Because none of the above scenarios is especially appealing and/or likely to occur, hourly billing will continue to discourage both the use of new technology and overall efficiency in law firms which bill by the hour. Consequently, these disincentives to efficiency and abuses of the hourly billing system create an atmosphere that is ripe for yet another change in the way attorneys bill their clients.

IV. THE PROBLEMS OF ADVANCEMENT

To illustrate the issues that attorneys now face in adapting to the new legal technology, consider the following examples:

Attorneys have traditionally used printed books for their research. Hundreds of reporters that contain both federal and state cases and statutes have been the standard tools for research. The number of books in the average firm often exceeds the space available for their storage. If a case or statute is needed which cannot be found in the firm library, a trip to the law library is required. For many solo practitioners, the law library is the primary source of research material. Traditionally, the only costs which can be passed along to the client for whom the research is conducted are copying costs and the actual time the attorney spends while researching. The cost of maintaining a library in the firm has been considered an overhead expense and, in order to cover that expense, an attorney must build that cost into his or her hourly rate.

The inconvenience of both space limitations and the time expended in trips to the library, which may be a considerable distance away, has been relieved to no small degree by the advent of online computer services, such as Lexis-Nexis and Westlaw. These services offer the luxury of a complete library via modem and computer, while consuming much less office space than the never-ending rows of books. However, the expense of these online services has been, for many attorneys, cost prohibitive. Books are purchased but once and remain available indefinitely. Traditionally, online services have charged by the minute, requiring multiple payments for the same materials if used repeatedly. The one cost advantage of the online services, other than the

19. *See* Kummel, *supra* note 1, at 392.

obvious advantages of quicker and more precise research, is that the monthly billing statement from the online services itemizes the research charges by client. Itemized charges allow the attorney to pass the actual cost of the service directly to the client for whom the service is needed, assuming the client is both able and willing to pay such costs. Under this scenario, the online services cause no increase in library overhead, other than perhaps the initial cost of the computer and printer. However, billing online costs directly to clients is under attack for both ethical and market-driven considerations.

Since the introduction of online services, computer research has become even more advanced. Today, we have available vast numbers of CD-ROM products which give attorneys even more research flexibility, not only allowing further replacement of bulky books on law firm shelves, but also providing a search engine[20] which is much more user friendly than the cumbersome indexes of the books. This form of research also allows attorneys who cannot afford online services, which have traditionally charged by the minute or transaction, to pay one flat fee for the CD-ROM, thus keeping their library costs at a fixed rate just as they do with book libraries. Unfortunately, CD-ROM products tend to be somewhat more expensive than their printed counterparts.

Responding to the CD-ROM market, online services are now offering flat fee contracts for their services so that attorneys can fix their research budget as they can with CD-ROM. Overall, this competitive market has created great opportunities for attorneys who have resisted the switch from books to computers. Nevertheless, these new services are still more expensive than traditional book libraries, albeit much more efficient and effective both in terms of time and the quality of the final product.[21]

Altogether, the new research technology means that practitioners now have greater amounts of information at their fingertips than ever before, and the research time needed to gather this information has been greatly reduced. In fact, an argument can be made that attorneys have an ethical obligation to use these more efficient services to represent their clients. Combining Rules 1.1[22] and 1.5[23] of the Arkansas Rules of Professional Conduct, it is conceivable that

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20. A search engine is a "program that helps users find specific information. One typically enters a word or phrase and the search engine will seek out matches for the word or phrase." WEST'S TRAINING PACKAGE-GLOSSARY; WEST GROUP WORLD WIDE WEB (1998).

21. When our firm was pricing a particular service, the cost difference between that company's book version and CD-ROM version, both offering the same availability of materials, was approximately $1,000, the CD-ROM being the more costly of the two.

22. Rule 1.1 of the Arkansas Rules of Professional Conduct states as follows: "A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation." ARK. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.1 (1986).

23. Rule 1.5 of the Arkansas Rules of Professional Conduct, as more fully set out in Part V, requires that "a lawyer's fee shall be reasonable." ARK. MODEL RULES OF PROFESSIONAL

the mandates of competent representation and reasonableness of fees, along with the broad availability and wide usage by other attorneys of these services, dictate that failure to use time-saving and more reliable research methods constitutes negligence. Consequently, the standard for what is considered adequate representation may now have been raised.

