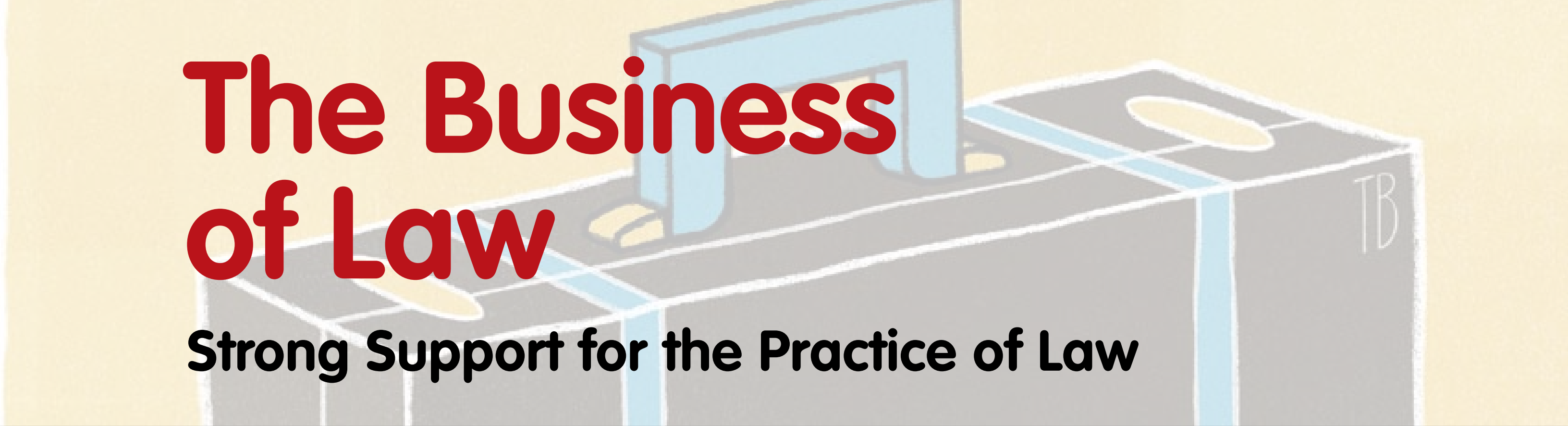

The Business of Law

Strong Support for the Practice of Law

ILTA White Paper **March 2010**

Are Alternative Fees the Death Knell for Cost Recovery?

JOHN GILBERT NQUEUE BILLBACK

While it would seem that fixed fees and flat rates would make cost recovery systems unnecessary for law firms, it is more likely that the opposite is true. Corporate law departments may be requesting fixed fees, but they are providing little insight into how these arrangements should be priced. So, while it may seem that cost recovery and fixed fees are diametrically opposed — "We don't need to keep track of copies and faxes since we are now billing for them as part of a fixed fee" — in fact, keeping careful track of these types of expenses is more necessary than ever.

SHIFTING THE RISK

With a traditional billing model, law firms bill their fees hourly and bill expenditures as they are incurred. The client incurs all risk. If the project requires more work than is anticipated, the firm bills more hours, and the client spends more money. The same is true on recoverable expenditures. If the firm makes more copies than expected, the client pays for them.

In recent years, corporations have tried to place some controls on their law firms, largely through outside counsel guidelines. Firms were generally limited in how much they could charge for copies or how many attorneys could attend a deposition. While this provided the client with more control, it did not shift any risk. Unless they were in direct violation of the guidelines, the client still had to pay the bill. Put another way, the firm might agree to bill no more than 15 cents per photocopy, but there was no limit on how many photocopies could be made.

Since the beginning of this recent "Great Recession," more and more corporate law departments have been trying to shift risk onto their firms, asking firms to provide a simple "fixed fee" for a project. The firm provides a single number and that's what the firm is paid. (This is an oversimplification in many cases: the fees may be based on project stages or particular outcomes. But the premise holds true.) This environment forces law firms to do a better job of controlling costs, as the firms are no longer rewarded for overruns.

