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CONVERTING HOURS WORKED INTO DOLLARS RECEIVED: HOW TO GET THE BILLS OUT AND RECEIVABLES COLLECTED

Joel A. Rose, Moderator*

I. Introduction

- A. Billing and the collections of fees are the lifeblood of a law firm. They are also two of the most difficult, as well as the most important, tasks confronting attorneys in private practice.**
- B. Whether it occurs on a monthly, quarterly or some other basis, there will come a time when a lawyer has to prepare a bill for a client and then to follow-up on the collection of that bill.**
- C. As a management consultant to law firms who calls upon 46 years' experience, it has been my experience that the partners most of the more financially and professionally successful law firms - of all sized and in most practice areas - understand that:**
 - 1. Fee arrangements must be part of an overall fee structure within the firm with variations approved only by the managing partners, management committee, etc.
 - 2. The vast majority of all open files should be billed in conformity with the overall firm fee policy /structure
 - 3. When a matter that is outside of the area of expertise of the originating attorney, the partner responsible for performing the work should agree to the fee arrangement.
 - a. The more "lone ranger" fee arrangements determined by attorneys who lack expertise in performing specific types of work, the greater the likelihood for billing errors and

disagreements resulting in client dissatisfaction and reduced law firm profits.

II. Types of Fees

There are many kinds of legal fees. I will describe a representative number of arrangements in today's practice environment.

A. Hourly Fees

1. Hourly fees are the most predominant billing method used by law firms.
 - a. It is easy for law firms to price legal services on the basis of hourly time charges.
 - b. Such pricing requires only the ability to set a rate, to accumulate time entries, and to do the math.
 - c. But it is not as easy to price legal services on a basis other than straight hourly rates.
 - (1) Total fees under an hourly rate system are frequently not limited by efficiencies, but rather by client controls, the size and scope of the matter, the lawyer's desire to be reasonable or at least not to alienate the client, and competition among firms.
 - (2) Since lawyers are not generally trained in the art of estimating legal fees for particular matters, and many engagements do not lend themselves to easy prediction as to total time.
 - (3) Litigation of complex cases, for example, is fraught with so much uncertainty that it is really anyone's guess, in most cases, how much time will be required to get through trial.
 - (4) Organizational systems that make perfect sense if the law firm is handling straight hourly work may become dysfunctional when the firm suddenly

begins pricing for legal services on a fixed-price or some other basis in which there is risk and reward sharing with the client.

2. Computing the base rate – What is my time really worth?
 - a. The attorney down the hall
 - b. The dollar amount your ego believes you are worth
 - c. Formula – based upon your net overhead percentage and your net income objective, i.e.,

Net Income Objective

100% - Net Overhead Percentage = Target Billing Objective

$$\frac{\$200,000}{100\% - 50\%} = \$400,000$$

Target Billing Objective

Number of Billable Hours = Hourly Rate

$$\frac{\$400,000}{1500 \text{ Billable Hours}} = \$266,666$$

$$\frac{\$400,000}{1800 \text{ Billable Hours}} = \$222,222$$

- d. Understand and allocate the fixed cost of doing business over the number of hours which you can reasonably expect yourself and others to work
- e. Understand the variable costs associated with the type of representation contemplated
- f. Remember the reimbursables and identify them for the client, including those which may reduce your firm's hidden operating costs telephone,

reproduction, fax, automated research, litigation support, etc.

- g. Ideally, the billing partner should monitor all of the time reported and work performed on the file for the purpose of insuring that work is being performed in a efficient and cost-effective manner to avoid “write-downs.”

B. Value Billing

1. Value billing is a method of billing that allows an attorney to bill a client in proportion to the value of the services rendered. What the client wants and needs will generally frame how legal services for the engagement can be fairly priced.
2. One key to effective value billing is to understand what the client values most in the engagement:
 - a. Is it highly specialized expertise?
 - b. Is this an engagement many firms can handle but the client is with your firm for inexpensive labor?
 - c. Is it speed of production?
 - d. Is it the reputation and credibility of the firm?
 - e. Is it a contact or connection? Or,
 - f. Is it risk sharing?
3. Structuring a fee arrangement that does not match up to what the client values frequently spells trouble for the relationship as well as for the collectability of the account.
4. Even though the recession has diminished the number of opportunities for lawyers to bill and collect substantial fees from highly profitable transactional deals, i.e.,

mergers, acquisitions, land development, etc., some opportunities still remain for attorneys to benefit from value billing.