Unfortunately, the reduction of research time required to answer a client's question also means that an attorney's billable hours are reduced.[24] Additionally, for the CD-ROM and flat rate online services, it is not readily apparent how and whether it is permissible to pass these costs on to the clients who benefit from these advancements. These expenses have been viewed as overhead, rather than as costs that can be billed to clients, because the services essentially replace traditional book libraries.[25] Nevertheless, from a law firm's business perspective, expenses have risen to pay for these more expensive services which provide clients with more efficient service, while collections based on billable hours have decreased because of the reduced time required to complete a project.[26] The problem becomes how to represent clients effectively using the best research tools available and, at the same time, protect the profit margins of the attorney. The goal must be to determine how both the client and the attorney can benefit from modern legal technology.

A similar problem arises from the advances in word processing programs.[27] After spending twenty hours on a project requiring the drafting of

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CONDUCT Rule 1.5 (1986).

24. To test this hypothesis, when our firm purchased a CD-ROM product on health law, we asked an associate to research an issue that had been researched several years ago without the advantage of any computerized assistance. The difference in the time required for the two research projects to be completed was striking. Where the original research project, concerning a very complicated issue involving the interaction of different statutes and regulations, required a full two weeks to complete, the second research project was completed in only three days. Both were of comparable quality, arriving at the same conclusion and finding roughly the same cases, statutes, and regulations. This substantial reduction in research time will result in long-term savings to our clients, and provide some relief to our associates, but will not add to firm revenues.

25. *See* Conn. Comm. on Professional Ethics, Informal Op. 96-3 (1996).

26. The old adage of the watermelon truck is applicable in this situation. If a person buys watermelons from the farmer at 75 cents, but can only sell the watermelons in town for 50 cents, the answer to his economic problem is not a bigger truck.

27. An analysis was performed based on a Price Waterhouse study which tested, among other things, the hypothesis that the greater the number of computer work stations, the more profitable the firm. *See* S. S. Samuelson and L. J. Jaffe, *A Statistical Analysis of Law Firm Profitability*, 70 B.U. L. REV. 185 (1990). The study determined that law firms make substantial investments in computer technology because they expect the technology to increase profitability. *See id.* at 197. To the extent that the computers replace expensive and unbilled staff time, this presumption was held to be true in the results of the study. *See id.* at 197, 208. Additionally, the article notes that firms may be unable to compete effectively for business in the legal market without computerized advances. *See id.* at 198. Despite these factors, however, the study determined that each time the number of workstations increased, the net

complicated documents for one client, who pays the bill for the entire time required to complete the task, a problem arises where similar documents are needed for later clients. Using the traditional form of hourly billing, the first client pays for the entire research and drafting time, while subsequent clients benefit at the first client's expense, paying only for the time necessary to tailor the document to their needs. Under traditional hourly billing practices, while all the clients get the service they request, the first pays much more than the others for the same service. Many attorneys have sought to bill the second and subsequent clients needing the same service some value-added fee to reflect the benefit they are receiving. Recent ethics opinions, however, challenge this practice.[28] On the other hand, it is not equitable for later clients to receive at no cost the benefit of earlier work; the value received is simply too great. Thus, attorneys must wrestle with the issue of how to balance the equities of this situation so that everyone receives fair value. This is a classic example of a situation in which negotiated value billing would be a superior method than traditional hourly rates for the initial client, the later clients, and the attorney.

V. ETHICS OPINIONS

Despite the rising costs of practicing law, attorneys can no longer blithely pass all their costs through to their clients. First, many companies flatly refuse to pay for internal costs such as copying or online research, which they consider overhead. Instead, they pay only for charges paid to third parties, and those only if incurred pursuant to the client's guidelines. Second, recent ethical decisions sharply limit an attorney's ability to charge such costs to clients. In December 1993, the Ethics and Professional Responsibility Committee of the American Bar Association handed down Formal Opinion 93-379 entitled *Billing for Professional Fees, Disbursements and Other Expenses*.[29] In that opinion, the ABA attempted to clarify what costs may and may not be

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income of the partners increased by only $127.00. *See id.* at 208.

28. *See* ABA Comm. On Ethics and Professional Responsibility, Formal Op. 93-379 (1993) [hereinafter *1993 Formal Opinion*].

