

## TECHNOLOGY AND THE HOURLY BILLING CHALLENGE

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Technology transforms practice. It can shake up hidebound patterns of behaviour, encourage bold thinking, transform expectations, and conquer time and distance. At the time, patterns of behaviour may seem inevitable, only to be undermined by technological innovation. In this paper, I want to start to explore the potential impact that technology may have on hourly-based billing. This is the economic model which values legal services provided to clients on the basis of the hours expended by fee-recorders, as a multiple of an hourly rate reflecting skill and experience.

The foundations of hourly-based billing date<sup>2</sup> back to Reginald Heber Smith<sup>3</sup>, who developed a mathematical approach to legal practice as a way of avoiding lawyers undervaluing their services. From that start in 1956, a practice restricted to a few elite firms spread to an entire profession. For over 20 years, however, the demise of the billable hour has been widely predicted<sup>4</sup>. The revolution has, failed to materialize.

For most lawyers in private practice, I don't really have to explain hourly billing. Except for government lawyers, I suspect that we have all grown accustomed to the practice. But from a technological and efficiency perspective, it appears counter-intuitive. Certainly it permits clients to apply apparently objective criteria to assess the basis of the probable cost of legal services, but it does not give them the essential element in the equation, a firm and reliable basis on which to assess how much it will all cost.

In theory, technology-driven, value billed initiatives have obvious advantages. They free us from the tyranny of the billable minute. They encourage innovation and efficiency. They offer us a tantalizing glimpse of revenue that is not limited by the finite variables of hours and hourly rate.

There are simply not enough hours in a day to increase billable hours, and there is a threshold beyond which the human costs of overwork are literally unbearable<sup>5</sup> —or as

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<sup>1</sup> Partner, Heenan Blaikie LLP Toronto. This article stems from friendships over two decades. It is dedicated to the late Richard C. Reed, whose kindness, enthusiasm and intellectual curiosity about this topic illuminated hours of discussion. David J. Bilinsky persuaded me to speak about it at the First Pacific Legal Technology Conference in Vancouver in 2003. He paired me with a remarkable co-presenter Dale C. Doan who was living the technology-driven practice. A bevy of friends contributed to discussions of the themes in North America, Europe and Asia: James Brill, William C. Cobb, Leary Davis, Jim Dimitriou, Ron Friedmann, Wendy London, Patrick McKenna, Rees Morrison, Mary Beth Pratt, Charlie Robinson, Robert Schack, Richard Susskind, Merrilyn Astin Tarlton, and Milton C. Zwicker. Bruce Lee-Shattock, a student at Dalhousie Law School helped me update the dated original and remove the infelicities and howlers. The remaining heresies I acknowledge mine.

<sup>2</sup> [http://en.wikipedia.org/wiki/Attorney%27s\\_fee](http://en.wikipedia.org/wiki/Attorney%27s_fee)

<sup>3</sup> Law office organization, by Reginald Heber Smith, Chicago, American bar association journal, 1940.

<sup>4</sup> The Billable Hour: Are Its Days Numbered? Douglas McCollam, The American Lawyer, November 28, 2005 <http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1132653918886> and Rip\_2 It's official: The billable hour is dead. At <http://commonscolld.typepad.com/commonscolld/2007/08/rip-billable-ho.html>

<sup>5</sup> For comments on the distorting effects of time see M.C. Kaveny, Billable Hours in Ordinary Time: A Theological Critique of the Instrumentalization of Time (2001) 33 Loy. U. Chi. LJ, 173 and DeVoe, Sanford E. and Pfeffer, Jeffrey When time is money: The effect of hourly payment on the evaluation of time (2007) 104 Organizational Behavior and Human Decision Processes, 1-13

one young Canadian put it on his return from Manhattan “Wall Street practice was killing me”. Nor can hourly rates be increased beyond what the market is prepared to pay and the competition is accepting.

Given this iron cage, the only variables that are attractive are premiums and leverage. Technology offers an edge in both places.

When I notice the way a few firms have embraced value-based billing, employing premiums and leveraging technology, I wondered why we hadn’t all moved in this direction<sup>6</sup>. Are we hide-bound traditionalists, unable to value technology, or simply stupid?

Perhaps, but I don’t think so. The lawyers and the firms I know are bright, often fiercely so. They’ve invested in technology. They don’t need lessons on how to run their businesses. So are the clients. Their legal budgets have been compressed. They face internal pressure to justify legal costs—regarded in corporate terms as negative, pure overhead. They have every incentive to move towards billing models that align risk and reward, that encourage efficiency, and that reflect the ultimate value of the service in the clients’ eyes.

Back in 1989, at the Second International Conference on AI and Law, Rees Morrison, who was then with Analytic Legal Systems spoke about why artificial intelligence technology had not yet gained wide acceptance within U.S. legal culture. He identified barriers including the reluctance of lawyers to use computers, lack of uniformity of computer platforms, and the practice of time billing, rather than value billing (which provides scant economic incentive to speed up tasks that are billed by the hour).

Almost twenty years later, intelligent legal information systems are still not a common fixture on lawyers’ desks. Yet taking Rees’ observations, computers are widely deployed and we have standardized user interfaces, if not operating systems. The culprit must be the last item: hourly billing.

It’s all so obvious—at least in principle. And it’s been obvious for two decades. Accordingly I went on an investigation. To look again at the logic of the technological imperative. To revisit the writings of the visionary few who identified the opportunity and who argued convincingly that we must embrace it. And finally to engage in a dialogue with the visionaries who are waiting, still waiting, for the resolution.

### ***Richard C. Reed, the Pioneer***

Beginning in 1987, Richard C. Reed, in a trilogy of works spanning a decade, sketched out a revolution in billing practices<sup>7</sup>. The new billing paradigm he predicted focused on

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<sup>6</sup> Not Snow, Nor Sleet, Nor Gadget Boom Will Kill the Billable Hour, National Law Journal - August 31, 1998, <http://www.wendytech.com/articlesbillablehour.htm>

<sup>7</sup> Reed’s work is found in a number of ABA collections: R.C. Reed, J.W. McRae, K.S. Marshall, A.W. Sorelle, and E.R.S. Alvarez, Alternative billing methods: A Status report from the task force, *Legal Economics* 15(6), 1989, pp. 18-26. *Beyond the billable hour : an anthology of alternative billing methods*, edited by Richard C. Reed. Published/Created: Chicago, Ill.: ABA, Section of Economics of Law Practice, 1989. *Win-win billing strategies : alternatives that satisfy your clients and you*, Task Force on Alternative Billing Methods ; Richard C. Reed, editor and chair: Chicago, Ill. : American Bar Association, Section of Law Practice Management, 1992. *Billing innovations : new win-win ways to end hourly billing*. Richard C.

value or benefit to the client, as opposed to the dominant paradigm which based billing on time expended by the lawyer. Reed argued that an ideal billing arrangement would involve a client who could select a lawyer with the experience and ability suited to the task, and a lawyer whose fees accurately reflected the client's perceived value for those tasks. He felt that client demands for increased efficiency would result in widespread adoption of alternatives to hourly billing.

