
LIBERATING YOURSELF FROM THE BILLABLE HOUR

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Prepare for a peaceful resolution of the war between the client's interest in results and the attorney's need to bill (insert lawyer joke here). George presents alternatives to the billable hour that benefit both lawyer and client.

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by R. James George Jr.

I started practicing law in 1971 as the 12th lawyer in an Austin, Texas, firm. The firm was one of the larger ones in the city, with nine partners, three associates, and five staff members. Little of the work was done strictly on an hourly basis, although each lawyer kept time records. We sent most clients an annual bill or a bill when the case was finished. The bills reflected the time spent, but we often adjusted the charge based upon what the lawyer believed to be the value of the legal services the client actually received. Some clients paid traditional annual retainers for our handling all or certain categories of cases, some clients were charged based strictly on the time, and some were charged flat fees. On rare occasions, the firm received a percentage of the recovery on a plaintiff's case. Monthly billing was rare, and of course cash flow was intermittent, coming largely in the first quarter of each year after the annual bills.

By 1992, my firm had grown from 12 lawyers to 100 lawyers, with 32 partners, 68 associates, and a staff of 112. Almost all of the work the firm handled, including litigation, was done on an hourly basis, with bills sent monthly.

Indeed, by 1992, hourly billing had become the norm throughout the country for almost all legal work. Clients were expected to pay shortly after they received their monthly or quarterly bills. Generally, the only lawyers who did not bill by the hour were plaintiffs' personal injury lawyers, who worked on a percentage-of-recovery basis, and criminal defense lawyers, who usually worked on a flat-fee basis.

The movement toward hourly billing actually started much earlier. In 1958 the American Bar Association published a report called "The 1958 Lawyer and His 1938 Dollars." That report noted that the amount lawyers were paid as fees, measured as a percentage of the gross domestic product, had dropped 66 percent in the 25 years following 1938. The report identified solutions to the problem: accurate time keeping; analysis of overhead; calculation of the desired annual income of the lawyer; and monthly or periodic billing based largely on the time expended by the lawyer, at rates high enough to generate the desired income. For whatever reason, the problem addressed in 1958 had largely disappeared by 1992: The percentage of gross domestic product paid out in lawyer fees increased from 0.529 percent in 1958 to 1.546 percent in 1992.

In 1992, two of my partners joined me in forming a small lit-

igation firm. At the new firm, we did litigation work concentrated on defending media companies against libel, privacy, copyright, and related claims. We billed by the hour, which meant following billing guidelines and going through periodic audits by those companies' insurance carriers. We began to handle some cases on a non-hourly basis, particularly cases involving plaintiffs' business litigation. We often handled those cases on a blended rate of hourly or fixed fees plus some percentage of the recovery.

Gradually, as it became clear that there were ways to defend business litigation on a non-hourly basis, we began to experiment with those systems. Our efforts afforded a substantial benefit to the client relationship and cut down on our administrative time. When the clients began to see our willingness to share the risk of successfully defending claims, they felt less need to spend a great deal of time auditing legal bills, constructing billing guidelines, and reviewing legal bills in relationship to those guidelines.

I found, however, that the system of non-hourly billing worked best when we dealt with small companies in which the business person affected by the litigation was our direct contact. Business people recognized that the hourly billing system rewarded effort, not results. As one client cynically—but aptly—put it, under hourly billing "the slowest lawyer won."

One of the truths that clients grasp fully is that lawyer fees are a necessary cost to resolve a dispute that cannot otherwise be resolved. In almost every case, business people are in a dispute that they have tried, but failed, to resolve. They turn to lawyers because they cannot resolve the dispute in any other way.

The client's goal is to get the matter resolved at the lowest total cost to the business. Clients recognize that the cost of resolving a claim made against that business involves at least three elements: (1) the amount of money spent on the transactional costs—lawyer fees, expert fees, deposition fees, and other expenses; (2) the cost to the business of having its personnel diverted to attending to a lawsuit instead of to the firm's core activity; and (3) the cost of the settlement or payment of the judgment if the matter is not resolved prior to trial. And there may, in fact, be a fourth expense—the generation of more litigation of a similar nature.

Business people faced with a lawsuit see it as a cost center that generates no internal benefit for the business. Lawyers,

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however, frequently believe that their magnificent pleadings, legal research, closing arguments, and other lawyerly tasks have some inherent value—which they do not. The lawyer’s work, whether brilliant or average, has no inherent value to the client. The client receives value only when the dispute that generated the litigation can be resolved in a way that is acceptable to the client.

