The Hours

IS THE BILLABLE HOUR RUNNING OUT OF TIME?

BY DANIEL LEE JACOBSON

The facts of history never change, but the memory of history often changes.

In Ray Bradbury's *Fahrenheit 451*, the job of the fire department is to set fires. When Clarisse, a character in the novel, says she had heard that it was once the job of fire departments to put out fires, she is rebuked by a fireman who says that such a thing could not be true. According to the official firemen's handbook, he says, it has always been that fire departments set fires.

In today's real-life legal and business communities, anyone who suggests that corporate lawyers once based their fees on standards other than the billable hour might suffer a similar rebuke. After all, corporate lawyers have always charged by the hour. The fact is so well known that it might as well be codified in the official lawyers' handbook.

But the scholarly literature paints a far different picture than the living memory of those who have always billed by the hour. The literature teaches that the widespread practice of valuing legal services by time increments is barely more than 40 years old. (John A. Beach, *The Rise and Fall of the Billable Hour,* 59 Alb. L. Rev. 941; William G. Ross, *The Ethics of Hourly Billing by Attorneys,* 44 Rutgers L. Rev. 1, 6-12; Ezra T. Clark Jr., *Getting Out of the Hourly Rate Quagmire, (Beyond the Billable Hour: An Anthology of Alternative Billing Methods)* at 183, (Richard C. Reed, ed.).)

The facts of history reveal that prior to the 1960s, attorneys fees were set by court and bar association fee schedules, by considerations of ethics, by case outcome, and by other intangible measures. This was true not only for business lawyers but also for the entire profession. In the early 1960s the prescribed fee for a marital dissolution in New York state, for example, ranged from $25 to $250—depending on the fee schedule of the county bar association. Fees were often adjusted upward from the schedule for more experienced lawyers, or downward for less experienced lawyers.

Attorneys who dared undercut the fee schedules to capture more clients were officially scolded. A 1960 ethics

Daniel Lee Jacobson (dlj@jacobsonlawyer.com) is an Orange County lawyer who practices civil litigation throughout Southern California. He is also a professor at Pacific West College of Law.

Getty Images

opinion released by the Illinois Bar Association stated, "[I]t is a far cry from the honest effort of a conscientious lawyer to determine what would be a reasonable fee for him to charge, to the practice of habitually undercutting the fees charged by the other members of the bar and letting it be known that whatever his brothers charge, he will take on the work for less." Note that in denigrating price competition, the Illinois Bar defined accepted billing practice for a "conscientious" lawyer: Begin from the appropriate fee schedule, then make an "honest effort" to determine a reasonable fee.

Sometimes an honest effort was based on the value the lawyer thought his or her services had brought to the client. Then–U.S. District Judge Simon Rifkind recalled in a January 1990 *ABA Journal* article, "Billing was a fine art. We asked ourselves, 'What have we accomplished for the client?' When we were successful, we were very well-paid." Among themselves, some practitioners called this system the "eyeballing procedure."

Interestingly, many of the modern alternatives to hourly billing are based in part on the same concept: estimating the value added by legal services to the client. (See "Billing Alternatives: Assessing Value and Shifting Risk," below.)

Basing legal fees on increments of an hour had its origins in the scientific management movement that spread throughout the country in the first third of the 20th century. By the 1940s, management consultants promoting greater efficiency and control were advising lawyers to charge clients by the hour. One of the early proponents was Reginald Heber Smith, a respected Boston attorney who had tested his management theories as head of the Boston Legal Aid Society. One of Smith's ideas for better managing the society's finances was to track the amount of time an attorney spent on each matter.

In a series of four articles published in 1940 by the *ABA Journal*, Smith advocated not only tracking an attorney's time but also billing clients based on the total hours expended. "Economy is basically a race against time," Smith wrote. He proposed that law firms could win that race by precise organization. Smith's articles were widely influential and have been reprinted many times since they first appeared.

Still, by the end of the 1940s fewer than half of the nation's attorneys had converted to hourly billing. Management consultants then discovered that attorneys who billed by the hour consistently made more money than those who did not. The consultants advised that lawyers simply pick a target salary, figure in overhead, and divide by the number of hours that could be charged to clients. The result would be the lawyer's hourly rate.