Twenty years later, we are still waiting for a revolution. One commentator memorably described hourly billing as the cockroach of the legal profession<sup>8</sup>. Was Reed wrong? Is change just around the corner? Why are we still marking time?

## **Background**

In 1987, Charlie Robinson, chair of the American Bar Association's section that focused on managing law firms, created a Special Task Force on Alternative Billing Methods. He asked Reed to lead a group tasked with devising alternative billing methods that measured value more effectively than hourly billing. Reed edited the first publication of the study, *Beyond the Billable Hour: An Anthology of Alternative Billing Methods*. This project led to the publication in 1992 of *Win-Win Billing Methods: Alternatives That Satisfy Your Clients and You*. The trilogy was completed with the 1996 publication of Reed's *Billing Innovations, New Win-Win Ways to End Hourly Billing*.

Reed's analysis rested on a lifetime's observation of developments in the legal market. He was aware of the changing dynamics of the marketplace and the transformational promise of technology. His analysis is replete with testimonials, real-life examples, and surveys. They all supported his belief that evolution towards alternative methods of billing was inevitable in the legal profession.

## **Reed and the Inevitability of the New Billing Paradigm**

Reed's analysis had three components:

- the weaknesses of the hourly billing method,
- the influence of economic pressures, and
- the impact of technology on the legal profession.

Billing methods could not be divorced from legal practice since the value of legal services was related to the quality of those services. Billing methods that did not measure value solely through time spent would provide incentives for efficiency and early resolution of matters. So what Reed articulated was an entirely new framework for thinking about the economics of legal services delivery.

Reed felt that most firms were in transition from lawyer-focused, cost-based billing systems to client-focused, value billing systems<sup>9</sup>. In the final book of the trilogy, Reed predicted that hourly billing would soon disappear.

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Reed: Chicago, Ill. : ABA Section of Law Practice Management, 1996. Reed's work was updated as *Winning Alternatives to the Billable Hour: Strategies That Work* by James A. Calloway, Jerry H. Gill, Mark A. Robertson, American Bar Association Section of Law Practice Management, Chicago, 2003

<sup>8</sup> Douglas McCollam, *The Billable Hour: Are Its Days Numbered?*, *The American Lawyer* November 28, 2005 at <http://www.law.com/jsp/ihc/PubArticleFriendlyIHC.jsp?id=900005441810>

## Disadvantages of Hourly Billing Methods

Hourly billing has long had its critics. They argued that looking at efficiency, cost and value to the client was a better approach. In particular, clients have long complained about the cost of legal services. They express frustration that lawyers calculate cost based on the expense of producing a service before a benefit is realized, whereas clients calculate cost as the total dollar impact of a legal problem. Clients noted that lawyers were neither efficient nor productive, and had little incentive to change. Time quotas can encourage time padding. The clients paying the bills doubted whether lawyers were being completely honest.

These client concerns were the result of a lack of incentives for efficiency, the unpredictability of expenses, a disconnect between the perceived value of legal services and their true cost, and the absence of any risk-sharing mechanisms between lawyer and client.

### *Lack of Incentives for Efficiency*

The hourly billing method may actually award incompetence and inefficiency, as the longer it takes to complete a task the more a

lawyer is paid. If the profitability of a law firm depends upon hours billed, little incentive exists to facilitate early or efficient resolution in a matter. Hourly billing places lawyers in a conflict of interest with clients, tempting lawyers to maximize hours so as to maximize profits. The client, on the other hand, desires both timely performance as well as fees that reflect their perception of the value received. The average firm's profit rests upon the number of hours billed; since technology reduces human time required for the

The ABA's 2002 Commission on Billable Hours stated that the over reliance 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 the 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

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<sup>9</sup> For an economic model of such systems, see Madjid Tavanna, QB. Chung, Dennis T. Kennedy, A decision support system for pricing in law firms (1998) 33 *Information & Management* 155-165.

completion of tasks, the result is a “productivity paradox” in which enhanced performance is uneconomic.

### ***Lack of Predictability in Legal Expenses***

Corporate clients are particularly concerned about the lack of predictability for legal expenses. This, together with the lack of control over the hours billed, means that budgeting for legal expenses is very difficult for clients when a hourly billing method is used.

### ***Lack of Relationship between Perceived Value of Legal Services and Costs of Legal Services***

In 1988, William C. Cobb published a model about the different types of legal work available, known as the Cobb Value Curve.<sup>10</sup> The Cobb Value Curve recognizes that there are four different categories of work, each with a different degree of value:

- **Unique:** Work whose importance is so crucial to a client that price is not an issue. For example, a corporate takeover.
- **Experiential:** Work for a client who seeks a lawyer with particular expertise in the subject matter. Price is naturally somewhat of an issue.
- **Brand Name:** Work which must be performed by a name brand firm because the client requires the firm’s reputation. The price of this work is more of an issue, and savings can be realized by having a less-known lawyer at a well known firm do this work.
- **Commodity:** Work which may be performed by any lawyer. As a result, clients will seek the lowest cost option, making this type of work extremely sensitive to cost.

The hourly billing method results in inappropriate delegation of work, and a poor mismatch between available and required expertise. The hourly billing method fails to recognize the significance of Cobb’s Value Curve, and its implications. The hourly billing method fails to recognize even the basic principle that different legal services have different value.

Even if the costs were mechanically computed and therefore a fair representation of time spent, they were unlikely to bear any significant relationship to the client’s perception of the value of the services provided.

### ***Absence of Risk-Sharing between Lawyer and Client***

Hourly billing tends to allocate risk entirely to the client. This can encourage inefficient practices and discourage early resolution, since the firm is paid regardless of whether it performed efficiently and regardless of the outcome.

