Analysing Alternatives to Time-Based Billing and the Australian Legal Market

Finance Essentials for Practice Management
Amora Jamison, Sydney
18 July 2007

Paper presented by Steve Mark
Legal Services Commissioner (NSW)

Each year the Office of the Legal Services Commissioner receives approximately 3,000 complaints relating to the conduct of barristers and solicitors in New South Wales. In many of these complaints grievances are phrased in terms of a lawyer conducting himself or herself unethically, however the heart of dissatisfaction is really a perceived over-billing by the lawyer. Anecdotal evidence from the Office of the Legal Services Commissioner suggests that about 80% of complaints include some grievance about overcharging. Evidence further suggests that most of the complaints about overcharging are inextricably linked to complaints about poor communication on behalf of the lawyer. Clients, it appears, under the present system of hourly billing are not being given an opportunity to freely communicate with their lawyer about their matter or the bill they receive. Time is money and today no lawyer can afford to waste time discussing matters that are not central to the client's case.

Complaints relating to overcharging are not a new phenomenon. Concerns about overcharging, evident worldwide have been around for years. Most people have a story about how their lawyer has charged them exorbitant fees and every person knows a joke about a greedy lawyer. Even lawyers themselves are making jokes about their billing practices. However in New South Wales it appears that the jokes are finally beginning to take their toll as the number of consumers applying for assessment of their legal practitioner's bills continues to increase and calls for the abolition of the billable hour continue to escalate. But why all the commotion?

Hourly billing has severely altered the legal working environment, often with detrimental effects. The billable hour today extends far beyond calculating how a client should be charged. Hourly billing is now used by firms to measure the utility of an employee - hours now decide salary levels, raises, promotions and bonuses – driving up billable hours at an unreasonable rate.[1]

[1] According to recent survey of legal practitioners by Mahlab, the proportion of lawyers putting in big hours is increasing, rather than decreasing, thanks to a boom in merger activity and private equity deals. Two years ago only 12% of the profession were working more than 50 hours a week. Today the number of practitioners working 50 hour or more has increased to twenty nine percent.[1] The increase is also due to the expanding expectations of law firms who now expect a lot more chargeable hours from their employees that they did in the past: see K.

Hourly billing is also being used by law firms to cost the legal services they provide. Such billing however not only prevents lawyers from accurately costing their services, hourly billing also prevents lawyers from understanding the real market value of their services.

Why consider moving away from time-based billing? The adverse effects of hourly billing

The effects of billing unsustainable numbers of hours every day of the year are not without their consequences. The constant pressure by firms to increase billable hours has created an atmosphere in which mentoring, training and collegiality are pushed aside and replaced by a heads down mentality. Many lawyers today who are bound by endless time pressures to maintain a successful practice often cite feelings of depression and unhappiness.[2] Linda Julian of Sydney based company strategic development consultancy Julian Midwinter and Associates reports that she meets very few lawyers in their forties who actually like the work they do.[3]

Associate morale is at an all time low and many are now choosing to leave the profession in search of less demanding work and a life. The Young Lawyers Section of the Law Society of New South Wales have commented that:

> "The current emphasis on billable hours means that junior lawyers in private practice and employee solicitors are often burdened with the highest budgets and have the least amount of control over the final bills. This has significant consequences in terms of lifestyle and retention rates in the profession." [4]

The expectation of attaining unachievable billable hours by firms has created an environment in which quantity of work is appreciated far more than quality.[5] Under an hourly billing system the lawyer who takes the most time on a matter is rewarded, as the number of hours billed is greater than the lawyer who does his work quickly and efficiently.[6] According to Michel Ryan, Administrative Partner at Courdert Partners, Australia, lawyers actually 'hate' time sheets:

> "At the end of the day, under the time sheet system, the one thing that determines whether it has been a good day or a bad day is the number of billable hours recorded.

Gibbs, "Firms' budgets behind billing fraud", Lawyers Weekly, 18 November 2005 available at http://www.lawyersweekly.com.au/articles

[2] K.Gibbs, "Firm's budgets behind billing fraud", *Lawyers Weekly*, 18 November 2005 available at http://www.lawyersweekly.com.au/articles

[3] Ibid.

[4] Phillippe Gray-Grzeszkiewicz and Davyd Wong, NSW Young Lawyers Submission to the Legal Fees Review Panel, covering letter.

[5] Douglas Richmond, The New Law Firm Economy, Billable Hours, And Professional Responsibility 29 Hofstra L. Rev. 207, 208 (2000)

[6] L. Harris, "A cost prescription for in-house counsel", Lawyers Weekly, 21 April 2006 available at http://www.lawyersweekly.com.au/articles

> What isn't measured is whether or not the lawyer has done a good job for the client. At the end of the day, nothing in the bill that you present to the client reflects how well you have performed, just the number of hours that you worked on it.
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> It is dispiriting to a good lawyer and it leaves clients with the wrong perspective."[7]

Hourly billing penalizes the efficient and productive lawyer who is able to complete a matter in less time than his slower counterpart. Critics of hourly billing argue that the number of hours it takes to complete a task does not necessarily correlate to the value of that particular task to the client. As the Chief Justice of the High Court Murray Gleeson stated, "It is difficult to justify a system in which inefficiency is rewarded with higher remuneration."