By offering clients predictable, known costs for litigation, law firms can eliminate a major concern many clients have: that the legal fees might ultimately be as much as, or more than, what the case can be settled for. In addition, if the client and the lawyer can target results and agree that the lawyer’s compensation depends in some substantial part on reaching them, the client can receive at least some assurance that the lawyer has an incentive to achieve the same goal as the business person in resolving the dispute.

In many kinds of litigation, the business client is sophisticated and knowledgeable about the inherent risk in a particular kind of litigation, and knows full well the range of potential total costs of the dispute. For example, in a large chain of retail stores, there are routine “slip and fall” cases where a customer sustains a moderate personal injury in the store. These cases present a modest risk to the company, but they must be defended. If the client pays a law firm by the hour, it must monitor the law firm’s work closely to see that the defense fees do not exceed the reasonable amount. On the other hand, the client can enter into a fixed-fee contract, perhaps with a bonus, for one firm to handle all of these types of cases in a given state or region. Then the client company will know its budget and legal fees in advance and ensure that its lawyers are focused on the client’s goal of timely and inexpensive resolution of these disputes. Many personnel or labor disputes also can be handled in this way.

The ability to analyze and predict the dispute resolution cost is not limited to smaller cases. Many industrial companies must defend product liability cases involving substantial injuries related to particular categories of alleged defects in their products. These companies routinely hire a law firm on a fixed-fee basis to defend all of the cases involving automobiles, seat design, or some other category, thus creating incentives for the lawyers to be effective and efficient in resolving these disputes. Arrangements involving groups of cases require the lawyer and client to make clear the scope of the lawyer’s responsibilities and the client’s expectations and goals.

The chanciest kind of case for a lawyer to handle on something other than an hourly basis is one involving a large amount of money, a high level of risk for the client, and only one case that is likely to arise from the facts at issue. In this situation, the client has an incentive to want the law firm to use every tool to achieve a favorable resolution, and the client is willing to pay a good deal of money to get that work done. In such cases, legal fees are likely to be relatively small compared to the total exposure the company faces from the litigation. Nevertheless, it still may be in the client’s interest to attempt to negotiate an alternative to an hourly rate in order to predict the basic costs involved in resolving the dispute and to create an incentive for the lawyer to succeed.

Bill Cobb, a Houston law firm consultant, describes the importance of risk to the client’s assessment of the value of legal work, using his famous “value curve” analysis: The value of the work of the lawyer depends a great deal upon the nature

of the dispute or problem the lawyer is trying to solve for the client. There is no fixed formula for setting a fee that covers these one-of-a-kind cases. We have, however, found basic steps that usually lead to an agreement that works for the client and the lawyer. We start with a fixed fee for 60 to 120 days. During that period our firm and the client agree to do an intensive investigation of the facts and applicable law. We review the client’s files, interview the people involved, and develop evaluations of the risk to the client and the various approaches available to successfully resolve the case. The client also must devote time, people, and other resources to the case. After this investigation, the client agrees to the range of acceptable monetary settlements and other business issues that it finds important. Then—and only then—can we either offer an analysis of the case that other lawyers hired to defend it can use, or agree with the client that we will implement a defense plan that the client has approved. The plan includes a fixed fee or a fixed fee with particular incentives. Key to the success of this approach are a fixed fee and a specific period of time, as well as the client’s active participation and willingness to set real goals for resolution of the case.

When tailoring a fee arrangement to a client’s needs, we try to make sure we know the client’s specific problems and goals. For example, we recently were asked to defend a case where a business was sued over a real estate transaction. The amount at risk was very large for this company. The client realized that it would need to settle the case, but almost as important as the

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absolute dollar amount of the settlement was the timing. We entered a fee agreement whereby the client would pay our firm several hundred thousand dollars if the case could be settled within a specific range of time. Our fee went down every month after the target date. The case was resolved, the client was pleased, and our firm made a good deal more than had we been paid on an hourly basis. A variation might involve bonuses for settling the case below the client’s targeted settlement value.

Of course the traditional contingent fee arrangement is available when the client is the plaintiff. Such arrangements can be an effective tool for any business litigation in which a sizable recovery is available and the lawyer is convinced of a substantial likelihood of success. In order to make these systems work, the client must have a realistic view of the value of the case, and the law firm must be able to analyze and accurately project the amount of effort needed to succeed in recovering money for the client and, thus, itself. Of course, the contingent fee can be modified in some fashion so that it includes partially guaranteed payment, either on an hourly basis or fixed-fee basis, but the essence of the relationship has to be an agreement by the client and the lawyer to undertake the project jointly, sharing the risk of failure and rewards of success. For example, a lawyer may agree to prosecute a case at 50 percent of the standard hourly rate, with the provision that if the client recovers more than “X,” the lawyer will be paid 300 percent of the hourly rate.