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<sup>10</sup> A lucid discussion of the Cobb Curve is available in Arthur Greene’s book “The Lawyer’s Guide to Increasing Revenue: Unlocking the Profit Potential In Your Firm”, 2005, ABA Law Practice Management Section, pp 76-78

In a billable paradigm, considerations of value or benefit to the client simply have no meaning. Moving away from this paradigm would allow us to focus on quality of services, speed of resolution, value or benefits conferred upon the client or results that were obtained.

### **Economic Pressures Resulting from Changing Market Conditions**

Reed recognized that the choice of billing method, as well as clients' considerations of legal expenses, were driven by economics. The 1980's were a time of very high personal and business incomes, a situation that created a seller's market for lawyers. The reliance on hourly billing was a relatively recent phenomenon, the result of the distortions of a boom market that encouraged inefficiency. The amount of available legal work and the apparent indifference of clients to legal expenses resulted in a situation in which hourly billing practices proliferated, and increases in operating expenditures were more than compensated for through increases in hourly rates and billable entries. This perpetuated the inefficiencies and inadequacies of the hourly billing method where they might not otherwise have been tolerated.

The recession initially impacted corporate clients, who re-examined their operating costs in response to decreasing profits. The change in the economy was accompanied by an increasing number of lawyers, an increasing number of non-lawyer legal service providers, and escalating operating costs. Competition significantly increased while revenues decreased. Clients began to critically evaluate the costs paid to outside counsel and increased use of in-house legal staff. Corporate clients reduced their reliance on outside firms and are increasingly considering the quality and cost of service when deciding which outside firms should be retained.

The result was a buyer's market in the legal profession. Taking advantage of the competitive nature of the legal market, corporate clients started to emphasize efficiency and the need for quality. As a result of the market change and the forced economies of the recession, corporate clients started to demand not only decreased legal costs, but also increased quality and value of services. Clients increasingly insisted upon discounted hourly rates, further weakening the relationship between costs of providing the service and compensation. Clients also increasingly demanded proposals for alternative billing, and collected information from past matters to allow for comparison of legal costs between firms.

Yet corporate counsel did not initially welcome the alternative billing methods suggested by the ABA's Task Force. Hourly billing practices continued and some firms responded to the decrease in revenues by lengthening the partnership track, increasing targets for billable hours, and through firm reorganization and restructuring. All the while the pain threshold of billable hour limits moved closer and revenues continued to decline as long-standing client relationships were terminated in the buyer's market.

While billing for legal services is largely price-insensitive in a seller's market, the buyer's market meant that increased operating costs could no longer be absorbed into hourly fees. Pressure to reduce costs resulted in an effort to shift legal services lower (towards commoditization) on Cobb's Value Curve, making firm differentiation critical.

Reed argued that the changing nature of the marketplace would force the legal profession to either adapt their billing practices to accommodate the changing market and the demands of their corporate clients, or face serious loss of profitability. As support for this proposition he attributed the failure of several well-established firms in part to their failure to recognize both new economic realities and the limitations of the hourly billing method. He suggested that the highly competitive market meant that the disadvantages of the hourly billing method no longer had to be tolerated, and that economic pressures and client demands would result in a revolution in billing practices.

### ***The Purposes for the Utilization of Technology***

According to Reed, technology would revolutionize the practice of law, the relationship between lawyers and their clients, the structure of law firms, and billing practices. As mentioned, the impact of technology provides a major incentive to move away from hourly billing because the reduction in time required to perform a task results in a corresponding reduction in billable hours. As a result, the increased use of technology should provide a significant impetus to move to an alternative billing method that emphasizes value instead of time expended.

Neither improvements to quality or improvements to efficiency are properly compensated for through the use of the hourly billing method. Improvements in technology require significant investment, and Reed argued that the need to invest in technology would result in a corresponding decline in the use of the hourly billing method.

What has technology done for us so far, and how have these changes placed pressure on hourly billing? First, technology has allowed us to both improve the quality of our legal services while reducing the number of routine, low-value tasks that lawyers must perform. Second, increased use of technology is incompatible with hourly billing for a variety of reasons, including:

- The Productivity Paradox
- The Commoditization of Legal Services
- Inability to Recover Costs of Technology
- Increased Flexibility for Payment

### **Improvements in Quality of Legal Services**

The use of document assembly systems requires less time and training and allows for a better quality product. High end work product retrieval systems help associates create documents that are superior in appearance and require fewer revisions. These advantages all reduce the time and cost required to produce a superior product, significantly increasing the motivation for a firm to move to alternative billing methods.

### **Reduction of Routine Tasks**

Technology has also reduced the number of routine tasks that a lawyer must perform, permitting lawyers to concentrate their time on thinking creatively for the clients. This advantage to the client is not reflected in hourly billing practices, as different types of work by the lawyer are not priced at different levels.

## **The Productivity Paradox**

Since the reduction in human time required as a result of the use of technology results in a corresponding reduction in billable hours, the effective use of technology creates a major incentive to move away from a billing paradigm dependent upon time spent as it reduces the time necessary to complete a task. The billable hours method penalizes lawyers who make efficient use of technology by reducing their ability to meet target hours. The increased use of technology should therefore provide significant motivation for legal professionals to move to any billing method that does not rely on hours spent.

## **The Impact of Technology on the Commoditization of Legal Services**

Technology has significantly reduced the complexity and the value of certain legal services. The introduction of document assembly software and standard legal form programs permit non-lawyers to perform many tasks themselves. This reduces the number of lawyers needed in the market as well as the total amount of legal work available. Examining the matter as a Cobb Value Curve, a greater number of legal services become significantly less unique and of little relative value to the client, and are therefore highly price-sensitive.

Technology can also reduce the lifecycle of new legal services thereby reducing them to the commodity level in a short period of time. The commodity level is where the competition is the most intense and where prices are the most sensitive. A firm continuing to use hourly billing would be at a significant disadvantage in such a market. The savvy deployment of technology has permitted small firms and solo practitioners to compete directly with larger firms for certain tasks, thereby increasing competition in the market, and further increasing price sensitivity. Increased use of technology has also made offshore outsourcing of legal services possible. Various firms, such as legalwise.ca in Canada, offer legal services from lower cost common law jurisdictions such as India.

Competition is further heightened by the availability of advanced technology that permits clients to collect and store information regarding legal matters and costs, and allows clients to make direct comparisons between firms.