The culture of hourly billing and the increased pressure to obtain high profits has ultimately lead to unethical and illegal billing practices where partners and senior lawyers are unlikely to question profitable practices.[8] According to a study by Professor Lisa G. Lerman, an expert on unethical billing practices in the United States, unethical billing practices are routinely practiced.[9] Today unethical billing has become so widespread in the United States that lawyers no longer deny that the problem is confined to those that have been prosecuted for billing fraud. Professor Lerman reports for example, that it is not uncommon for lawyers to order paralegals to double bill and bill for time they did not spend working[10] or for lawyers to bill their client for social conversations where business may only constitute a small component of that conversation. [11]

The problem is that billing by the hour is really an inexact science in which hours are determined at the end of the day by using rough estimates. Most firms do not instruct their employees about how to bill appropriately or the methodology of hourly billing. A recent study in the United States on the billing practices of associates has revealed that only one of twenty-five participants recorded their hours in a logbook immediately after completing a client's work.[12] What is more astounding however is that almost half of the participants in the study admitted to inflating (either intentionally or accidentally) their hours.[13] In the United States questionable billing practices that have assisted in inflating hours include billing for time for thinking about a client's case while taking a shower, billing time for thinking about a client's case whilst driving to work and billing time whilst discussing a client's work

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[7] Australian Financial Review, 12 July 2000.
[8] See Michael D. Goldhaber, New Study Shows Fraudulent Billing Not An Isolated Matter, *New York Law Journal*, Oct 12, 1999 at 1.
[9] Lisa G. Lerman, Lying to Clients, 138 U. PA. L. Rev. 659, 665 (1990)
[10] See Dennis Curtis & Judith Resnik, 'Teaching Billing: Metrics of Value in Law Firms and Law Schools', 54 Stanford L.R. 1409, 1416 (2002).
[11] Id at 702.
[12] Dennis Curtis & Judith Resnik, 'Teaching Billing: Metrics of Value in Law Firms and Law Schools', 54 Stanford L.R. 1409, 1417 (2002).
[13] Id at 1417.

whilst at lunch with friends.[14] Billing for unrelated personal charges such as cellular phones and clothing because of extended unplanned stays have also emerged as common practice.[15]

Although there have never been any studies conducted in Australia about the practice of unethical billing courts in Australia, the OLSC is frequently faced with allegations of professional misconduct as a result of overcharging.[16] In *Veghelyi v Law Society of New South Wales* (unreported, CA (NSW), Kirby P, Mahoney and Priestly JJA, CA 40257/91, 6 October 1995, BC 9505459) Mahoney JA commented on gross overcharging as follows:

> "A solicitor's entitlement to remuneration is conventionally stated in terms of what is fair and reasonable in the circumstances…where charges are so beyond that as to be grossly disproportionate professional conduct may be involved…A principle stated in such terms is, of course, inherently indeterminative. But I do not think that it is possible to formulate the principle in terms which are more specific." [17]

In this case, the solicitor Veghelyi had overcharged a client for acting in a family law matter and had charged clients fees $1100 above the scale of costs that existed at the time. The Appellant argued that it was logically unsound for the Tribunal to assert that his fees were a gross overcharge because he charged above the scale.

According to Mahoney JA in order to determine what is 'fair and reasonable' and what is grossly disproportionate one needs to consider various factors. Mahoney JA referred to the comments by Gleeson CJ in *New South Wales Crime Commission v Fleming* (1991) 24 NSWLR 116 who discussed the determination of reasonable legal expenses" by referring to "the market for legal services in which the client, as a consumer, is obliged to seek such services" and Kirby J's judgment which identified eight general criteria for determining 'reasonable legal expenses'. Mahoney JA opined:

> "Whether costs are fair and reasonable will depend upon - or at least be affected by - facts such as the size of the solicitor's firm, the resources employed or available to be employed by it, the value which the lawyers place upon heir skill and expertise, and the urgency of the client's requirements."

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[14] Id at 1418.

[15] Adam C. Altman, 'To Bill, or Not to Bill?: Lawyers Who Wear Watches Almost Always Do, Although Ethical Lawyers Actually Think About It First', 11 Geo J. L. Ethics 203, 215 (1998).

[16] In New South Wales, overcharging under both common law and statute is deemed professional misconduct. Section 208Q of the *Legal Profession Act 1987* provides that deliberate charging of grossly excessive amounts of costs and deliberate misrepresentations as to costs amounts to professional misconduct. The terms 'deliberate charging of grossly excessive amounts of costs' and 'deliberate misrepresentations as to costs' are not defined in the Act but have been addressed by the courts. For cases on overcharging see - *New South Wales Bar Association v Amor-Smith* [2003] NSWADT 239; *Veghelyi v Law Society of New South Wales* (unreported, CA (NSW), Kirby P, Mahoney and Priestly JJA, CA 40257/91, 6 October 1995, BC 9505459); *New South Wales Bar Association v Evatt* (1968) 117 CLR 177; *New South Wales Crimes Commission v Fleming* (1991) 21 NSWLR 116; *Law Society of New South Wales v Foreman* (1994) 34 NSWLR 408.

[17] at p. 6-7.