- a. Client A pays for a research project on an hourly basis. Client B asks essentially the same question. How should Client B pay for this result?
 - b. The firm has invested heavily in sophisticated technology that enables the attorneys to store, retrieve and utilize prior work product in a fraction of the time it would take a non-automated firm to perform the same work. How should the firm be paid for the completed work?
5. Value billing is a fee arrangement which should always be used with the full agreement of the clients.
- a. As an example of the above: Don't agree with Client B to bill on a hourly basis and then "value bill" based upon hours charged to Client A.

C. Task-based Billing

1. Frequently, clients will require budgets by tasks and then will insist on billing against the budget.
 - a. This approach requires real discipline on the part of the attorney to think through the functions that are likely to be required.
 - b. Clients like this approach because they realize lawyers, in their desire to get the work and not to appear too expensive, tend to seriously underestimate the costs of each task. Clients then can force law firms to discount as the case unfolds.
 - c. If you are driven to this method, you should try to bargain for relief among tasks so that if you underestimate the work in, for example, filing a

motion to dismiss, you might be able to make it up in the discovery phase of the case.

- (1) In addition, you might build in some mechanism for adjustment of the estimates should unforeseen events occur.
- (2) If your estimate states the assumptions on which they are based (e.g., four depositions) and it turns out that the client, after consultation, wants eight depositions taken, you can escape the effects of your low-ball estimate for that phase.

D. Modified hourly rate with a success fee

1. The client pays on a reduced hourly rate basis with a success fee based on results.
 - a. Defining success is generally a problem in this type of engagement. This approach can get complicated if the modified hourly rate also involves a cap or ceiling on total charges for the matter.
2. In such circumstances, the firm is taking two risks:
 - a. The reduced hourly portion
 - b. The firm will not be able to accomplish the work within the ceiling amount.
 - c. If the firm exceeds the ceiling, on the basis of its standard hourly rates, it may ultimately get its hourly rates on the matter only if it earns the success fee.
3. In this scenario, the firm's underestimation of the total work effectively eliminates its upside of a success fee. If it is not successful, the firm will not make its hourly rate on the engagement. Generally, arrangements where the

firm makes its hourly rate if it is successful, but where it makes far less than its hourly rate if it is not successful are not good arrangements for the firm.

Note: An article in the handout describes various types of alternative fee arrangements

E. Fixed Fee

1. Many engagements, particularly in the transactional area, have been priced on a fixed-fee basis, i.e., Bond transactions, lease work, a simple will an incorporation, etc. also typically priced on a fixed-fee basis.
 - a. The expansion of fixed-fee pricing into new areas is being encouraged by clients and by some firms.
 - b. Fixed fees cause the firm to ask how efficiently it can handle the matter and still effectively represent the client's interest versus how much can be reasonably done on the matter without the client reacting negatively.
 - c. The opportunity for the law firm to exploit this type of billing is to be able to deliver to client value at low levels of hourly time and/or to assign this work to lower compensated attorneys who are competent to perform it.
 - d. One way is to achieve efficiencies in work retrieval, another is to have value related to something other than time spent. Value in this context really means value to the client from the lawyer's particular contribution, i.e., if the client can negotiate a particular deal to license software, for example, the transaction may mean millions to the licensee.

F. Contingent Billing

1. Contingent fees are obviously not new, but firms may be increasingly tempted to use contingent fee arrangements in more cases than in the past.
2. Contingent billing should only be undertaken after an evaluation of (a) likelihood of success and (b) amount available if successful.
 - a. In assessing risks, one might calculate that there is a 50 percent chance of liability, and if the liability hurdle is cleared, there is a 50 percent chance of getting a judgment for \$500,000. As a matter of probability, there is a 1-in-4 chance of a judgment of \$500,000; the probability of a lesser amount would be somewhat higher.

If the case were taken on a one-third contingency arrangement and would cost about \$150,000 in time to try, there is a very good chance that the firm will lose on the case.