## **Hourly Billing Provides No Mechanism to Recover Investment in Technology**

The use of technology requires significant investment in capital, training, implementation, and development. Such investment eventually results in a situation in which the time spent by the lawyer will not reliably measure the cost of providing technology-assisted services. Continued investment in technology for the purpose of reducing human time should force lawyers to move away from hourly billing.

## **The Impact of Technology on the Flexibility to Pursue Alternative Billing Methods**

Legal services that are performed through the use of technology will be better able to adjust to fluctuations in market conditions. In removing the need to tie the service provided solely to the time required to produce the service, the use of technology permits a firm to select a more appropriate billing method. In an environment other than one relying on hourly billing, the use of technology would become a critical element of

success, as increased efficiency and quality would improve their ability to compete in the market.

## **Today**

So much for the theory, largely dating from a decade ago. Did the revolution come? Have we abandoned billable hours? If not, why not? Those were the questions I posed to a group of friends who had worked on these issues since Reed's books. Indeed I spoke to Reed, as well as most of the team who had worked with him on the original analysis.

While there was some evidence that small and solo practitioners were more likely to make use of value billing, often providing their clients with the comfort of fixed fees, larger firms were likely to retain hourly billing. Ultimately, the consensus appeared to be that this retention was in no small part due to large corporate clients who preferred hourly billing. For these clients, hourly billing provides an understandable metric that allows them to monitor costs. Instead of transition to value billing, firms and clients have worked out ways to reduce costs within an hourly billing system; while economic pressures have resulted in the use of fee caps as well as various discounts or incentives, these are simply ways of increasing pressure on hour rates; the basic hourly billing model remains unchanged.

## **The Brains Trust**

The quotes in italics are all anonymized comments from that survey:

### ***Solo, Texas***

Except for the contingent fee lawyers who take a percentage and the criminal defense lawyers who take fixed fees in cash only, there are very few lawyers who go with fixed fees for more than just a limited number of standard services.

### ***Consultant, Texas***

The myth of technology-driven change is that we can kick-start the change process by the use of more sophisticated technology.

Technology is a myth. Every good technology consultant will tell you that technology is only as effective as the will and the ability to use it. That requires a culture shift. The law firm must execute the right strategies that in turn drive the need for the technology. We are then left with revolution.

### ***Law School Dean, North Carolina***

There are significant differences between sole practitioners and multi-lawyer firms, particularly larger firms, in reliance upon hourly billing. 87.5% of large firm respondents reported less than 25% of fee receipts from alternatives to billable hours, but only around 25% of smaller firm respondents). The Survey reveals that a majority of sole practitioners and lawyers in two and three-person firms receive a majority of their income, and one-third receive 75% or more of their fees, from non-hourly billing;

Level of fee receipts other than hourly billing, by firm size

The size of the city has also been shown to be important in determining a reliance upon hourly billing. Attorneys in towns more than 100,000 people are two to three times more likely to practice in a situation where hourly billing predominates than is the case for attorneys in cities of less than 25,000 people. Likewise attorneys in small towns are far more likely to initiate (by a margin of two to one) alternative fee arrangements than attorneys in cities of 100,000. Younger attorneys are much more likely to be implementing alternative billing arrangements than are older attorneys. The results of the survey indicate that attorneys over the age of fifty are twice as likely to bill primarily by the hour than attorneys under the age of thirty.

Alternatives to hourly billing are employed more often in corporate and business matters, criminal matters, estate planning, family law and general litigation, and substantially less often in the case of administrative practice, anti-trust, bankruptcy, construction law, civil rights, education, environmental, health, labor law and insurance defense. As expected the lowest level of reliance on hourly billing was reported in plaintiffs' personal injury practice and in real property.

### ***Solo, California***

My experience is that solo and small firms are more into alternative billing procedures. Their clients like the idea of fixed legal expenses. Corporate clients are more focused on "cost control" and believe that hourly billing allows them to accomplish that goal. They use the detailed itemized bill as a means of fee dispute resolutions and attorney control. Law firms also use billable hourly fees as a means of measuring associate and partner worth/compensation etc.

### ***Managing Partner, New York***

Based on our experience that the billable hour still reigns. It still accounts for more than 90% of our revenues.

If anything has changed, it is that we are "encouraged" by market forces to:

1. Prepare budgets for matters.
2. Agree to caps.
3. Use blended rates.
4. Put a portion of our fee "at risk" based on achieving the desired outcome on time, etc.
5. Bill at reduced rates with a bonus for achieving the desired outcome on time, etc.

Such arrangements are still all based on the billable hour, and they are most certainly the exception rather than the rule.

So I'd have to say we are still waiting for the revolution. Personally, I don't think it will ever happen. If the billable hour goes, I think it will be slowly and meekly.

### ***Consultant, Alberta***

With the exception of some of the leading US firms doing primarily insurance defence litigation (e.g. Reminger & Reminger in Cleveland) there is next to no real alternate billing activity. And Mario Ciano, the managing partner of Reminger, who really was one

of the very first to pioneer alternate billing, tells me it is still a tough sell to Fortune 1000 companies . . . even today.

Why isn't it happening? Well, we will do it if the clients want it, but most of the clients (irrespective of what they might say) seem to prefer to deal with billable hours . . . still "the" system that they understand. So, when economic conditions require that the legal department attempt to get more for less, that same legal department will demand a discount in billable hour rates rather than the law firm becoming more innovative around how they manage the files, deliver the legal product, or price their services. Who can figure?

### ***Law Firm Administrator, California***

The opinion of the administrators I spoke with about your question is that the billable hour is still the measurement used, but matters are not always billed as billable hours. Clients continue to put pressure on firms to provide fee estimates in trial matters, or provide flat fees. The time forms the basis for the estimates, time is logged, and a cost/benefit analysis is conducted. Clients continue to demand more information and control over the hours billed. Billable hours are the financial backbone of law firms and form the basis of most decision making, and lawyers and clients continue to think in these terms.

### ***Marketing Director, Pennsylvania***

Preparing a fee proposal involves work. It's much easier just to give the standard rate and hope that clients also will find it easier to be billed by the hour. The excuse is that each transaction is different and has different circumstances, making it hard to predict what the cost will be.

In requests for proposals, clients often ask for alternative fee proposals. In addition to the blended rates, fee caps are sometimes requested (and are the hardest to deal with, in my opinion) as are volume discounts (the percentage of the discount increases as the dollars increase). Some types of fee arrangements are used in specific practice areas -- for example, for labor and employment work, a retainer often encourages clients to call with questions and seek advice for something that might have future consequences.