Mahoney JA then continued stating:

> "What is fair and reasonable for a large firm may be, in the ordinary case, grossly excessive for a sole practitioner. This is to be borne in mind, for example, in any assessment of the value of the evidence of other solicitors as to whether fees, which have been charged, are fair and reasonable. What is fair and reasonable, though still a matter of judgment by responsible practitioners, must be determined following an appropriate analysis of the practice of the particular solicitor."

It is not just overcharging however that is of concern to the critics of hourly billing, the effects on the lawyer/client relationship have had an equally devastating effect. The unfortunate consequence in focusing on billing as many hours as is physically possible has meant that lawyers no longer take the time to sit down and communicate with their client about the fees involved or how the lawyer is going to proceed with the case. The factory environment of the law firm reinforces the ethos that time is money and one cannot waste time on tasks that cannot be billed.

Under the present system of costs disclosure clients are handed a document they believe is a quote specifying a fixed amount that they will be charged at the conclusion of the matter. However when the case is completed more often than not the client is handed a different bill with an amount often far exceeding the original 'quote' they received. What clients fail to understand is that at the commencement of their discussions about their individual matter they are not receiving a quote but merely an estimate of how much the matter may cost them. The common belief that clients are receiving a quote rather than an estimate of costs is evidenced time and time again because most lawyers do not take the time to sit down with their client and explain the fact that they are only being given an estimate of costs. The demands of hourly billing and the pressure of law firms not to waste time on irrelevant matters such as discussing costs has prevented lawyers from communicating such vital issues to a client.

Alternative billing methods - the benefits for your firm

There are several different methods that can be used as an alternative to hourly billing. These methods include fixed or flat fee billing, capped fees, contingency fees or percentages, blended hourly rates, retrospective fees based on value, relative value, task-based billing, and discounted billing. Each of these alternatives discussed below are based on the concept of value rather than profit.

Value based billing is not about obtaining a discount but rather billing work based on the value to the client and the practitioner. Under a value billing arrangement the value of the services provided are based largely on the client's perception. Value billing is therefore a subjective determination of value. If a client believes he is getting value from his lawyer's services, he is. If the client doesn't believe he is getting value, he isn't. This applies similarly

to the practitioner. The focus of value billing is on results, efficiency and reward, not hours billed.

The calculation of value is primarily based on the client's understanding of what services the solicitor is to provide. Under the value billing system hours and rates remain important but are not the determining factor. According to Richard Reed, Chair of the American Bar Association's Value Billing Task Force, valuing legal services involves analysing three criteria: responsibility, expertise and productivity.[18] Thus in order to assess the value of the service a client may take into consideration the effectiveness and efficiency of the lawyer's work, the urgency of the work, whether the advice provided by the lawyer was correct, the degree of complexity, the predictability of results and the effect of the client on exposure to loss.[19]

In order to implement value billing successfully a reasonable written agreement must be reached.[20] Issues to cover in the written agreement could include the following:

- The billing schedule and the client's right to request some other schedule if desired;
- The people in the firm who will be working on the matter;
- A suggestion that the firm's personnel department perform certain tasks under the lawyer's supervision such as document collection and production (where appropriate);
- Advising the client that they will not be billed for work if additional lawyers work on the matter for training purposes (or get up to speed if taking over the matter);
- Advising the client that their matter will be closely monitored and that regular meetings should be scheduled to protect against duplication, non-productive work and over-billing;
- Advising the client that the disbursement will be closely monitored;
- Ascertaining what travel or other expenses the client will or will not pay.[21]

The major benefit of value-based pricing is that "it forces both lawyer and client to think through and communicate the objectives of the client and the services that will be required to meet those objectives."[22] Value billing can therefore provide a reality check system whereby the client can undertake an assessment of his/her expectations. The value billing arrangement also encourages regular negotiations between the practitioner and the client

[18] Richard C. Reed, "Billing Innovations: New Win-Win Ways to End Hourly Billing," American Bar Association, Section of Law Practice Management (1996).
[19] Charles Kovess, Specialisation, value billing and successful legal practice, 66(10) Law Inst. Jnl. 895, 895 (1992).
[20] John W. Toothman Esq, Alternative Billing: Living with the Uncorked Genie, 7(3*) Accounting for Law Firms*, 1994.
[21] See Mark A. Dombroff, 'Helping Clients Understand the Billing Process' in Richard C. Reed, Beyond the Billable Hour: An Anthology of Alternative Billing Methods.
[22] Richard C. Reed, "Billing Innovations: New Win-Win Ways to End Hourly Billing," American Bar Association, Section of Law Practice Management (1996) at 121.

whereby both parties can meet at regular intervals during the matter to assess the initial value agreed upon. The arrangement of ongoing assessment meetings provides the client an opportunity to make a commercial decision about whether or not the practitioner should proceed and the practitioner and opportunity to revisit the initial value assessment if the matter becomes more complex.

Taking the time to discuss the matter and the billing process will also alter the power relationship that typically exists between the lawyer and the client. In most lawyer/client situations, the lawyer is the all-powerful knowledge base who is there to provide a service the client is unable to perform. Discussions often ensue across the oak table and formality is the key. Value billing encourages informal discussions where both parties are able to bring their own ideas to the discussions and are able to negotiate without a power struggle. Thus the lawyer and client are able to develop a better relationship based on communication and trust.