29. *See id.* The Committee noted:

> It is a common perception that pressure on lawyers to bill a minimum number of hours and on law firms to maintain or improve profits may have led some lawyers to engage in problematic billing practices. These include charges to more than one client for the same work or the same hours, surcharges on services contracted with outside vendors, and charges beyond reasonable costs for in-house services like photocopying and computer searches. Moreover, the bases on which these charges are to be assessed often are not disclosed in advance or are disguised in cryptic invoices so that the client does not fully understand exactly what costs are being charged to him.

Id.

permissibly charged to clients when charging an hourly fee for services. When the client has agreed to pay attorneys' fees based on the time spent accomplishing the client's goals, the attorney may not bill the client for more time than is actually expended on the task, except to the extent that the attorney rounds up to minimum time periods. Both one-quarter and one-tenth of an hour are acceptable minimum time periods. Additionally, when charging an hourly fee, a client may not be billed for overhead expenses incurred by the attorney which are generally associated with the maintenance, staff, or equipment of the law firm. Nevertheless, the client may be billed for in-house services performed in direct connection with the client's matter, such as photocopying, computer research, long distance telephone calls, courier services, secretarial overtime, and other similar services, provided the attorney's charges to the client are reasonably based on the actual cost of the services provided. As for third party services, such as court reporters and expert witnesses, the attorney may charge only the actual amount of the cost incurred to procure those services, except to the extent that the attorney incurs additional costs in acquiring the third party service.

The Committee gave several examples of problematic billing practices which it intended its Opinion to regulate. One example occurs when an attorney schedules court appearances for three clients on the same day. He spends a total of four hours at the courthouse, the same amount of time he would spend for each client individually but for the fact that he was able to schedule several cases for the same day. A second example involves travel time. An attorney, traveling on behalf of one client, is able to work on another client's file en route. Third, and more problematic, with the advanced computer technology available today, research performed on a particular topic for one client may later become relevant to a second client. Overall, the three scenarios highlight the billing conflicts that arise in the attempt to be fair and equitable to both clients and attorneys.

The Committee's inquiry began with the Model Rules of Professional Conduct. Rule 1.5 addresses the reasonableness of attorney fees directly, listing factors to be considered when setting a fee, which 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.[30]

Second, the Rules require full disclosure to the client of the basis for determining legal fees. Disclosure should be made at the outset of the representation, for example, in the engagement letter.[31] The Comment to Rule 1.5 also instructs that "[w]hen developments occur during the representation that render an earlier estimate of the fees substantially inaccurate,"[32] the attorney must consult with the client regarding a revised estimate.[33] The Comment recommends that the attorney furnish each client with a written statement or memorandum explaining the charges to reduce the possibility of any misunderstanding. The duty to disclose the manner in which an attorney assesses fees is also supported by Rule 7.1, which prohibits an attorney from making false or misleading representations about the attorney or the attorney's services, or omitting a fact necessary in order for the client not to be misled.[34]

In response to the three hypothetical situations raised by the Committee in the Opinion, the Committee's position, based upon the ethical Rules, is as follows:

1. Spending four hours of time on behalf of three clients does not earn an attorney twelve billable hours;

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30. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.5(a)(1)-(8) (1997).

31. Rule 1.5(b) of the Rules of Professional Conduct states, "When the lawyer has not regularly represented the client, the basis or rate of the fee shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.5(b) (1997). Similarly, the Model Code of Professional Responsibility, "DR 2-106, contains . . . the same [requirements of] reasonableness, but does not require that basis of the fee be communicated to the client 'preferably in writing.'" *1993 Formal Opinion*, *supra* note 28, at n.2.

32. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.5 cmt. 1 (1997).

33. *See id.*

34. Rule 7.1 of the Arkansas Rules of Professional Conduct provides:

A lawyer shall not make a false or misleading communication about the lawyer or the lawyer's services. A communication is false or misleading if it:

(a) Contains a material misrepresentation of fact or law, or omits a fact necessary to make the statement considered as a whole not materially misleading;

(b) Is likely to create an unjustified expectation about results the lawyer can achieve, or states or implies that the lawyer can achieve results by means that violate the rules of professional conduct or other law; or

(c) Compares the lawyer's services with other lawyers' services, unless the comparison can be factually substantiated.