- b. Control of the settlement process is another factor to be considered.
 - (1) If the client (without consequence under the fee arrangement) can reject a settlement offer that the firm, in its professional judgment believes should be taken, the risks the firm is taking when it accepts the engagement include the risk of the client being unreasonable or not following the firm's advice.
 - (2) This additional risk needs to be addressed as part of the engagement, either by adjusting the fees that be earned by the firm if the client rejects a recommended settlement offer, or by permitting the firm to convert the arrangement to an hourly rate

arrangement and to withdraw if hourly charges are not paid.

- (3) The latter suggestion is fine theoretically, but ignores two likely factors: the client may lack the funds to pay on an hourly rate basis, and the firm may not be able to walk away from the case at the point the settlement is rejected.
3. An experienced attorney (the attorney who will be performing the work if the matter is brought into the office by someone who has little or no experience in that practice area) should be given the responsibility for evaluating these cases from the point of view of liability, damage, the law and collectability.
 - a. Included in this assessment should be an analysis of the potential profitability of the case.
 - b. The more “lone ranger” fee arrangements determined by attorneys who lack the expertise in performing specific types of work, the greater the likelihood for billing errors and disagreements resulting in client dissatisfaction and reduced law firm profits.
4. After a contingent fee case is accepted, all activity in the file – included the amount of time the attorney has devoted to that mat matter - should be reported and analyzed on a periodic basis and profitability projections updated in conjunction with the periodic reports.
 - (a) If the experienced attorney who recommended taking these matters or responsible for performing the work on these matters was involved in a series of

“shirt losers”, it maybe time to evaluate that attorney.

G. Combination of Value, Contingent and Hourly Billing

1. Probably great if you can get it, but as a practical matter, not easily attainable with individual clients and attainable on a limited basis with corporate, commercial and institutional clients

III. Retainers

A. We recommend obtaining retainers from all new clients.

B. Types of Retainers

1. Advances for costs
2. Initial charges
3. Security billing
4. Full billing
5. Evergreen retainers

C. Beware of the client who is able to accumulate enough money for a retainer, but is unable to pay the balance of the fee.

IV. Acceptance of New Cases: How and by Whom

A. Acceptance procedures for different types of matters justify a different review process

B. A file from a new client or a new file referred to the firm by an existing client that is significantly different than the usual type work performed for that client should be approved in advance by a designated partner.

C. Matters which will consume a significant amount of firm time and resources should be reviewed and accepted by more than one responsible partner.

1. As the firm grows, at least one person be aware of all new matters which the firm has undertaken
2. Conflicts check – Nothing worse than two attorneys who accept retainers from conflicting sides in the same manner or the attorney who accepts a new matter and devotes a considerable amount of time to that matter only to find that he or she cannot represent that client because of a conflict.
3. Adequate staff
4. Legal competence
5. Ethical problems
6. Marketing concerns
7. Fee arrangements

D. All new Client Intake Forms should be reviewed by the Managing Partner on a daily basis to assure compliance with firm policies

E. Setting consistent fee relationships

F. Utilizing your firm's experience factor from prior representation in similar cases or for similar clients

G. Limit risks created by desire of business producer to generate new work through impartial evaluation of a new matter requiring significant commitment of firm resources

H. Avoid "backbiting" among partners when given matter proves to be less profitable than originally contemplated

V. Client Selection Improves Firm Profitability

A. Managing Partners in many law firms agree that their firm's revenue and profitability would improve if their firms developed a well-conceived methodology for client screening and selection that would be implemented fairly and consistently.

1. The decline in the volume of profitable work from quality business clients and the "tanking" of certain transactional practice areas during the last three years, due to the recession, has caused partners in many firms to relax their usual qualitative client selection process and accept work assignments from "high risk" clients under the guise that it is better to be busy working for a questionable client that may produce a fee, than to sit behind a desk and do little or nothing.

B. Identifying and Avoiding "High Risk" Clients

1. All firms should establish due diligence guidelines and procedures with respect to new clients.
2. Asking the right questions and documenting the answers through new business intake forms that call for basic client, matter, billing and conflict information.
3. Typical questions for prospective clients should include the following:
 - a. How did the client select the firm?
 - (1) Are prospective clients referred to the firm through other clients or business contacts or are they contacting the firm "cold?"
 - (2) Are any attorneys related to the prospective client or otherwise socially acquainted with them?