Alternative billing models – The Australian Experience

In Australia the move towards alternative forms of billing has been slow. There has been much resistance by law firms to change their established billing practices. The push for change is thus largely coming from clients. A survey conducted in April 2005 by the Australian Corporate Lawyers' Association showed that almost 60 per cent of companies were seeking alternatives to hourly billing from their legal advisers.[23] The Australian Financial Review noted that:

> *"Australia's largest law firms are coming under pressure from corporate clients to deliver more services for less money as organisations search for new ways to reduce costs."*[24]

According to a recent survey of members of the Australian Corporate Lawyers Association by Mahlab Recruitment and Harris Cost Lawyers, 96% of respondents reported that they were "moderately keen" to investigate alternative billing arrangements. Respondents however reported that they have been unable to adopt any alternate methods because companies and external counsel have largely been unable to negotiate any type of agreement other than one based on hourly billing due to a "perceived inability of law firms to calculate a proposed fee and bear risk."[25]

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[23] Marcus Priest, "Time is up for lawyers' hourly billing" Australian Financial Review 17 May 2005 at p.3.

[24] Katherine Towers, Susannah Moran, Marcus Priest, "Judgment day: lawyers feel heat over costs, services" Australian Financial Review, 16 May 2005 at p.1.

[25] Harris Cost Lawyers & Mahlab Recruitment, "Does your lawyer fit the bill? A joint survey assessing Corporate Counsel/Law Firm relationships", February 2006 at p. 5, available at http://www.harcosts.com/HC_survey.pdf

Firms and lawyers seem reluctant to move away from the status quo and speak out about alternatives to hourly billing. The author of this paper suspects that one of the reasons why law firms have not embraced the concept of value billing is because they may not really understand the concept of billing for value. As Altman observes, calculating a bill based on value is an elusive task for many lawyers and imposes greater responsibilities on the lawyer.[26] Alternative methods of billing are more complex and the long-term effects of change are unknown. In a value billing arrangement the lawyer in addition to working on the matter must devote time to analysing the client's needs, ability and willingness to pay for the value received through open communication. Lawyers will often argue that they do not have time to perform these additional tasks if they are required to maintain their current billing demands.

When used, the most common methods of alternative billing by firms within Australia are 'fixed/flat fees' or 'capped fees.'

The fixed/flat fee arrangement permits the client and lawyer to agree on a set fee for specified services. The flat fee may be used alone or combined with other billing arrangements such as an hourly fee or a contingent fee. The fixed fee arrangement is most commonly used in highly competitive services and volume work such as wills and real estate matters.

The fixed fee arrangement brings benefits both to the lawyer and the client. A fixed fee is easy to administer and forces agreement between the lawyer and the client on the service to be provided. For the lawyer the fixed fee provides greater freedom in case management. For the client, the fixed fee arrangement provides clients with some predictability by allowing clients to know exactly how much the matter will cost. Clients are therefore given a greater opportunity to determine the overall cost under this arrangement.

A disadvantage of the fixed fee arrangement is that it can limit flexibility within a matter and raise conflict of interest issues between the lawyer and client when the lawyer is tempted to prefer his own interests to that of the client's interests.[27] The conflict may arise because the predetermined fee might lower the quality of service when representation becomes unprofitable. The fixed fee can also be disadvantageous to lawyers if the cost of providing the service exceeds the estimated cost. As a result, lawyers must foresee all contingencies and fully understand the costs of providing services, or risk losing money on the engagement.

The capped fee arrangement uses a 'ceiling' for all fees for a particular matter. The client pays the law firm up to a specified maximum amount, but no more. Under this billing arrangement a law firm may charge an agreed hourly rate for the time required to complete the matter but may not exceed the ceiling in

[26] Adam C. Altman, 'To Bill, or Not to Bill?: Lawyers Who Wear Watches Almost Always Do, Although Ethical Lawyers Actually Think About It First', 11 Geo J. L. Ethics 203, 225 (1998)
[27] Rodney D. Seefeld, Billing Alternatives, Wis Law. Sept 1991, at 13, 14 cited in Sonia S. Chan, ABA Formal Opinion 93-379: Double Billing, Padding and Other Forms of Overbilling, 9 Geo. J.L . Ethics 611, 626 (1996).

total compensation for services rendered. A variation of this arrangement is caps on hours or fees for particular time periods during representation or for particular stages of the work or a unit fee, which is a fixed charge for a specific service irrespective of the actual time spent in providing that service. For example preparing correspondence, handling a phone call or taking a deposition has a fixed charge.

Statistics in Australia indicate that the fixed/capped fee arrangement commonly referred to, as 'event-based costing' is becoming the billing method of choice amongst those firms who are beginning to understand the importance of value.