If an issue goes beyond the retainer arrangement, then the work is billed hourly.

In some transactions, there are success fees; in others, when a deal craters, for example, there may be an agreement to reduce fees.

### ***Solo, Florida***

I listened to the lessons in the books and bill almost exclusively on a fixed fee basis. I have had the luxury of predictable volume combined with a practice high in perceived (also real I hope) value. Clients seem to relax more when they know that my 6-minute anecdote does not carry an extra cost of \$35.

### ***Managing Partner, Ontario***

The key measuring stick of profitability of associates in most law firms is the billable hour. Although other approaches to billing--such as fixed-fee arrangements, caps, and

value billing-are becoming more common, it is likely that the billable hour will continue to be the measuring system of productivity for the foreseeable future.

I believe he touches on the key issue: How do you measure the value of what we do for clients? No one has the answer, other than the billable hour.

### *New Zealand Consultant*

I'm beginning to think that the whole concept of "office" is dying - we are seeing heaps of evidence in this part of the world with people leaving conventional office space and conventional employment arrangements to work in ever-changing cloverleaf/flexible groups:

- a) Fear of the stability of large organizations (post Enron)
- b) Ability to command equally challenging, interesting work at half the rates charged by large organizations with high overheads
- c) Eagerness to work with as many different people as possible, and form work groups to suit individual situations.

My view is that come-the-revolution when lawyers begin to take a project management view of their work - in all respects:

\* I would suspect that Pareto rules again, i.e. that 80% of what we do can be classified as "commodity/repetitive/known" and 20% as "first-time/one-off".

\* If we accept this, then the first step for any given 'task' is to generate a report extracted from an information system which gives us time-spent and fees charged for the same/similar tasks in the past and the resources used, and then get to work adding any special factors which may impact on the task to hand or expected from this particular transaction.

\* This leads to value-billing - we should be able to cost the job rather quickly at this point.

\* The client is then quoted a project fee, but with the caveat that any additional work/negotiation will be charged at an hourly rate.

\* All work to be done within a project management environment - get more 'consultant-like'. This alone will force the debate of billable hour vs not.

\* Also, looking at any work from a holistic project point of view rather than a collection of individual tasks which, sadly, are all-too-often done out of context of the client's real business/business objectives, we might be able to introduce "what's it worth to you" billing - i.e. have the client set the price, with bonuses for meeting targets or more heretically, performance-related bonuses related to the client's gains.

Basically, I guess I'm saying that until we change the billing ENVIRONMENT, we ain't gonna change the approach.

As one respondent to the recent ABA survey reported: although corporate clients say they will consider alternatives, they are moving in the opposite direction of managed care - pressure on rates, auditing of hours. Insured cases are even worse.

## ***The Ethical Questions Surrounding True Hours as Against Value Hours***

While the law of costs initially appears to endorse hourly billing by emphasizing the reasonableness of time expended, officials appear to have the flexibility to recognize alternatives<sup>11</sup>.

Under *Ontario Civil Procedure Rule 57*, the court may consider a number of factors in exercising discretion to award costs; these factors will also be considered by the assessment officer when reviewing costs. The fundamental factor is the value that the client received for the professional services rendered which will generally be reflected in the success of the proceeding. However, the annotated *Rules of Civil Procedure* and *Orkin On Costs* recognize that a number of factors may be taken into account in the award of costs.

The time spent on the client matter is another factor that must be considered in reviewing the lawyer's bill. A flat fee (achievable through technological innovation) that is disproportionate to the time spent on the matter may be allowable in certain circumstances.

In *Davies v. Hunter*<sup>12</sup>, the Supreme Court of British Columbia confirmed the registrar's decision to disallow fees on the basis that the time spent by the solicitor and skills used were insignificant in relation to the amount involved, the importance to the clients and the result obtained. It is unclear how heavily past work or technology that allows a lawyer to provide a service at a superior speed would be weighed in favour of a higher bill.

The important point is that fees must be disclosed and must be objectively reasonable. Hourly billing makes it easy for a lawyer to fulfill her or his duty to disclose up front the basis on which a client will be charged for legal services and expenses. Lawyers must communicate to the client the rate of fee, preferably in writing, before or within a reasonable time after commencing representation.

How does this affect leveraged billing through technology? It means revealing to the client the basis on which the client has been charged, with some explanation of how that figure was ultimately arrived at. A negotiated fee beforehand is the easiest way to proceed, but simply highlighting the logic of how the fee is arrived at goes a long way.

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<sup>11</sup> For the ethics of hourly billing, see L.A. Watson, Communication, Honesty, and Contract: Three Buzzwords for Maintaining Ethical Hourly Billing, (1997) 11 Geo. J. Legal Ethics 189

<sup>12</sup> (1995), 40 C.P.C. (3d) 273 (B.C.S.C.[In Chambers])

Some of the best practical advice we have seen was set out a few years ago in an article for the Young Lawyers' Section of the ABA. It provided lawyers faced with the challenge of maximizing billable hours while satisfying clients with the following advice:

- Never overbill. One thing is quite clear: A lawyer may not bill a client for more time than the lawyer actually spent on work for that client. This ethical restriction does not prevent you from rounding up to minimum time periods (such as one-quarter or one-tenth of an hour).
- Be descriptive but diplomatic. In billing time to a client, provide a full description of the work done. Do not simply bill the client eight hours for "work on case" or "work on transaction." The bill sent to the client reflects your work and must adequately apprise your client as to what work you performed.
- Avoid describing your work in ways that imply it was not time well spent. "Repeated telephone calls to unresponsive adversary" or "fruitless search for relevant case law" might accurately describe your time, but "efforts to settle matter" or "legal research on x issue" are equally accurate.
- Explicitly describing the work performed is not only appropriate under the ethical rules but expedient. Your relationship with your client will benefit if the client understands the basis for the charges on your bill and feels the time was productive.
- Be efficient but don't shortchange yourself. Ethical rules require that an attorney's fees be "reasonable." Lawyers are prohibited from exploiting an hourly based fee arrangement by using wasteful procedures. In essence, this means using good judgment.
- On the other hand, don't be overly concerned about seeming inefficient. New attorneys might deliberately understate the time a project took in an effort to appear more proficient. Don't do it! It takes a less-experienced attorney longer to complete a project. That's why your hourly rates increase the longer you practice. If you spend 20 minutes, bill 20 minutes. If you spend 20 hours, bill 20 hours.
- "Unproductive" time. Minimize unproductive time, but accept that you will have it. Use it wisely, such as staying caught up on your reading or organizing your files.
- Record time daily. Enough said. You will especially appreciate this tip if you've ever tried to recreate a month's worth of work at one time.

