Get Beyond Hourly Billing and Into the New Decade

By Stephen E. Seckler and Matthew Sullivan

Hourly billing has been common practice in the legal profession for more than a half-century. While clients sometimes complained, until recently, law firms had little incentive to set fees any other way.

Now, as a result of the recession and other factors, clients are demanding not only lower rates, but fixed fees. In addition to seeking to control runaway legal expenses, clients want more certainty and predictability. The challenge for lawyers, therefore, is to find ways to reduce fees and increase predictability without reducing firm profitability.

Flat-fee billing is not without precedent in the legal profession. For example, it has long been customary to charge a fixed fee for residential real estate closings or simple wills. In most other matters, however, law firms have little experience in anything other than setting an hourly rate and counting the hours worked.

The good news is that other professions have been using fixed fees successfully for years. Accounting and management consulting firms, for example, figured out a long time ago that by standardizing processes (i.e., standardizing the way work gets done) and tracking the resources needed to complete different types of projects, lawyers will accumulate the information required to project future efforts and optimize existing costs.

- **Prepare project estimates and communicate**

To move away from hourly billing, attorneys need to better understand the costs of tasks required for a given project. This means that, before beginning a project, a lawyer needs to invest time estimating how long individual tasks will take and which firm resources will provide the optimal price and service with an optimal profit to the firm.

For litigation projects, that may mean dividing the litigation into stages and projecting the tasks and their prices for each of those stages. For large corporate transactions, projections may include the number of documents to be reviewed and number of entities to be formed. Those measures should be written into the contract so both parties understand the assumptions associated with the price.

In order for a fixed-fee arrangement to work well, both sides need to communicate regularly. One of the basic principles of fixed-fee billing is that the fee will be revisited if unanticipated problems arise in the transaction.

- **Manage costs and profits**

Once law firms are receiving a fixed fee, there is a natural incentive to reduce costs and maximize profits. A myriad of initiatives can contribute to reducing costs, but two techniques often overlooked in law firms are allocating tasks to the most efficient resources for a given task and keeping resource utilization high.

Allocating tasks to the most efficient resource does not necessarily mean assigning work to the associate with the lowest rate. Fox example, a firm may be indifferent to assigning a task to "time keeper 1" with a $300 hourly rate who will require one hour to complete it as compared to "time keeper 2" with a $200 rate who will require one-and-a-half hours.

In either case, the price to the client (i.e., firm revenue) is $300. However, if TK1 is more profitable for the firm than TK2, the firm will benefit by assigning the task to TK1.

For example, if TK1 earns a salary of $160,000 plus 30 percent for benefits, then his hourly cost for 1,800 hours is $116. If TK2 earns $125,000 plus 30 percent for benefits, his hourly cost will be $90. Therefore, TK1's profit for the hour required of the project will be $300 minus $116, or $184; TK2's profit for the one-and-a-half hours he would require is only $300 minus $135, or $165. TK1, therefore, is more profitable for the given task.

Another useful technique for law firms is managing resource utilization. The revenue for two equally paid associates who are gainfully engaged 90 percent of the time is approximately the same as three associates who are gainfully engaged 60 percent of the time, but the two associates cost one-third less.

Measuring quality is another integral part of measuring cost. In its simplest terms, the cost of reworking errors and repairing client relationships as a result of mistakes is a real, measureable cost. Simple measures such as error rates in a given document are a useful way to begin incorporating quality into an overall cost and quality program.

Firms may find that incorporating additional quality measures such as tracking for missed issues or over-complicated analyses will be useful in controlling costs and standardizing the effort required for a given type of initiative.

To adopt alternative fee agreements and maintain profits, lawyers must spend time understanding costs and planning for the most cost-effective ways to operate. Client bills may be lower, but if done right, profits may remain the same or even grow as lawyers discover ways to get work done better, faster and cheaper.

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