According to the Harris Cost/Mahlab survey on members of the Australian Corporate Lawyers Association, referred to above, 75% of respondents consider fixed and capped fees to be the most appropriate form of billing for routine matters and for large complex commercial transactions.[28] David McClune, Director of Marketing and Client Service at Allens Arthur Robinson agrees that fixed fee work is the most used alternative to hourly billing. McClune has noticed an increase in the use of fixed fee billing in areas such as financial services, property and insurance litigation and that clients are now actually looking for a fixed fee quote.[29]

The use of event-based costing has also gained popularity overseas with firms in both the United Kingdom and the United States using fixed or capped fees as the primary alternative to hourly billing. According to a 2002 PWC financial management in law firms survey in the United Kingdom, fixed fees now account for 15% of revenues of top 100 law firms. Use of the fixed or capped fee to bill has been adopted amongst the magic circle and leading second tier firms in London.[30] Similarly, the fixed or flat fee is also the most frequently used alternative free arrangement in firms across the United States for individual tasks.[31] The arrangement is often used for commodity services in a highly competitive market.

Other less used alternatives to hourly billing in New South Wales include as follows:

(a) Contingency fees or percentages

[28] Harris Cost Lawyers & Mahlab Recruitment, "Does your lawyer fit the bill? A joint survey assessing Corporate Counsel/Law Firm relationships", February 2006 at p. 29, available at http://www.harcosts.com/HC_survey.pdf

[29] K. Gibbs, "Scales of (billable) justice", Lawyers Weekly, 5 April 2007 available at http://www.lawyersweekly.com.au/artuicles

[30] Ibid.

[31] The 2002 Commission on Billable Hours questionnaire revealed that between 54-63% of firms of between 2-50 lawyers used flat or fixed fee billing over a three-month period in 2002. Larger law firms had a 30-38% usage rate. Furthermore, 72% of responding firms had a fixed/flat fee arrangement with outside counsel; see also K. Gibbs, "Lawyers consider alternative billing", Lawyers Weekly, 27 May 2005 available at http://www.lawyersweekly.com.au/articles

A contingency fee agreement depends on the results achieved by a lawyer in a particular case. Under this arrangement the lawyer agrees to receive as a fee a certain percentage of the verdict or settlement. If there is no recovery, then there is no payment**.** Use of the contingency fee is beneficial to a client because it can enable the client to access a service they may not otherwise be able to afford. This fee arrangement is most often used in personal injury matters. It can also be used effectively in commercial cases, especially where recovery is doubtful.

The main disadvantage of the contingency fee arrangement is that it can increase the firm's risk and have a negative impact of the firm's cash flow. As a result, those firms with little experience, inefficient operations, poor screening processes, or weak financial skills risk losing money. Contingency fees can also discourage the running of test cases by firms who do not have the wealth to cope with unsuccessful results.

(b) Blended hourly rates

Blended billing, a hybrid of hourly billing allows a firm to set an hourly rate regardless of who is doing the work. It is a practice that is used widely in the United States and often used in litigation rather than transaction matters.[32]

Blended billing is advantageous to the law firm in that it is easier to negotiate and administer than having specific rates for each level of lawyer. Law firms benefit because they are able to use employees to do the work who may otherwise have a lower hourly billing rate such as a paralegal or junior lawyer. The main disadvantage of blended billing is that its use may endanger the quality of the work being performed unless there are strict quality controls in place. Blended billing, like hourly billing does not ensure predictability of the legal costs.

(c) Retrospective fees based on value

The retrospective fee based on value method differs in approach from other alternative billing methods because the exact amount of the fee is not known until the matter is concluded. The disadvantage of this arrangement is that neither the client nor the lawyer knows in advance what the fee will ultimately be. The arrangement also depends on a close and trusting relationship between lawyer and client, which may in some cases, be difficult to establish or maintain. Furthermore, determination of value may differ between the client and lawyer and cause disagreement.

(d) Relative value

Under this arrangement the lawyer and client draft a schedule of services that can be broken down by subject matter and task. Attached to each task is an

[32] According to the 2002 Commission on Billable Hours questionnaire almost one out of every two in house respondents have used the blended billing method over a twelve-month period.

agreed relative value or multiplier. This method recognises that tasks performed by a lawyer differ in value.

(e) Task-based billing

Task-based billing is designed to report the cost of legal services by tasks rather than by the chronological approach which law firms and corporations are generally familiar. Under a task-based billing arrangement law firms report their time using billing codes, which describe particular tasks. The lawyer is requested to provide a budget in advance of performing the particular task and may not (without prior agreement) exceed the budget. In many instances, the standard or discounted hourly rate is used in conjunction with the task-based or project billing to arrive at the budgeted amount.

(f) Discounted billing

Law firms sometimes offer, and corporations sometimes request a discount on the law firm's bills in consideration for a certain volume of business. For those particular clients who need a lawyer on a regular basis and also have multiple matters, a discounted hourly rate is negotiated to accommodate the volume.