- b. What is their business and who are their competitors?
 - (1) What is the prospect's business? (Check website, Lexis/Nexis for articles, etc.)
 - (2) Where did they originate? (spin-off from another company, sole-proprietor, etc.)
 - (3) How many law firms have they retained?
 - (4) Are they one-time users of legal services, or do they have on-going legal needs?

- c. What is their financial situation?
 - (1) Client size (annual sales documentation and search of business and net worth of individuals)?
 - (2) What is their outstanding debt load?
 - (3) What are the source(s) of funds to pay for legal work?
 - (4) What fee arrangement is being contemplated?
 - (5) What is the client's ability to pay retainer?
 - (6) What is the client's attitude toward "evergreen" retainers?
 - (7) Are there any outstanding judgments against them, either as a company or as individuals?
 - (8) Have there been any bankruptcy filings made (lien and judgment searches through Westlaw's *Information America* or comparable resource)?

- d. What are their legal needs?
 - (1) What is the nature of the work being contemplated?
 - (2) What is the expected duration of the assignment?
 - (3) What is the expected total volume of billings?
 - (4) What are the expectations of the client regarding the outcome of legal services?
 - (5) Do their legal needs comport with the firm's strategic plan regarding the firm's desired mix of business?
 - (6) What is their experience with other law firms?
 - (7) Has the prospect used other firms on the matter in question?
 - (8) If applicable, what are the client's reasons for changing law firms?
 - (9) How many law firms have they retained?
 - (10) How do they allocate work among these firms?
 - (11) Has the client ever sued an attorney for malpractice?

C. Basic Due Diligence

1. Regardless of the answers to the above questions provided by the prospect to the questions set forth above, the firm should perform the following checks:
 - a. Reference checks, including funding sources;

- b. Website review, if prospect has one;
 - c. Search and/or review of company financials;
 - d. Credit reports run on individuals (with client's permission); and
 - e. Conferences with prior or existing counsel, with prospective client's permission.
2. If this due diligence uncovers a "high risk" client, then more due diligence is necessary.
- a. Litigation search (home state, at a minimum);
 - b. Nexis search for articles, news, etc.
 - c. Westlaw's Information America.

VI. Methods of Recording and Standardizing Reporting Time on Billable and Non-Billable Activities

A. Method

- 1. Recording time in client file
- 2. Manual central recording /time slips
- 3. Daily time logs
- 4. Computer time reporting – central input by each attorney or secretary
- 5. Networks
- 6. Central inputting
- 7. Disks

B. Standardize Reporting time

1. One tenth of an hour
2. One sixth of an hour
3. One quarter of an hour

C. Recording of Services Performed

1. Full description
2. Generic category descriptions
3. Complying with client demands

D. Methods of Increasing Billable Time by Lawyers

1. Establishment of goals
2. Incentive compensation

VII. Billing for Reimbursement Costs

- A. Out of pocket disbursements are a must, i.e., travel, expert witnesses, legal research, etc.**
- B. Reimbursement for “non-cash” firm expenses, reproduction, faxes, etc.**
- C. Firm should strive for as much “reimbursement” as possible since, as with all lost revenue, the “bottom line” is affected on a direct basis by lost opportunities**

VIII. Billing for Work Performed

- A. Insure that the client understands the firm’s billing and collection policies**
 1. Written confirmation of the specific work to be performed, the methodology for submitting bills to the client and the firm’s expectations concerning the timely payment of the bill

- B. Bill timely and regularly**
1. In accordance with the agreed upon billing schedule
 - a. Monthly
 - b. Quarterly
 - c. Upon completion of phases of the project
 - d. At closing or completion of the project assignment
 2. Lawyer discretion
 3. Augmenting of retainers or security deposits
- C. Get solid system support, whether it is the nature of the staff who assists in billing/collecting or computer methods**
- D. Review billing effort at least monthly, i.e., unbilled time and expenses**
- E. Know when payment of outstanding bills are slow. Review collections and accounts' receivables at least monthly(, or more frequently for long-time unpaid receivables)**
- F. Don't accept attorney excuses for not billing or following up on receivables if not timely**
- G. If billing and collection problems with an attorney(s) continue, designate a partner to follow-up on billings and collections.**
1. Designate another partner to serve as Billing and Collections Partner
- H. Charge interest on delinquent payment (comply with applicable ethical considerations when doing so)**
- I. Meet with the clients to discuss payment needs/timing, they all understand cash flow**

J. Acceptance of client payment with credit cards

1. Positives
 - a. Makes it easy for clients to pay for legal services
 - b. Assures the law firm of the speed of collection and timely payment bills
 - c. Creates a marketing advantage for the firm
2. Negative
 - a. Administrative charges the credit card company makes to the firm that accepts payment for legal services by credit card
 - b. Possible fee dispute with a client after the engagement when the client has used a credit card to pay the bill.

