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## Services rendered: How to fix the billable hour system

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**Law firms and corporate counsel should work together to fix the billable hour system rather than eliminate it, says Mike Trotter**



The billable hour has legions of critics and very few public supporters. Like the genie that won't go back in the bottle, it continues to play a dominant role in law firm economics and management.

Ironically, the system was forced upon law firms by their clients. Many firms resisted it but, in due course, embraced the billable hour with great enthusiasm and unwavering commitment.

During the last quarter of the 20th century, it became the standard basis for billing business clients for the services provided by law firms and greatly increased the profitability of major law firms.

Hourly billing is not the only source of greater profitability, however. Much-increased leverage has also been a big contributor and has played an important role in significantly increasing the cost of legal services.

But somehow, the billable hour system has become the most important management tool for law firms. So, rather than eliminate it, the time has come to fix the billable hour system. The fix needs to be a joint effort of both private practice firms and corporate law departments, although corporate counsel hold the upper hand.

### Billing evolution

The billable hour system has not always been the principal basis for law firm billing. After World War II, many major firms in the US had retainer relationships with their largest clients - they were paid a fixed fee each year to handle all of a client's regular legal work.

For other clients, most firms had fixed charges for routine matters like drawing a will, creating a small corporation, answering a garnishment, filing a trademark application and so on. These charges were quoted in advance and collected when the project was completed. Local bar association medium fee schedules often served as a guide to billing routine matters. These schedules disappeared in the 1970s when the US Supreme Court ruled that they were per se illegal under the Sherman Act.

As time went on, more and more clients expected to be billed based on time alone, and law firms became accustomed to thinking about their bills in the same way.

When the billable hour system became commonplace, it worked well because of existing circumstances. Most lawyers at major law firms were not compensated based on their billable hours (associates' compensation moved up in lockstep with that of their colleagues, and partner compensation at many firms was managed with a modified lockstep system). As a result, there was not a relationship between the hours lawyers billed and their compensation.

All of the established firms were much smaller than the major firms are today and many had more partners than associates. As a result, the partners usually personally supervised the work for which they were responsible, including the quality and efficiency with which it was performed. There remained a feeling that law firms had fiduciary obligations to their clients to charge only for work that was properly and

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efficiently provided. It did not occur to most firms that their profitability might increase if they changed the way they worked and were paid.

After 1960, the amount of work available to major firms began to increase rapidly and, for a while, most had more work to do than they had lawyers to do it. Consequently, their lawyers were fully occupied and had neither the desire nor the opportunity to bill unnecessary hours to clients' files. Their principal objective was to get the work done as efficiently as possible so that they could move on to the next project.

However, as firms grew by adding young lawyers to service their clients' needs, their partners made more money as a result of the increased leverage. Soon enough, the partners realised that maintaining or increasing their firm's leverage would be necessary to maintain or increase their own compensation. They also realised that the time billed by each lawyer had an impact on the firm's profitability, and that each lawyer's value to the firm was at least in part related to the number of hours he billed and the rate at which his time was charged.

During the 1970s and 1980s, recording time changed from being a billing aid to a measure of the value of the work performed. As firms grew in size and the supply of available lawyers increased (especially of young and inexperienced lawyers), the incentive to complete a project economically diminished, while the ability and the incentive to invest larger amounts of time increased.

Many firms began to confuse their role in selling legal services with selling time. In determining the value of their services to be charged to clients, they began to divorce considerations of quality, efficiency and results, and to rely solely on the hours invested in the effort.

From the law firm's point of view, the relationship between 'value' and 'costs' to the client became markedly less important. And why not, since it was their clients that had insisted on eliminating quality, efficiency and results from the process of determining the legal fees they had to pay?

After more than 40 years of growing reliance on the billable hour system, almost all of the lawyers in the United States, outside or inside, became acculturated to the use of billable hours and hourly rates.

### Billable hour resilience

In recent years, the billable hour system has been denounced and disparaged by clients and lawyers alike, but it has demonstrated remarkable resilience. Why has the billable hour system survived so long, despite its continuing vilification?

It has survived because it is relatively easy to administer and because, properly administered, it serves the interest of both clients and law firms better than most of the highly acclaimed alternatives: percentage contingent fees, value billing, retainers, fixed fees, fixed or hourly rates (with kickers and deflators), among others.

The billable hour system provides an easily understood and applied measure of the value of the services rendered. The most accurate way to measure the value of legal services should be the costs saved to, or the profit earned by, a client from a particular service.

Charging a client a percentage of the dollars it receives for a successful claim asserted in litigation or mediation is widely accepted as a fair method, although it is not without its inequities and uncertainties. A high-percentage contingent fee can be just as unfair to the client as an hourly rate matter that is carelessly or deliberately overworked.

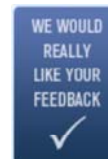
If a claim is relatively strong and certain of success, then the percentage charged for pursuing it should be less than when the claim is relatively weak and uncertain. Some plaintiff's lawyers tend to accept low but easy settlements, rather than pursuing higher awards for their clients that would require their lawyers to make greater investments, without guarantees of success.