Reform of legal process

In 2005, Brett Walker a practising barrister and former President of the NSW Bar Association presented a paper entitled 'Lawyers and Money' at the St. James Ethics Centre's 2005 Lawyers' Lecture.[33] The title of the Lecture was by no means unusual or provocative because the terms 'lawyer' and 'money' sit comfortably next to one another as they have done for many years. What was however provocative was the content of the lecture and its uncomfortable focus on the assertion that law firms are now no more than 'mega firms' with a sole focus on big business, money and profit. Walker asserted that for a number of law firms in the Australian marketplace profit is today the only driving force. According to Walker these big law firms have more in common with merchant banks and large accounting companies than the smaller law firms and lawyers in sole practice. Walker commented:

> "..the published aspirations of many big law firms have much more in common with large accounting combines and dazzling millionaire's factories, than with their legal colleagues in small firms, in the country and in sole practice.
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> So too, it may appear, much of the work of commercial lawyers, and not only in big firms, has a diminishing connexion with justice, let alone an involvement in administration. The wrong fork in the road was taken when the profession determined to specialize and sub-specialize its brightest graduate almost as soon as they had obtained their generalist law degree and practical legal training. In many cases, the commercial lawyers are

[33] B. Walker, "Lawyers and Money", 2005 Lawyers' Lecture, St James Ethics Centre, 18 October 2005 available at http://www.ethics.org.au/about-ethics/ethics-centre-articles/ethics-subjects/law-and-justice/article-0465.html

> really part of the clients' entourage, being served with the client by the litigators and counsel. Perhaps it is time for that division to be recognised formally: by the business-services part of the legal profession, the lawyers closest to the big money of their business clients, having nothing really to do with the general corpus of law and no real interest in the administration of justice, to leave the legal profession and join with the management consultants, accountants, finance brokers and merchant bankers.
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> "....excessive proximity to business clients, and their money, seems to have produced elements of imitation unlikely to enhance professionalism. The phenomenon of the big – and bigger and bigger – law firm should probably not simply be witnessed passively as if it were a force of nature."[34]

The 'law as a business' mentality is a relatively new phenomenon for the legal profession. Historically, lawyers were generally sole practitioners who trained under a system of apprenticeship with little interest in running business solely for profit. The traditional role of the English common law lawyer was as the personal representative of his/her client. To assure the effective operation of the adversary system, the lawyer was required to make oaths to the courts to conduct themselves ethically and in the best interests of their clients, avoiding conflicts of interest.

This idea of the lawyer as personal representative was initially transplanted from the United Kingdom to the Australian legal system with great success. However after a number of years, the profession began to evolve and the rules gradually changed. Partnerships began to emerge as the basic organisational model adopted by most law firms. From the late 19th century the partnership model grew to be the dominant model of organisational structure for the legal profession in Australia. Today however, competition and market forces have redefined the practice of law and the partnership model is no longer the only structure available.

Over the past twenty years the legal profession in Australia, as in other parts of the world (most notably the Untied States and the United Kingdom) has undergone major structural and organisational change. Since the 1970s virtually all of the leading law firms in Australia have expanded both in size and capacity by merging with one another to create 'mega-firms.' In recent years a number of these mega-firms have also expanded their international connections.[35] Unlike a generation ago, an increasing large percentage of law firm partners are recruited from other firms, not associates who are promoted from within. Whilst the general partnership model worked reasonably well for the smaller law firms, its usefulness for the larger firms is now being questioned:

> "The decentralized management style embodied in the model was perhaps tolerable when firms had a single office and a couple of dozen

[34] Id at p.7.
[35] For a detailed discussion of the rise of mega-firms in Australia see D. Weisbrot, Australian Lawyers, Longman Cheshire, 1990 at pps 257-266.

> partners. It is far less functional in firms of several hundred partners spread over multiple locations that must respond rapidly to changing market conditions."[36]

Marketing themselves as businesses the focus of these the mega-law firm has changed considerably from those that existed 100 years ago. Today the importance of loyalty and maintaining client relationships has expanded to include the mantra of 'profit', and firms are in danger of this becoming their sole purpose. Driven by profit, firms today are experiencing the need for improved management procedures. Maintaining and increasing profits per partner is a crucial objective for law firms these days and the hourly billing requirements imposed on junior staff and associates is one means for partners to achieve this end. However the increasing pressure for alternatives to the billable hour have forced many firms to reconsider its utility in today's legal marketplace.

Law firms today are facing an increasing amount of pressure to maintain their clients and provide value for money. Unlike 100 years ago, law firms are today experiencing a new type of consumer who considers all of the options and information before they agree to engage the services of a firm. Today's consumers consider the quality and price of the service based on their own perception of value and choose between competing products or services on that basis. As Calloway and Robertson comment:

> "A half-century ago, people and their attitudes were significantly different from those of today. Most clients greatly appreciated lawyers who took them by the hand and managed important legal matters. Many clients were uneducated and unaccustomed to dealing with documents and legal matters. Legal services may have tended toward directing courses of action, as opposed to offering advice.
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> The twenty-first century consumer of legal services is usually better educated and more independent …The consumer of today wants explanations, information, and options. ..
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> The busy pace of modern life means that today's consumer is likely more "time challenged" than his or her forebears. A desire for convenience and flexibility is another consumer attitude that affects the delivery of legal services. We will see more law firms cater to the individual consumer market, employing "innovative" ideas such as expanded and convenient office hours, "one stop shopping" integration with other professionals, and rapid production of legal documents while the client waits." [37]

This new well-informed consumer is being experienced in all types of firms regardless of their size. In the mega-firms, the well-informed consumer has become the in-house counsel; whilst in the smaller firms it is the individual consumer.

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[36] J. Jones, "Partnerships: Can It Survive in Today's Mega-Firms?", New York Law Journal, 18 June 2002, available at http://www.hildebrandt.com/Documents.aspx?Doc_ID=997

[37] J. A Calloway & M.A. Robertson, Winning Alternatives to the Billable Hour: Strategies that Work, American Bar Association, 2002 at pps 11-12.