ARK. MODEL RULES OF PROFESSIONAL CONDUCT Rule 7.1 (1986).

2. Traveling for six hours for one client and working for five hours while en route for a second client does not earn an attorney eleven billable hours;
3. Reusing old work product does not re-earn the attorney the hours previously billed to and paid for by the first client.[35]

Overall, the Committee decided that the attorney who agrees with his client to bill solely on the basis of time expended on the client's matter is obligated by the Rules of Professional Conduct to pass the benefits of his time-saving efforts on to the client: "The practice of billing several clients for the same time or work product, since it results in the earning of an unreasonable fee, therefore is contrary to the mandate of the Model Rules."[36]

As for what costs can be passed along to the client, the Committee stated that general overhead expenses should not be charged to the client, absent complete disclosure in advance of the engagement. The type of expenses that a client would not normally expect to incur, in absence of an agreement to the contrary, include the attorney's costs for a library, malpractice insurance, office space, and utilities. Traditionally, these costs are included in the hourly rate each client pays for services rendered.[37]

With all of the above limitations in mind, however, the Committee addressed only issues arising from strict hourly-based billing. The Committee left the door open to alternate billing methods when those methods are fully disclosed by the attorney and agreed to by the client. The Committee specifically stated, "This is not to say that the lawyer who agreed to hourly compensation is not free, with full disclosure, to suggest additional compensation because of a particularly efficient or outstanding result, or because the lawyer was able to reuse prior work product on the client's behalf."[38] Accordingly, if an attorney properly discloses to the client that, in addition to billing the client in the traditional hourly method, the attorney reserves the right to bill the client for work based on its value, such as with forms or previously drafted documents, then the attorney is complying with the ethical requirements. The attorney is able to provide the client a valuable service, while ensuring adequate compensation for the true value of services. Similarly, if the

35. *1993 Formal Opinion*, *supra* note 28.

36. *1993 Formal Opinion*, *supra* note 28. It goes without saying that a lawyer who has undertaken to bill on an hourly basis is *never* justified in charging a client for hours not actually expended. If a lawyer has agreed to charge the client on this basis and it turns out that the lawyer is particularly efficient in accomplishing a given result, it nonetheless will not be permissible to charge the client for more hours than were actually expended on the matter. *1993 Formal Opinion*, *supra* note 28 (emphasis added).

37. *1993 Formal Opinion*, *supra* note 28.

38. *1993 Formal Opinion*, *supra* note 28.

attorney devises a reasonable method for passing on to the client the additional cost of CD-ROM technology or the portion of a flat rate contract with an online service used on behalf of a client, and if the arrangement is properly disclosed to and agreed to by the client, this type of cost arrangement would comply with the ethical guidelines of the ABA Opinion. Because these billing methods deviate from the standard hourly method, it requires the attorney to make full disclosure to ensure that the client understands and agrees to the arrangement. The best way to accomplish all of these goals is through the effective use of the engagement letter.

VI. ALTERNATE BILLING ARRANGEMENTS

While proving to be problematic, the hourly billing method can be altered to produce more efficient results for clients without significant alterations in attorney revenues. This article does not advocate the complete demise of the billable hour because the method has proven itself in many instances to be an effective measuring rod for the proper fees a client should pay. Although a fixed or value-based fee for a particular service is entirely efficient and appropriate in many situations, for ongoing clients with a variety of matters needing legal attention a fixed or value-based rate may be impracticable, requiring the attorney and client to reach a new bargain on fees each time the client has a new legal matter to resolve.

While clients object to its excesses, many also fear that abandoning the hourly rate for purely fixed or value billing will make it difficult for them to evaluate and control the cost of their legal services. As a result, they do not want to abandon hourly billing entirely, only to modify it to avoid rewarding inefficiency and ineffectiveness. Especially for ongoing client relationships, a hybrid method of the billable hour and value billing for documents and research already in the attorney's data banks would promote efficiency of legal resources and allow the attorney to pass along those efficiencies to the client in the form of a reduced monthly statement. Some of the methods that can be either incorporated into hourly billing or used in lieu of the traditional method include incentive fee arrangements, task-based billing, and flat fee arrangements.