It is harder to represent defendants on a contingent fee basis because it is harder to assess a proper fee where the value of the outcome is less certain. It is difficult to apply the same standard to money saved as to money won. The amount of an award won in court and collected is certain; the damages avoided in a successful defence are usually more speculative. The amount claimed by the other side is rarely seen as reasonable or likely to be obtained. And there is no clear metric to calculate the value to a client of a brilliant but failed defence effort. For these reasons, there are far fewer defendants' actions taken on a contingent fee basis.

### Monitoring services

It is not the hourly billing system itself that is the problem, but rather how it is used. Many clients have been too willing pay very high hourly rates without carefully scrutinising the statements presented. Equally, many law firms have turned a blind eye to unnecessary or inefficient work performed on client matters. Self interest has:

- discouraged rigorous management of legal projects;



- encouraged sloppy timekeeping practices; and
- tolerated the practice of charging clients for work that was unnecessarily or ineptly performed by lawyers with higher billing rates than the work required.

In-house lawyers, most of whom have earned their spurs in private practice, view themselves as practising lawyers rather than as policemen assigned to oversee the billing practices of their outside counsel. Their tolerance for established major law firm billing practices is, in part, an outcome of their own private practice experience and perspective.

Most law firms charge only three times as much for the services of their most experienced lawyers in comparison with the rates charged for inexperienced associates. This differential is not nearly sufficient to reflect the relative knowledge and skills of the lawyers involved and their ability to cost-effectively serve the needs of their clients. Increasingly, clients are refusing to pay for the work (and training) of young lawyers, and true legal experts are raising their rates to even higher levels.

Corporate law departments, if they use private practice firms that have justifiable reputations for cost-effective service delivery and honesty in preparing their statements, can deal with the problems of the hourly billing system (with the support of appropriate technology staff experts).

Recent developments in technology are providing law departments with the tools to monitor and supervise the work of outside counsel. Corporate counsel can now look over the shoulders of their outside lawyers to evaluate the necessity, quality and efficiency of the services being performed.

Already many corporate law departments have software tools that can:

1. review the statements submitted by external counsel to determine if the hourly rates charged are the same as those agreed to;
2. monitor how many hours a day particular firm lawyers are working on each of their matters;
3. limit the number of hours that an individual lawyer can bill to a matter on any day; and
4. determine whether their outside counsel are selling the services of the same lawyer(s) to other clients at a lower price.

For the first three, there are several providers of software systems designed to assist corporate law departments in managing their relationships with law firms. Three of the top players in the market are Mitrtech's TeamConnect, LexisNexis's Counsel Link and TyMetrix's 360 Degrees. Each of the platforms offer e-billing and matter management solutions, document management and legal hold capabilities, as well as reporting, budgeting and forecasting tools.

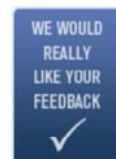
For the fourth, there are several service providers. One of these is TyMetrix, which packages and sells anonymous data (no firm or timekeeper names) from clients that have agreed to participate. Another is Valeo, which compiles rates from public sources and maintains a database of rates by firm, timekeeper name and year, with the citations scrupulously noted.

E-billing systems provide automated rate and billing rule enforcement, business process rules and real-time reporting. These programs will 'red flag' potential issues, which can then be resolved by staff and the lawyers responsible for oversight of the matter. If there has been a violation of the agreed rate schedule, the system automatically adjusts to the proper billing rate or allows the reviewer to make an adjustment.

These systems also support the storing of evaluations of outside lawyers who have worked for the client on previous matters, which enables in-house counsel to quickly obtain information about any such lawyers. It can also determine if any conflicts exist as a result of a law firm representing one area of a business while it is suing another. Configurable systems, like TeamConnect, permit each practice area to customise data points to be aggregated.

## How to fix your law firm's billable hour system

- Carefully plan and frugally manage each engagement
- Have a clear understanding with the client about the scope of the engagement and appropriate staffing and budget
- Use lawyers with appropriate levels of knowledge, experience and judgement for particular aspects of each matter, whose rates are based on



their suitability and capability to contribute to the work at hand, and not on years in practice

- Keep scrupulous time records
- Ensure a senior lawyer familiar with the matter and the lawyers working on it reviews and edits each bill before it is sent, so that all of the time charged is appropriate
- Forthrightly and voluntarily write down or eliminate from bills inefficient and/or unnecessary time
- Have relationships with other reliable cost-effective service providers in order to outsource work that can be performed as well or better by others at a lower cost
- Acquire and use the best new technology to improve the cost effectiveness of legal services rendered
- Recalibrate rate schedules to accurately reflect what each lawyer and non-lawyer can contribute to the matter at hand (this may result in billers having more than one rate, depending on what they are doing and what they know)
- Promptly advise the client of any unexpected developments and departures from the quoted budget

### Revisiting fees

To make the hourly-rate system work for them, corporate law departments should retain private practice firms that:

- work hard to deliver cost-effective services;
- use technology effectively;
- carefully scrutinise drafts of their bills and honestly write-off time reflecting inappropriate charges (including needless, sloppy or inefficient work); and
- charge hourly rates that are appropriate for the work performed.

If they do so, they are likely to be satisfied with the use of the hourly-rate system for much of their legal work.

Law firms that maintain high standards of productivity and accountability to their clients will continue to enjoy the confidence of their clients. The method used to value the firm's services is less important than the firm's commitment to provide its clients with cost-effective services as a fair price. Those that do so will continue to prosper.

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