Historically, before the existence of in-house counsels, the practice of corporations was to brief out all of their work to one firm alone. The reliance on one particular firm permitted a solid and trustworthy relationship between that firm and the corporation, effectively allowing the law firm to have free reign in the fees they charged that corporation for the legal services they performed. Hourly billing, adopted from the accountancy profession, was the preferred method firms used to price their legal services with the firms allocating a rate to each practitioner and calculating fees by multiplying time recorded by each practitioner's allocated price. Rarely, because of the trusting nature of the relationship between the corporation and the law firm, did the corporation question the fees and/or the value of the firm's services. It was not gentlemanly to do so. This unique relationship was evident in other jurisdictions worldwide. Milton C. Reagan Jr states of the relationship between corporations and Wall Street law firms for example, as follows:

> "For firms, the relatively powerful market position of large corporate clients gave those clients minimal interest in aggressively monitoring the cost of legal services. A 1959 Conference Board survey of almost three hundred manufacturing companies, for instance, reported that companies generally indicated that they were happy with that law firm and "have never given any thought to hiring another…..
>
> Since corporate clients tended to look to a firm for most of their legal needs, they provided the firm with a steady stream of income. The close connections between a firm and its clients were reinforced by the presence of many firm alumni in the legal departments of those clients, the personal ties between lawyers and corporate executives drawn from the same social class and background, and the accumulation by the firm of detailed knowledge of its clients' operations."[38]

However, as the corporations started to grow in size and influence the dynamics of their relationship with the legal profession gradually started to erode.

The growth of corporations in Australia during the 1960s and 1970s and new market pressures caused many corporations to evaluate the services being provided by their legal representatives as their need for legal services increased. Realising that much of the work they had tendered out to law firms could be done by appointing legal practitioners on their staff, corporations began to rethink the way that they obtained legal services. Their answer was to rationalise the use of these services by employing in-house counsel to perform the day-to-day work that was traditionally performed by the law firms. The effect of appointing in-house counsel was significant, resulting in a major loss of income for the legal profession. Over the ensuing years the power of in-house counsel grew and gradually the once solid ties between the corporation and the law firm slowly began to come apart.

[38] Milton C. Reagan Jr, "Eat What You Kill", at p.24.

Today the in-house counsel has an unfettered power in choosing which firm to brief for those matters that require the engagement of a law firm. In deciding which firm to use in-house counsel are now more scrupulous, questioning the value of the firm's work and the fees the firm charges.[39] It is no longer a question of loyalty as to which firm gets the work. Retaining individual lawyers rather than specific firms has become an important priority for in-house counsel as they shop for specialised representation on high stakes matters. Thus those lawyers with the most specialised experience in a particular matter will be chosen even if the corporation has had no experience or dealings with that law firm before. Consequently many of the mega-firms are now finding themselves having to bid for the work of the corporations:

> "…in-house counsel now tend to act as savvy consumers who shop around for representation on each matter. Law Firms compete for such work in "beauty contests" in which they present proposals indicating how they plan to provide cost-effective service on particular engagements. Corporations aggressively negotiate alternatives to hourly billing, such as incentive-based fee structures and discounts." [40]

Reducing external legal costs is a major issue for corporations. According to the study by Harris Cost Lawyers and Mahlab, discussed above, reducing external legal costs was the most pressing business issue for in-house counsel.[41] This is clearly refected in the decreasing number of matters in-house counsel are referring to law firms.[42] The study also revealed that a law firm who offers alternatives to the billable hour is a more attractive option than firms who do not. The study found that 49% of respondents were 'very keen' to investigate billing arrangements other than the use of hourly billing. Ninety six percent of respondents indicated that they were 'moderately keen' to investigate alternative billing arrangements.[43] The study concluded that overwhelmingly in-house counsel are interested in finding a basis to charge other than the billable hour.[44] The reason for this, according to Scott Sloan, Managing Partner of Dibbs Abbott Stillman, is because clients are looking for lawyers to "articulate and therefore charge their value in ways that are more aligned to their businesses, and that makes more sense in how they measure their profitability and their expenses."[45]

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[39] See T.L Sager & S.A. Lauer, The Billable Hour: Putting a Wedge Between Client and Counsel, Law Practice Today, November 2005 available at http://www.abanet.org/lpm/lpt/articles/fin12032.html

[40] Id at p.33

[41] Harris Cost Lawyers & Mahlab Recruitment, *"Does your lawyer fit the bill? A joint survey assessing Corporate Counsel/Law Firm relationships",* February 2006 at p. 12, available at http://www.harcosts.com/HC_survey.pdf

[42] According to Mahlab's study the average number of matters handled by external law firms in 2004-2005 was less than 100 at id p.11.

[43] Id at p.30.