### ***Practical Considerations for Value Billing***

First, if a lawyer were to develop a precedent whose existence would reduce the costs of future transactions, would it be fair and acceptable under present billing rules to charge the first client for all of the time expended in the initial preparation of the package?

Second, if the same lawyer stands by the billable hour model strictly, then is it fair to the lawyer that all subsequent clients will only pay a fraction of the original cost?

Although hourly billing conventions and taxation of account rules protect lawyers, law firms, and clients from what could otherwise become an unfair and unregulated scene, the use of technology in law practices may have the unusual effect of only harming the lawyers and their firms. After all, if a tremendously valuable precedent agreement takes 20 hours of skilled legal research and drafting the first time around, but only 45 minutes the next time that it is used, does this mean that it was worth \$5,000 to the first client and only \$187.50 to the second client? Obviously not. Yet in each case, the lawyer charged \$250 per hour and kept completely accurate track of her time. The old billing rules would

allow each bill to go out. However, the value to the respective clients and the skill and responsibility of the lawyer and her firm are not properly reflected.

In the example given, let us assume that the use of the complex contract is of equal value to either client. We might easily jump to the conclusion that the lawyer should bill the same \$5,000 to each client. While there are situations where this may be appropriate, this may not always be the case.

We suggest that the lawyer should carefully consider all of the key client indicators and apply this analysis of the value of her professional services provided in creating the agreement to that client. By key client indicators, we mean such things as:

- the size of the client,
- the sophistication of the client,
- dollar amounts reflected in the agreement itself,
- importance of the agreement to client,
- historical relationship of the law firm with the client, and
- promotional value indicating a courtesy discount.

Although both agreements are of equal value to each client, one of them may be a small, one time, bargain hunting business, whereas the other client may be a medium size, loyal, repeat business. These indicators may affect the lawyer's decision regarding the respective amounts to charge each client.

In addition, if the agreement is other than a purely unique, custom document (in other words, if it will have multiple uses or many re-creations in the future) then a courtesy reduction for the first client together with a value billing for all subsequent clients will prove to be fair to all concerned.

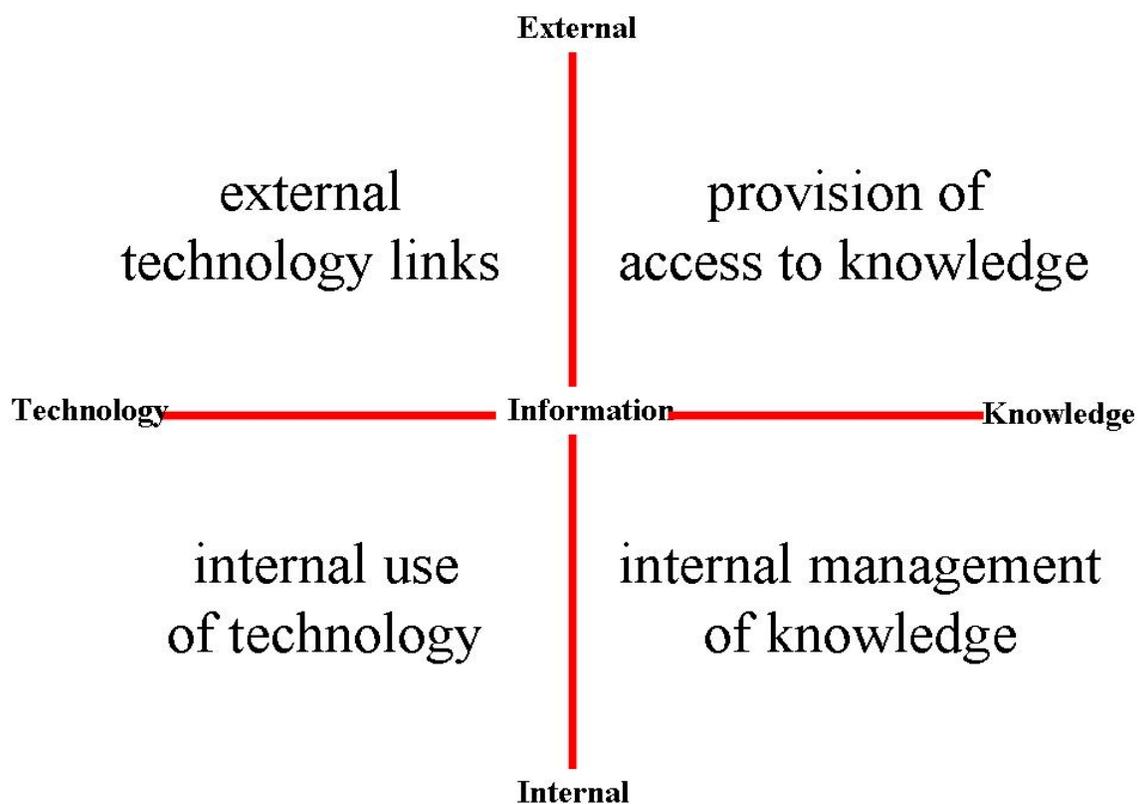
Another alternative that certainly deserves consideration is having an honest discussion with the client regarding the value of the document to his or her business. It is recommended that you begin that discussion with some prepared ideas as to what you believe the value of the document should be. However, you may have settled on a range of values and the discussion with the client may prove to be beneficial to your law firm, in terms of the amount that you recover, as well as beneficial to your ongoing relationship with that client, as the client will recognize an openness on your part to consider the value of the work that you have done on its behalf.

On a final note, when a document that may have multiple uses or many re-creations is first prepared, consider immediately saving it in a precedent library under the area of law in question. Otherwise, the document could get lost or the effort in locating it may become less of a priority. Time permitting, go back to the document and prepare a generic copy leaving names blank, isolating deal specific clauses, and so on. Then turn it over to a legal assistant to fit it into a merge format. Now, the opportunity exists to consider marketing the agreement or at least having it handy for all of those future uses.

## ***Reinventing the Practice of Law – the Next Revolution?***

Let's look at all of this another way. Perhaps the most provocative European writer about the systemic impact of technology upon the practice of law is Professor Richard Susskind, whose thoughts are best accessible in his monthly articles in *The Times*, and in his ground-breaking books "The Future Law" and "Transforming the Law"<sup>13</sup>. Susskind has developed a matrix which helps us analyze the future evolution of legal services. The matrix models how we are deploying the technology as well as how it benefits the enterprise in terms of both profitability and competitive advantage.