K. “Cut the bleeding” wherever possible!

IX. Methods of Handling Delinquent Accounts

- A. Need to determine what constitutes a delinquent account, i.e., 30, 60, 90 or 120+ days**
- B. The definition of a delinquent account must vary among clients depending upon nature and extent of work performed for a particular client, as well as payment practices of particular clients and financial capabilities of regular clients at particular point in time**
- C. Delinquent account collection procedures including written communications, telephone calls and personal visits are a must in order to maintain a viable business.**
 1. Equally important is the appropriate mixing of these techniques for particular clients

D. Pro's and Con's of Keeping the attorney involved or excluded from the Collection process with delinquent clients

E. Termination of services

F. Negotiation of settlements

1. Clean-up of dated unbilled time and accounts receivables by considering a one-time 25 percent discount credit of accounts receivable and unbilled time more than 180 days old.

a. This collection may provide a cash flow stream of operating capital that may not otherwise be available.

2. These monies should not be distributed to the partners.

G. Suing for fees

X. Controlling Billings and Collections

A. Centralize the control process in a partner /lawyer management

B. Role of the office manage / bookkeeper

C. Final responsibility lies with the Billing attorney

XI. Impact on Responsible Attorneys for Delinquencies

XII. Practice Area Considerations in Billing

A. Corporate/Securities

B. Real Estate

C. Estates/Trusts

D. Bankruptcy

E. Matrimonial / Family Law

XIII. Concluding Comments

About Joel A. Rose*

Joel A. Rose is a Certified Management Consultant and President of **Joel A. Rose & Associates, Inc.**, *management consultants to the legal profession*. The firm, national in scope, is headquartered in Cherry Hill, New Jersey.

Mr. Rose received a B.S. from New York University and an M.B.A. from the Wharton Graduate School of Business, University of Pennsylvania. He has extensive experience consulting with private law firms, corporate law departments and government agencies. Mr. Rose performs and directs consulting assignments in law firm management and organization, strategic and financial planning, lawyer compensation, the feasibility of mergers and acquisitions and marketing of legal services. He has extensive experience planning and conducting retreats and special expertise resolving problems among and between lawyers.

Mr. Rose is a guest columnist on law office management and economics for the New York Law Journal and has had numerous articles published in the Philadelphia Legal Intelligencer, the Pennsylvania Law Weekly, the New Jersey Law Journal, The Law Firm, Inc., chapter publications of the Association of Legal Administrators and other state and local bar association journals. Mr. Rose is a contributing author of the book, Model Partnership Agreements for New York Law Firms, published by the New York State Bar Association and of the monograph The Quality Pursuit, Assuring Standards in the Practice of Law, published by the American Bar Association. Mr. Rose is on the Board of Editors of Accounting and Financial Planning for Law Firms and Law Firm Partnership and Benefits Report. He Chairs the Finance and Management Subcommittee of the Law Practice Management Section of the New York State Bar Association and the Continuing Legal Education Committee of the New York State Bar Association. Mr. Rose is a member of the Law Practice Committee of the American Bar Association and the coordinator and moderator of the Annual Conference & Workshops on Law Firm Management & Economics. He frequently presents tele-seminars and webinars for bar associations and national legal organizations, and speaks at bar association meetings and at chapter meetings of the Association of Legal Administrators. For five years, Mr. Rose chaired The Acquisition and Merger Committee and Co-Chaired the Large and Extra-Large Law Firm Interest Group of the Law Practice Management Section of the American Bar Association. He is a member of the National Panel of the American Arbitration Association, the Economics Section of the New York State Bar Association, and an associate member of the American

Bar Association. Mr. Rose is a fellow in the College of Law Practice Management and is listed in Who's Who in America.