Non-hourly compensation results in substantial benefits to lawyers and law firms and substantial changes in the culture of a

law firm as well. First, time is recognized as having no inherent value. The lawyers who put in more time on a project do not necessarily generate more revenue. It has been my experience that lawyers who work on a fixed fee or contingent fee basis often work harder than the lawyers whose time generates revenue for the firm. Lawyers are free from the micromanagement that results when hourly work is recorded on timesheets and translated onto monthly bills. This creates a major psychological difference. The lawyers see their work as driven by their own internal incentives, as well as the client's needs; they realize that time, in and of itself, will not necessarily be rewarded. If the lawyer fails, the firm does not make any money, no matter how hard the lawyer worked or how good the work was.

Second, litigation billed in ways other than hourly can change the nature of law firms themselves. There are very few large law firms that exclusively handle plaintiffs' litigation on a contingency fee basis. Firms that handle only contingent fee cases tend to have few associates relative to partners and generally depend on leverage of the senior lawyers' skills rather than leverage of time. They often pay junior lawyers a relatively small annual salary, and the junior lawyers' total compensation is greatly increased if the firm makes a large profit on the contingent or fixed fee work. The law firms that work on a contingent fee basis have to have additional working capital because they cannot depend on monthly cash flow from clients. The same is true for many firms that specialize in criminal defense, because they tend to work on fixed fee or other arrangements that do not reward associates' time but generally reward senior partners' skills. Today's megafirms with large numbers of associates and relatively few partners depend on hourly billing and associates' billing capacity, rather than on senior lawyers' trial, negotiation, or settlement skills.

Large or small, however, a firm's ability to survive on any alternative billing system depends on whether the firm's clients will view the legal fees as a necessary part of dispute resolution and will worry about self-interest rather than the profits of the lawyers. We frequently find that in large corporations, legal departments are reluctant to enter into alternative or incentive-based fee arrangements because they believe that if the law firm makes too much money on handling a case—no matter how successful and profitable the venture is for the client—the legal department will be criticized. Ironically, some of these same corporations see it differently when they consider the contributions of their executives and are willing to pay huge bonuses to individuals who add value to the bottom line. People who own businesses or small corporations, however, tend to be less concerned with the profit margin of their suppliers—and therefore more willing to explore alternative billing arrangements—as long as those suppliers provide quality products and allow the

corporation itself to be successful.

Agreements between a lawyer and the lawyer's client should always be clear and in writing. When a lawyer handles civil litigation on a basis other than time spent on the case, that is even more essential. Lawsuits have a way of changing. The agreement must deal with future counterclaims, cross-claims, interventions by other parties, and the addition of claims that were not originally included. The lawyer must always have an agreement at the start or at least some system for addressing the changing nature of a particular case. When the agreement involves more than one lawsuit, the lawyer must carefully identify the lawsuits or characteristics of the lawsuits that the parties intend for the lawyer to handle. There is, however, no perfect retainer agreement. The lawyer will always have a fiduciary duty to the client. And the very nature of non-hourly billing is that the lawyer is betting on his or her skills. Sometimes the arrangement will not work financially for the lawyer, but most of the time, the lawyer will succeed financially when the client does.

The ABA Model Code of Professional Responsibility and the professional rules of every state require that legal fees not be unconscionable. That should not change. Legal fees determined in a free-market environment by knowledgeable people making knowledgeable decisions, however, are more likely to be reasonable than legal fees that concentrate on the time expended by the lawyers. A lawyer's time is not inherently more valuable than any other person's time. Lawyers have no God-given right to make \$500 per hour, and they should not be paid huge amounts of money for simply "trying" to succeed. No lawyer will succeed all the time, but the inherent value of lawyers to society has to be measured by the value the lawyers add to resolution of disputes. If we look too hard at the pieces of lawyers' work, we forget to look at the bottom line. The bottom line is what we do to actually help the client.

Of course, it is not unethical or wrong for lawyers to charge by the hour for their work. Plumbers, electricians, accountants, and psychoanalysts often charge for their time. But a review of any state or ABA ethics rules will show that time is only one factor to be considered in arriving at "reasonable" compensation. A litigator's time is worth little, but that litigator's skills to resolve a client's dispute in a way acceptable to the client are worth a great deal.

I am convinced that if I make it clear to my clients that I am willing to take risks with them, and the clients know that they will have to pay a certain amount of money to achieve resolution of a problem, our relationship will improve dramatically. By at least offering clients an alternative to hourly billing, litigators have an opportunity to show that they are willing to share some risks in order to create closer and more lasting relationships. □

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