Writing in a 1959 issue of *DICTA*, a Denver Bar Association publication, attorney Phillip S. Habermann explained the system this way: "[I]f you want to take home $14,000 a year, and your overhead is $6,000, then you have to average $16.67 an hour for the 1,200 hours a year that you can charge up to a client."

Billing Alternatives: Assessing Value and Shifting Risk

Many of the alternatives to hourly billing attempt to price legal services by estimating in various ways their value to the client. The **contingency fee,** for instance, ties the cost of legal services to the success of the representation. Some corporate clients use the contingency arrangement only when they are plaintiffs; others use it when they are defendants or in transactional matters. The latter system is called **incentive billing,** which combines a low hourly rate or fixed fee with a bonus if the firm resolves a matter at or below an estimated amount.

According to the Association of Corporate Counsel, the **fixed fee** is the most common form of alternative billing. The client pays a negotiated amount for a case or project, sharing the risk of unexpected costs with the law firm. This arrangement can be particularly useful for routine or repetitive matters, and it also can be effective whenever the firm and the client are able to accurately estimate the amount of work required.

Value billing begins with a negotiated fee at the outset and ends with an assessment of the entire project's worth. Theoretically, the value of the services is best assessed at completion. The inherent problems with setting a fee *after* performance, however, make the arrangement vulnerable to challenge as unethical, invalid, or unenforceable.

Task billing, sometimes considered a variation of value billing, avoids some of the pitfalls of attempting to assess value after performance. Estate planning lawyers, for instance, commonly charge clients a set fee for drafting a trust or will. The arrangement probably is best suited for matters that involve a limited number of discrete operations, leading to an end product with a known market value.

While the **discounted hourly fee** is self-defining, the **bulk hourly fee** requires some explanation. The term *bulk* implies a large volume of work, which the firm provides for a discounted hourly rate. The **blended hourly rate** combines all of a firm's staff rates into a single rate. Senior partners, junior associates, and possibly even paralegals bill at the same blended hourly fee.

A **partner-based fee** bills the client only for the partner's work, usually at a higher-than-normal rate. **Phased billing** requires a law firm to negotiate a maximum fee for certain parts of a project. If the firm exceeds the maximum for a portion of the work, the exceeded amount goes into a suspended account, which the firm can recover by cutting expenses on another phase. Though a client might like this system because of the predictability of costs, the firm assumes much of the risk if it underestimates the scope or length of a matter.

All of these arrangements can incorporate the concept of a **capped fee,** which sets a maximum amount for the contractual work and shifts much of the risk for underestimating costs to the law firm.

By the early 1960s the hourly fee was gaining broader acceptance in the legal and business communities. In 1962, for instance, nearly 50 percent of the lawyers in Allegheny County, Pennsylvania, reported that they billed by the hour. (Robert I. Weil, *Economic Facts for Lawyers; Resurvey Shows Dramatic Changes in Pennsylvania Practice,* 6 Law Office Econ. and Mgmt. 373, 380 (1965).) By the end of the decade, the hourly fee had spread throughout the nation.

For attorneys, the major attraction of hourly billing was internal control and increased revenue. But corporate clients also benefited. The new standard seemed more objective, and it could be measured and compared to legal billings in similar matters. Corporate clients understood how to sell products by the unit, even if those units were hours of work rather than numbers of widgets.

But the ascension of hourly billing occurred largely without critical assessment. Even many of its proponents advised that the new system should be integrated with other systems rather than replace them entirely. "[T]ime records are … valuable but not conclusive," wrote Eugene C. Gerhart in *The Art of Billing Clients.* (1 Law Office Econ. and Mgmt., 29, 43 (1960).) "You ought not to bill clients merely on the basis of time," advised Harold Paul Seligson. (*Building a Practice,* 38–46 (1964).) And J. Adrian Rosenburg recommended, "[T]he legal fees of modern law offices should consist of a healthy admixture of annual retainers, contingent fees, and items charged for on an hourly basis." (Mich. State Bar J. 16, Apr. 1955.)

FORMULA FOR SUCCESS?

TARGET SALARY
+ OVERHEAD
÷ HOURS CHARGED
= HOURLY RATE

For the most part, however, these voices were ignored. In 1975 the U.S. Supreme Court ended the argument when it ruled that fixed-fee schedules, a mainstay of previous billing systems, violated the Sherman Antitrust Act. (*Goldfarb v. Virginia State Bar,* 421 U.S. 773 (1975).)