Susskind's grid gives us a conceptual framework within which both to do technology planning and to assess the economic opportunities it opens up. Where should tomorrow's firm be investing? What technologies offer competitive advantage?

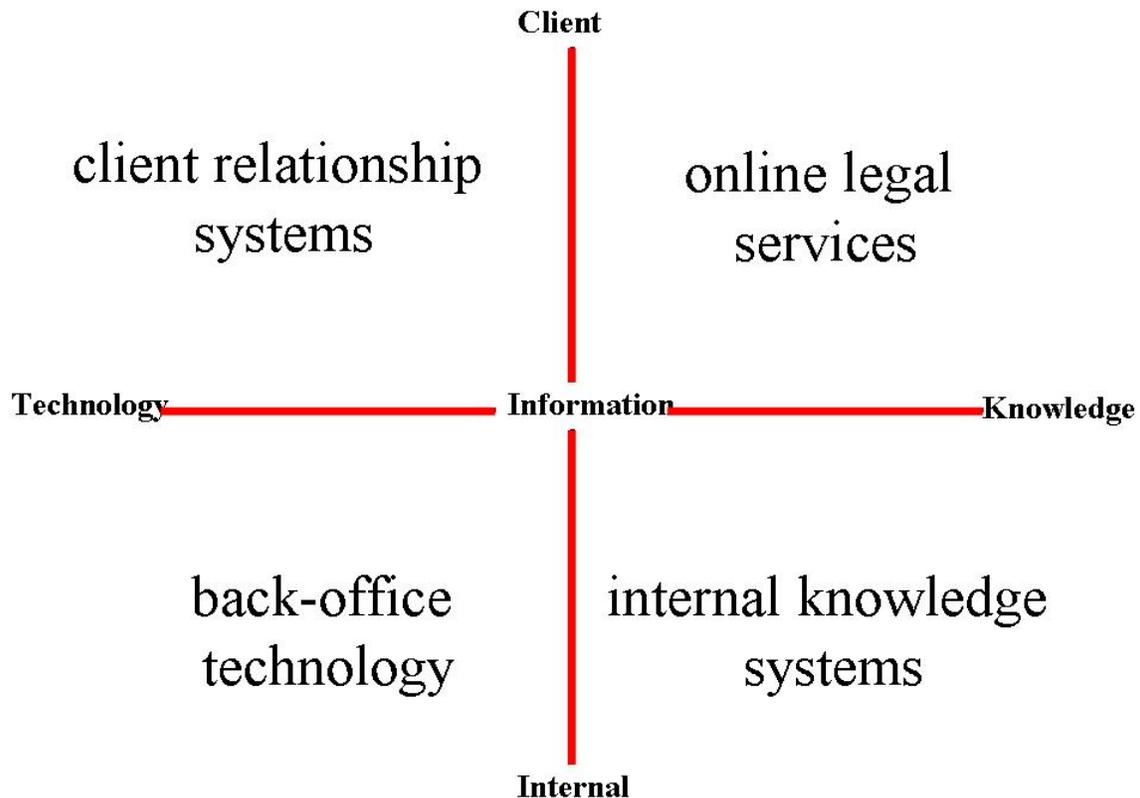


Susskind's grid charts the interrelationships between technology, information and knowledge as they play out within the economy of the private law firm. The horizontal axis maps the legal information continuum—on which legal technology developments are played out. The vertical axis splits the world on an external/internal dimension—in the law firm this split is between the client's world and the law firm's internal matters. Combining these axes creates four quadrants representing a purely internal use of

<sup>13</sup> Professor Susskind's work is found at *Essays on law and artificial intelligence* Richard Susskind: Oslo : TANO, c1993. *The future of law : facing the challenges of information technology* Richard Susskind: Oxford: Clarendon Press, 1996. *Transforming the law : essays on technology, justice, and the legal marketplace*, Richard Susskind. Oxford: Oxford University Press, 2001.

technology (bottom left), external technology linkages (top left), internal management of knowledge (bottom right) and the direct provision of legal knowledge to clients (top right quadrant).

The bottom left of that chart is concerned with the professional systems that drive the firm: word processing, spreadsheets, operating systems, time and billing systems and hardware. However, although these are important topics that must be dealt with, they are unlikely to give a firm any significant competitive advantage or offer a compelling reason for a client to retain it. Over the last decade law firms that have invested heavily in technology, have moved from bottom left to embrace the other quadrants.



Let's turn to the bottom right: Knowledge management, and the development of internal know-how does have a competitive dimension, but it's largely invisible to clients. It's a way of enhancing quality and ensuring consistency. It benefits clients, but indirectly.

The top left involves deploying technology to manage client relationships, but short of legal services delivery. This includes services for clients to look up billing status, access document archives, and receive electronic mail. All these bond clients to firms, but they do not provide direct economic returns. In an optimal situation, they may pay for themselves.

Susskind's point is that the top right quadrant is likely to be where the action should be—the provision of online legal services. This is both where competitive advantage lies and where escape from the tyranny of hourly billing exists. Not coincidentally, these services scale onto William Cobb's value curve.

Susskind's examples are 2nd generation web sites, virtual lawyer programs, online legal guidance systems and expert drafting systems<sup>14</sup>. These are potentially disruptive to established markets, since successful initiatives have the potential to define and capture new markets. To a great extent, they focus on diagnostic and preventive law—as Richard puts it, better the fence at the top of the cliff, then the ambulance at the bottom.

One example of these products are the substantive software packages developed for the consumer market. In 1999, one of these products, “Quicken Family Lawyer”, received the highest form of flattery by being held by Texas judge Barefoot Sanders to be illegally practicing law.<sup>15</sup>

The electronic provision of legal services is by no means limited to consumers. For example, Linklaters has developed Blueflag.com, an online legal service provider geared towards corporate clients. Some of the services Blueflag provides include:

- Financial services risk management advice for major capital markets
- Automated generation of confirms which comply with ISDA Rules (International Swaps and Derivatives Association)
- Guided implementation of international employee share plans
- Legal advisor on cross-border regulatory issues for investment managers and pension custodians in Europe

Some examples of commoditized corporate services in the top right quadrant include:

- Linklater's Blueflag.com (global regulatory information)
- Allen & Overy New Change
- Berwin Leighton's law and tax BeProfessional (employment law advice)
- Simmons & Simmons, Elexica.com

According to AmLaw Tech magazine, as of 2001, Linklaters invested a staggering \$15 million on the development of Blue Flag, charging yearly subscription fees for access to its services. Susskind's prediction about the ability of 2<sup>nd</sup> generation, top right quadrant products to capture broader markets appears to have traction: Linklaters also reported having reached an agreement with Wolters Kluwer to bring Blue Flag's legal compliance product to the financial services industry.