A. Incentive Fee Arrangements

The incentive fee arrangement creates an incentive for the attorney to obtain a favorable result at a lower cost to all clients in a manner not unlike the contingent fee arrangements for plaintiff clients. An example of such an arrangement might involve a client-defendant in a product liability action.

After the attorney makes an initial investigation, perhaps at established hourly rates, the client and the attorney agree that the expected damages, if the client is held liable, will be between $50,000 and $200,000; the client has a 50% chance of prevailing upon a motion for summary judgment or at trial; and the estimated legal fees through trial will be $150,000. The attorney and client further agree on a "target resolution value" of $90,000, which includes probable legal fees incurred and the amount estimated for a settlement or judgment. The incentive fee arrangement reached between the client and attorney might be as follows:

Resolution Value	Client Pays
$0-25,000	150% of fees
$25,001 - 50,000	135% of fees
$50,001 - 80,000	120% of fees
$80,001 - 100,000	100% of fees
$100,001 - 130,000	90% of fees
$130,001 - 180,000	80% of fees
$180,001 - 250,000	70% of fees
$250,001 and up	60% of fees

The attorney is given an incentive to resolve the lawsuit for the lowest possible cost to the client. The client benefits either from low fees and/or settlement costs due to a favorable resolution of the case or from reduced fees if the settlement or judgment is not favorable. However, substantial thought and effort must go into the formulation of the incentive fee agreement each time it is used in order to be fair to both the attorney and the client. It is not a fee arrangement that should be used without a thorough review of the facts and law relevant to the particular matter.

B. Task-Based Fees

Another option is adopting a fee system based on tasks completed rather than hours worked. Tasks can be defined as narrowly as a specific deposition or as broadly as completion of fact research and case analysis. A task-based system can operate in a variety of ways. For example, fixed fees for specific tasks might be negotiated, creating an incentive for the attorney to perform

efficiently and including an amount calculated to cover the costs associated with the task in addition to attorneys' fees.

To illustrate, if the attorney and the client agree that the cost for a motion for summary judgment would be $5,000 and the attorney normally bills at an hourly rate of $200 per hour, the attorney would have an incentive to complete the work related to the motion in less than 25 hours. On the other hand, the client knows his cost for the summary judgment motion would not exceed $5,000. Thus, the attorney bears the risk that the task might take more time than estimated, but reaps the reward if he can do it in less. On the other hand, the client gains protection against escalating expenses he cannot easily control. To avoid misunderstanding, however, the scope of the task must be carefully defined and every effort made to ensure that the charge for the task is fair.

A second approach is to use task-based estimates to create a working budget. This approach does not offer the attorney the incentive for efficiency nor the client the cost guarantee of the former approach; it does permit the client to control the decisions that drive the cost of legal services. If expenses are going to exceed the budget, the attorney must explain and obtain the client's approval. Many clients feel they can efficiently control their legal costs, particularly litigation costs, as long as they control the decisions that drive these costs. For example, what witnesses should be deposed? What legal theories should be developed? These clients are willing to pay more, but only if it is their decision and they see a cost benefit to the service in question. These clients perceive that attorneys made such decisions by default in the past and that legal costs can best be controlled when they make the decisions instead. Incremental, task-based budgets allow clients to accomplish this better because they require attorneys to evaluate and budget for each aspect of the litigation preparation or other legal service.

C. Flat Fee Billing

Flat fee billing is similar to task-based billing, but the fee is charged for handling a matter from beginning to end. This option works well where there is a high volume of similar matters with approximately the same time and costs involved. For example, repetitive transactions such as mortgages or title opinions lend themselves to flat fee billing. Highly individualized matters, however, such as litigation, are less suited to this approach and might be better candidates for incentive or task-based fee arrangements.

VII. ADDED BENEFITS OF TECHNOLOGY

Curiously enough, the technology that has caused some of the concerns raised by this article can also play a part in better understanding how to bill clients for particular tasks. Technology exists in computerized legal billing programs to monitor how much time is expended on any one task so when subsequent clients require similar tasks the attorney can better estimate the average cost. In essence, the technology that is currently reducing revenues can also assist in assessing the true value of attorney services. For example, defense litigation fees and costs have traditionally been the most difficult to estimate for value billing purposes. Thus, the hourly rate has typically been the method of choice when billing the defense client. However, technology now exists to track costs and time spent on litigation and to build a data base that, over time, will allow an attorney, or corporate counsel, to determine a value-based fee for defense litigation.