FIX THE LEAK BEFORE YOU FIX THE FEE

Under an hourly billing model, it is necessary to keep track of the number of hours spent on a project in order to bill for them. With a fixed fee, it is necessary, instead, to track hours to make sure that the project is profitable. Similarly, in a traditional model, the firm must track recoverable expenses in order to bill them back to the client. In a fixed-fee environment — despite the fact that these specific charges are no longer recoverable — it is even more important to track all project-related expenses. There is no quicker way to get the firm in financial trouble than by quoting fixed fees without absolute clarity as to the firm's actual expenses related to the matter.

For a law firm, fixed fees require a detailed profitability analysis by practice area, by client and even by matter. Some expenses, such as client lunches and business development

This article was first published in ILTA's March 2010 white paper titled *"The Business of Law: Strong Support for the Practice of Law"* and is reprinted here with permission. For more information about ILTA, visit their website at www.iltanet.org.

costs, are clearly the firm's responsibility (overhead), but these still must be considered when calculating the profitability of a client or matter. Expenses related to photocopies, scans, faxes and phone calls are historically the client's responsibility, but they are not always fully tracked and sometimes not tracked at all. Other expenses that are typically the responsibility of the client are often not recovered if they are incurred outside the firm's systems. Examples might include overnight charges or online research. It is imperative to capture information about all expenses, no matter where and how they are incurred. Many times this phenomenon is referred to as "financial leakage."

COST RECOVERY SYSTEMS TO THE RESCUE

The same systems that provide cost recovery also provide law firms with insight into their expenses and ensure productivity. Unlike a relationship where firms bill for hours and recover for expenses, alternative fee arrangements force firms to be more efficient, and reward them for that efficiency. Gaining a full picture of all fees and expenses related to a matter, including areas of "financial leakage," is more important than ever.

For example, imagine a matter that generates 1,000 photocopies in a given month. The attorney's administrative assistant may make most of the copies, but say the partner himself makes 200 on a Saturday. Uninterested in looking up a client/matter code, the partner simply enters "9999." If the firm doesn't have a good mechanism for managing exceptions, it loses track of 200 copies. Then when reviewing a pre-bill, the engagement partner writes off another 200. The client receives the bill, complains a bit, and receives a credit for a further 200, never even realizing that his organization was not billed for the delivery of the documents by FedEx or for the online research that went into creating those documents. If the firm were tracking a billable amount to factor in a monthly flat fee for the client, it would base its price on less than 40 percent of its expenses. The rest has been "leaked." That profitable negotiated monthly fee may not be so profitable after all.

TIME IS MONEY, AND MONEY IS MONEY

When working in fixed fees with no ability to bill for excess costs, even a small loss in profitability can make a big difference to a firm. The key to fixed fee billing is to collect good data throughout the firm and then apply that data to sound profitability analyses. Firms account for every hour worked, even those that are not billable, and it is similarly crucial for firms to collect all expense data. This includes copies, faxes, prints, phone calls and scans, as well as travel, court fees, research, overnight delivery, courier and credit card charges. The key is automation to ensure information is collected as these expenses are incurred, rather than asking attorneys and administrators to recreate it after the fact, or worse yet, to guess.

Once all data is collected, use it to get a full idea of your profitability. Analyze by matter, by partner, by client and more. Make sure all write-offs are accounted for, and make sure they provide value; reducing the bill for an already unprofitable client does not serve the firm. And make sure you factor all that into the pricing of any fixed fee arrangement, so that your firm's profits don't leak away. **ILTA**

JOHN GILBERT is Vice President of Sales & Marketing at nQueue Billback, a provider of information accountability, expense management and cost recovery solutions worldwide. John has more than 20 years' experience in supporting law firms. He was formerly Vice President at PerfectAccess Speer, where he helped pioneer the methodology used to customize Microsoft Word for the legal environment including the awareness and removal of metadata in documents. He can be reached at jgilbert@nqbillback.com.

This article was first published in ILTA's March 2010 white paper titled *"The Business of Law: Strong Support for the Practice of Law"* and is reprinted here with permission. For more information about ILTA, visit their website at www.iltanet.org.