ABA Commission on Billable Hours Report

ABA
Defending Liberty Pursuing Justice

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Excerpts:

- Current State of the Profession
- Alternatives That Work
- Model Law Firm Policy
- Billable Hour Snapshot

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.

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

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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.

*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.

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**Part II—Why Billable Hours are so Entrenched**

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

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4This 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.
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. 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.

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.

7 See Id.
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).

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 contingency. 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. 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.