The American Bar Association Litigation Section has promulgated a Uniform Task-Based Budget and Billing Format which is designed to project and track the cost of litigation by significant phase and task.[39] The goal of the ABA system is to enable counsel to plan efficient and effective litigation, effectively communicate the activities and costs of litigation, and maintain efficient and effective litigation by understanding and discussing with the client any variations from the norm. The format is divided into the five basic phases of litigation: Case Assessment, Development and Administration; Pretrial Pleadings and Motions; Discovery; Trial Preparation and Trial; and Appeal. These five phases are then subdivided into tasks.[40] All activities associated with a task should be included in the budget and bills for that category.

The ABA system is just an example of how to use technology and the billable hour to make the gradual conversion to a value-based billing system. Regardless of the method used, knowing one's individual capabilities and typical costs for past work can help the average attorney who is comfortable using hourly billing move to alternative methods without the worry that revenues will decrease unnecessarily.

In the final analysis, no one method of billing will fit all clients. For one-time, task-oriented clients, such as those needing wills, simple divorces and other repetitive document-driven matters, a fixed fee based upon the task itself is easy to determine and appropriate for the client. For clients who require ongoing representation, a mix between hourly rates and task-based billing may

39. *See* ABA, UNIFORM TASK-BASED MANAGEMENT SYSTEM: LITIGATION CODE SET (May 2, 1995).

40. *See id.*

be more appropriate. Additionally, for work more suited for hourly rates, such as research and litigation in an unfamiliar area of the law, different levels of hourly rates may be appropriate.

Litigation matters may be grouped into three broad categories. First, there are the enterprise-threatening matters which involve direct threats to the viability of the business itself or to the highest levels of enterprise leadership, such as the CEO and the Board of Directors. Cases involving trademark infringement, antitrust, intellectual property, or board of director liability issues generally fall into this category. Second, there are matters which require the specialized expertise of an attorney who practices primarily in a specific area, such as tax or labor and employment issues. Third is routine, repetitive work where cost may be the most critical factor. This category includes contracts, collections, and routine family law issues. In many cases, the same attorney may be capable of handling matters from any of the three general categories, but each category may require a different fee structure. In some manner, attorney and client must reach a fee arrangement for each matter handled.

VIII. THE VALUE OF THE ENGAGEMENT LETTER

No matter what fee arrangement is used, the starting point must always be a proper engagement letter. Although not specifically mandated by the Rules of Professional Conduct, a fee arrangement is best memorialized in writing, regardless of whether it is a list of standard charges or something tailored to a client's individual needs. Misunderstandings between clients and attorneys are all too frequent, and this is especially true of fee agreements viewed in hindsight. A proper engagement letter can minimize such problems. Whether a cost reimbursement provision, an incentive fee, hourly rates, or flat fee, in each instance an engagement letter should be used.

The following is a sample engagement letter which may be tailored to the individual client and the preferred method of billing.

> Dear Client,
>
> You have asked that we provide legal representation to you, and we will be honored to do so. This letter will set forth the terms of our engagement to represent you with respect to _(the Matter)____. Please acknowledge your acceptance of these terms by executing the appropriate signatory block at the end of this letter, and returning it to the above address.
>
> You have engaged __the name of firm or attorney__ (the "Firm" or "Attorney") to undertake certain legal representation as directed by you in the above referenced Matter. _____ will be the primary

attorney in the Firm working on the Matter; however, from time to time, others may be involved as the Firm considers necessary. It is agreed that _____ will be the primary contact person within the Firm and that _____ will be the contact person for the Matter unless the Firm is instructed otherwise. The Firm agrees to use its best efforts in representing you; however, you understand that the Firm is giving no assurances regarding the outcome of the Matter.

In connection with the engagement, you will pay the Firm for the performance of the legal services and pay certain expenses incurred in connection with the representation, all as more specifically set out in the following paragraphs. Payment is due upon receipt of each invoice or statement. Additionally, you will cooperate fully with the Firm and provide all information known or available to you which may aid the Firm in representing you in the Matter. Further, by this letter, you have authorized the Firm to take all actions which the Firm in its discretion deems advisable on your behalf. In keeping with this commitment, we agree to notify you promptly of all significant developments and to consult with you in advance as to any significant decisions attendant to these developments.