[44] Id at p.30. The level of interest by in-house counsel is not just limited to Australia. In a recent study in the United States by the Association of Corporate Counsel, 62% of in-house counsel indicated that they were interested in alternatives to hourly billing: see http://www.acc.com

[45] K. Gibbs, "Scales of (billable) justice", *Lawyers Weekly*, 5 April 2007 available at http://www.lawyersweekly.com.au/artuicles

Smaller firms are also facing similar pressures to reconsider their billing arrangements thanks to a new breed of commercially savvy clients seeking value for money. Individual clients, like in-house counsel, are beginning to question what it is exactly that lawyers are selling to them - their time or their skill, and, if it is their skill, isn't there a better way to measure that value than by watching a clock? Clients who are pressuring the firms for alternatives to hourly billing are not, however, simply looking for a "discount." They are looking for a means to make their legal expenses predictable and rational, in proportion to the value of the result to them.[46] Savvy clients are also demanding more from their lawyers requesting greater access to information on the progress of their matters.

Noting the increased pressure by such clients the managing partner of a small Sydney firm has now adopted a holistic approach to providing fee certainty in response to the pressure of his clients. In order to change his billing practices the managing partner implemented a new practice management system and in May 2004 the firm engaged an independent consultant to review the cost of every matter that went through the firm.[47] This process allowed the law firm to successfully implement event based costing for many services. The law firm now aims to implement event based costing for all of the firm's services by July 1, 2007.[48]

The increasing pressure and competition felt by both the large and smaller firms for transparency and accountability have forced a number of firms to not only re-assess their pricing policies but also re-assess whether they are capable of meeting the needs of consumers today. Realising that consumers are demanding increased access to information and services, a number of law firms have in effect rebuilt themselves to cater for their clients needs, resembling more and more the clients they service. One way in which law firms have been able to do this is through incorporation.

In New South Wales there are now more than 735 incorporated legal practices (ILPs) of which approximately 42 are incorporated multi-disciplinary practices (MDPs). The majority of ILPs were previously existing traditionally structured law firms. There are currently two ILPs that have listed on the Australian Stock Exchange, with another currently making its initial public offer. New ILPs are being formed at a rate of approximately 15-20 per month. It is expected that by 2010 there will be approximately 1200 ILPs in New South Wales alone.

Incorporation brings with it a higher degree of transparency as well as an additional managerial requirement. Law firms that have incorporated are required pursuant to the Legal Profession Act to implement and maintain

[46] J.W. Toothman, Alternative Billing: Living With the Uncorked Genie, 7(3), Accounting for Law Firms available at http://www.devilsadvocate.com/Articles/vol7no31.html
[47] K. Gibbs, "Firm's budgets behind billing fraud", *Lawyers Weekly*, 18 November 2005 available at http://www.lawyersweekly.com.au/articles
[48] K. Gibbs, "Lawyers consider alternative billing", Lawyers Weekly, 27 May 2005 available at http://www.lawyersweekly.com.au/articles

"appropriate management systems" to ensure that legal services are provided by solicitors in accordance with the Act. ILPs must show that they have procedures in place which evidence compliance with what my Office considers to be the ten objectives of a sound legal practice:

1. Competent work practices to avoid negligence
2. Effective, timely and courteous communication
3. Timely delivery, review and follow up of legal services to avoid instances of delay
4. Acceptable processes for liens and file transfers
5. Shared understanding and appropriate documentation from commencement through to termination of retainer covering costs disclosure, billing practices and termination of retainer
6. Timely identification and resolution of the many different incarnations of conflicts of interest including when acting for both parties to a transaction or acting against previous clients as well as potential conflicts which may arise in relationships with debt collectors and mercantile agencies or conducing another business, referral fees and commissions etc.
7. Records management which includes minimizing the likelihood of loss or destruction of correspondence and documents through appropriate document retention, filing, archiving etc and providing for compliance with requirements as regards registers of files, safe custody, financial interests
8. Undertakings to be given with authority, monitoring of compliance and timely compliance with notices, orders, rulings, directions or other requirements of regulatory authorities such as the OLSC, Law Society, courts or costs assessors
9. Supervision of the practice and staff
10. Avoiding failure to account and breaches of s61 of the Act in relation to trust accounts.

These ten commandments as they are fondly known are backed up by a self-assessment process, which assists ILPs to develop management practices in addressing the "ten commandments. This in turn has been designed to entrench ethical behaviour. In addition the improved management practices make it more likely that the ILP will better cost the services it offers and develop a range of more flexible and transparent billing practices.

The Writing is on the Wall

This paper has explored the increasing pressure by the many facets of the legal marketplace on present day legal practices to adopt alternatives to the billable hour. This pressure includes:

(a) The adverse effect of the billable hour on staff moral and productivity;
(b) Calls for its abolition by influential members of the profession such as the Chief Justice of New South Wales who refers to hourly billing as "the tyranny of the billable hour";
(c) In-house counsel no longer bound by law firm loyalty and requiring tighter budgets;

(d) Dissatisfaction by individual clients who are questioning the value of hourly billing;
(e) Increased competition; and
(f) The emergence of new legal practice structures such as ILPs (which can become listed companies) requiring more transparency.

The legal profession is at a cross-road. If law firms continue to take the path of morphing themselves into a business and possibly even an industry then they must change their pricing policies in accordance with the demands of the marketplace. However, as a regulator of the legal profession I find this constant necessity to attack the premise unfortunately increasing alongside the growing focus on profit, that a clash exists between profit and ethics. In my view, no such clash need exist. The only clash is between ethics and greed.