Lest anyone think that this is simply a European phenomenon and that somehow Canadian firms stand aloof from these developments, let me add that back in October 2001, Blue Flag was being used in Canada by the Investment Funds Institute of Canada. No Canadian firm could offer anything comparable.

<sup>14</sup> For alternative speculations on how technology transforms practice, see *How digital technologies are changing the practice of law*, Shulamit Almog. Lewiston, NY : Edwin Mellen Press, 2007; *Information technology and lawyers: advanced technology in the legal domain, from challenges to daily routine*, edited by Arno R. Lodder, Anja Oskamp. Dordrecht: Springer, 2006.

<sup>15</sup> *Unauthorized Practice of Law Committee v. Parsons Technology Inc.*, 1999 U.S. Dist. LEXIS 813 (US Dist. Ct. Tex.); see also Daniel Fisher, *Arrest that Software!*, March 8, 1999, Forbes, p. 94.

When the research for this article was originally undertaken in 2002-2003, the potential of client-facing services seemed readily apparent. From all accounts, the revolution predicted by those arguing for such services has, itself, failed to materialize or to have involved the sort of profits predicted. Only in Australia have firms like Blake Dawson working under the pioneering leadership of Liz Broderic, succeeded in developing technology-driven models of direct client service. Blake Dawson's services are impressive and include:

For example, Blake Dawson has targeted compliance training and reporting as an area where legal knowledge and skill can be applied to meet legal needs in areas like corporate governance and money laundering. The service is delivered to Australian and New Zealand companies by Blake Dawson lawyers.

Minter Ellison has a similar risk and compliance management tool, SafeTrac, which has been offered to its clients since 1989.

## **CONCLUSION**

The billable hour may remain, largely due to client demand. As a result, Reed's revolution may not have happened (yet!), but it would be dangerous to ignore the lessons he offered decades ago: increased use of technology and the billable hour are generally incompatible<sup>16</sup>.

While firms have not been afraid of investing in new technology, not all technology investments are made equal. Susskind's model provides a useful paradigm that allows firms to see where their technology dollars are being spent and whether or not these are netting returns.

Forward thinking players have already begun to use technology to make commodity services more easily available to clients, as well as pressuring near-commodity legal services towards commodity level. For example, as an electronic solution, Blue Flag does not charge on an hourly basis, but instead relies on a yearly subscription fee. Clients interested in the services Blue Flag provides are much more likely to turn to a product rather than rely on unknowns, particularly as their product develops name recognition.

While certain tasks will always remain unique or require expertise for the foreseeable future, the shift towards commoditization is not limited to strictly low end legal work. Outsourcing to lawyers or research services with relevant legal experience provides an opportunity for the firm who can exploit the lower costs of offshore, and risks to those firms unable to distinguish their bread and butter from commodity level tasks more inexpensively performed overseas.

The growth of outsourced legal services also undermines hourly billing based models, for a number of reasons. Firstly, outsourcing can use the differentials of lower costs and the availability of large pools of legal talent to provide fixed fee predictability for low-level or routine legal services. Secondly, there is some evidence of the application of business

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<sup>16</sup> The popular press has recurring articles on the demise of the institution of billable hours. Not much appeared to have changed between Adam Liptak Stop the Clock? Critics Call the Billable Hour a Legal Fiction, New York Times, October 29, 2002 and Time's Running Out on the Billable Hour by Kit R. Roane Jul 13 2008 at <http://www.portfolio.com/news-markets/top-5/2008/07/13/Curbing-Runaway-Legal-Fees>

process software to the delivery of legal services in some of the Indian companies servicing the North American market. Finally, if Indian service providers can provide faster turn around due to the exploitation of time differences, then some of these efficiencies can result in increased profits to the firm. What is also happening that the clients become used to the predictability of fixed fees, or fees which are more readily calculated.<sup>17</sup>

Firms must take care to differentiate themselves by focusing on the areas where they truly add value, so as to better hedge against both technologically superior and offshore competition in commodity areas. Of course, using this technology to improve a firms own bottom line is equally important, and recognizing that certain tasks lend themselves towards technology, commoditization, and value billing, may help clarify where to focus future technology investments and how to charge clients for them.

### **Final Comments and Hints**

So given all this, what is the message?

- Focus your practice. Understand what it is that really makes you money.
- Keep good models and precedents. Whether you are just running a will generation package, or constructing the next Blue Flag, good prior work product is essential.
- Keep your clients informed. On fee matters, communication is essential. Reasonable fees are disclosed fees.
- Do not overlook the capacities of the programmes you already possess. Every lawyer uses just a fraction of the tools available. You may already have the tools you need.
- Keep up to date on changes. Always keep the Lawyers Weekly in the washroom.
- Either deploy document management software or structure your office so that you know exactly where your electronic files are on a particular transaction.
- If you invest in automated document generation software, ensure that you print copies of each work generated to an Adobe Acrobat PDF file, so you have captured the work product actually delivered.
- You can not rely on any system that embeds substantive knowledge to keep up to date on statutes and court developments. You still have your lawyer's job to do.
- Remember that technology is not a substitute for sound professional judgement. Automatically generated documents are just a starting point.

Above all keep in touch with communities of other lawyers who can advise you on the basis of their experience. PracticePro has a wealth of experience. Our second recommendation may seem slightly odd to Canadians – it is the American Bar Association's Law Practice Management Section which offers an extraordinary wealth of

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<sup>17</sup> Indeed, there is some evidence in the marketing materials for Indian firms that will charge premiums for 24 hour turnaround but progressing discount rates if greater time is allowed for completion. For tasks in which time may not be pressing, the costs savings are undeniable since services will be provided by experienced lawyers for a fraction of what an articling student would cost in North America.

access to ideas and insights, through web pages, LPM Magazine , books and list-servs. One of the most successful is targeted at solos – Solosez. Law firm technology consultants may be of help.

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