You and the Firm agree that the Firm will bill you at the following hourly rates of $_____ for the primary attorney, and other attorneys at $___ to ___, depending on their skill and experience. Paralegals and law clerks will be billed at the rate of $___ per hour. From time to time, the Firm's rates are changed and revised rates will be reflected on the Firm's statements. The Firm will keep a written record of its time and will generally record time in one-quarter hour minimum increments. In the event form documents are used which have been developed by the Firm at the expense of other clients, a flat charge may be added to compensate for the time savings inuring to your benefit. You and the Firm may agree upon certain flat fees, capped fees, discounts, premiums or other forms or arrangements with respect to any particular Matter from time to time. Upon request, the Firm will provide you with a budget or other estimate of legal fees with respect to any Matter. If so requested, you agree to assist the Firm in developing such budget or estimate and in developing a strategy related to such Matter, including clear goals, desires, and intentions. We agree that we will discuss and resolve promptly any issues which arise with respect to our bill whether such issues relate to fees or expenses.

You acknowledge that the Firm may incur various expenses in

providing services to you in this matter. You agree to reimburse the Firm for all out of pocket expenses paid by the Firm, or if you are billed directly for these expenses, to make prompt, direct payments to the originators of the bills. Such expenses include, but are not limited to, charges for servicing and filing papers, copies, courier or messenger services, recording and certifying documents, depositions, transcripts, investigations, witnesses, expert witnesses, telephone (cellular and long-distance), telefacsimile, postage, and travel. The Firm may charge a flat fee for computerized research of $____ per search. The Firm may charge a per page fee for printing laser copies of documents or computerized research results.

It is the practice of our office to compute not less than one-fourth of an hour for each telephone call no matter how short its duration and such additional time as may actually be expended, whether the telephone calls are from or to you or others concerning your Matter. We, therefore, encourage you to make notes about subjects to be discussed so as to maximize your time spent on the phone. We also encourage facsimile transmissions for information you may want to provide to us, especially if it involves a matter that does not need an immediate response.

The Firm reserves the right to withdraw from this engagement if you fail to honor this letter of understanding or for any just reason as is permitted or required under the Code of Professional Responsibility or permitted by applicable court rules. Notification of any such withdrawal shall be made in writing to you. In the event of any such withdrawal, you agree to pay for all expenses properly incurred pursuant to this letter of understanding. You may cancel our engagement at any time, but you will owe us for all expenses and fees incurred through such date, plus the costs, expenses and fees reasonably incurred by the Firm after such termination to wind up our representation.

This letter of understanding contains the entire agreement between you and the Firm regarding representation in the Matter and the fees, charges, and expenses to be paid relative thereto. Please sign where indicated below and return one original of this letter to the Firm and retain one original in your files. Your signature constitutes your acceptance of the terms and conditions of our engagement as set forth herein.

The Firm is pleased that you have chosen us to represent you. We assure you that we do not lightly accept your trust and confidence. We will endeavor to serve your needs promptly, responsibly

and efficiently. If you ever have any questions, comments or concerns, we encourage you to immediately address them to any member of the Firm.

Sincerely,

FIRM NAME

AGREED TO AND ACCEPTED:

_____
(Client's name)

_____
Date

This form letter can easily be adapted to fit almost any client or situation and can address the particular fee concerns attorneys may have. Proper disclosure to clients and their consent to the type of fee determination used by the attorney are keys to ethical and profitable billing practices, as well as savings to the client.

IX. CONCLUSION

The proper use of the engagement letter is neither the end of the discussion nor the ultimate answer to these problems, but it is the starting point for any solution. Over the long term, attorneys must look critically at their practice areas and determine which areas are candidates for non-traditional billing. Whether we like it or not, our clients are insisting on legal billing practices that incorporate the same market factors and customer service orientation they must consider in operating their businesses. The old paradigm of hiring an attorney, ceding to him the power to decide what should be done, then paying for each hour dedicated to that effort, is disappearing. In the last decade, American business has learned hard lessons about surviving in the global economy. Clients now expect their attorneys to do the same. Those of us who recognize this changing environment and embrace it as an opportunity may prosper. Those who do not are not likely to survive.