The hourly billing system, however, produced unintended consequences for both clients and lawyers. Corporate clients, for instance, reacted to a widespread suspicion of overbilling by hiring fee auditors—whose continued employment, of course, is contingent on finding billing irregularities.

Clients also adopted billing guidelines that function as automated auditors. According to William G. Ross, for instance, Exxon USA used outside counsel guidelines in the 1990s that included standard-of-practice expectations. "[T]he Law Department's decision to retain a particular firm is based in part on the firm's expertise and knowledge," the guidelines stated. "We therefore assume familiarity with the basic substantive law at issue in the matter for which the firm was retained; any exception to this general expectation should be discussed fully at the time of retention." The guidelines also stated, "[I]n conducting legal research … the law firm is expected to utilize all appropriate sources reasonably available, including previously prepared briefs and memoranda."

At their best, fee auditors and retention guidelines keep outside law firms honest. At their worst, they stifle creativity, legal judgment, and ultimately the quality of representation.

Some of the most insidious effects of hourly billing, however, occurred within the profession. Simply put, the time spent on a matter—rather than the quality of legal work—has become the de facto measure of value. As one associate from a large California firm says, "It's not whether you win or lose, it's how long you take to do it." California Attorney General Bill Lockyer puts it succinctly: "Frequently, the enemy of settling lawsuits is the hourly-fee billing machine."

The billable hour is also the standard for attorney productivity, a standard that has inched upward since the hourly system gained acceptance. A 1961 study by the Oregon Bar Association, for instance, found that the median billing by attorneys statewide was 1,236 hours a year. In 1965 an ABA study showed the normal collectible billing to be between 1,400 and 1,600 hours a year for associates, and 1,200 to 1,400 hours a year for partners. In 2006 the expected standard at some firms is as high as 2,400 billable hours a year.

The broader concern is that an hourly billing standard will produce lawyers who know best what they do most, which is bill hours. As a result, they may not be well schooled in how to effectively represent and achieve the goals of their clients. On an individual level, young lawyers who are evaluated on the basis of billable hours aren't likely to have much, if any, time for professional development or pro bono activities.

Increasingly, these criticisms are being echoed by the corporations that hire outside counsel. According to a 2005 monograph on alternative billing published by the Association of Corporate Counsel (ACC), "[C]orporations don't want to buy what a firm considers to be its inventory (hours). … Absent some overriding strategic goal/interest, corporations need lowest total disposition costs in the shortest possible time."

Though criticism of the hourly billing system has gone on for years, there is no evidence of a stampede to replace it. An alternative billing survey conducted by the ACC in 2002 found that 54 percent of the 77 in-house counsel who responded said they had retained law firms in the previous year using something other than the hourly fee arrangement. But those results were based on the voluntary responses of

Continued on page 68

The Hours, continued from page 39

readers—often a flawed method of polling. Two years later the ACC reported that 84 percent of in-house counsel still relied on the hourly rate for a median of 75 percent of the work sent to outside law firms.

That doesn't mean corporate clients aren't experimenting with alternative billing systems. The same 2004 ACC report found that two-thirds of in-house counsel use discounted hourly rates for a median of 30 percent of their outside work. It also found that only about 25 percent of corporate law departments employ a billing method other than the hourly fee for a median of 10 percent of their outside counsel's work.

Morrison & Foerster, a San Francisco–based firm with more than 1,000 lawyers worldwide, decided more than a decade ago that it would experiment with alternatives to the hourly fee. Tom Umberg, a former manager of the firm's Orange County office and currently a California state assemblyman, explains, "Partners in the firm recognized that to be competitive we had to be flexible. In some cases, alternative billing methods are more beneficial to the firm in the long run." Umberg estimates that more than 50 percent of the firm's clients are billed for some of their work on a basis other than the traditional hourly fee.

In addition, Morrison & Foerster counts an associate's pro bono hours as the equivalent of billable hours. Thus, associates are able to meet the firm's billable hour standards while furthering the profession's traditional role as a provider of legal services to the poor.

The ACC's survey statistics suggest that the hourly fee will not disappear from the legal profession any time soon. But those statistics were generated largely by lawyers who, like Bradbury's fireman, misremembered history. The billable hour was never a stone idol, the profession's sole standard of value. In widespread use for only four decades, it may yet prove to be a transitory convention. The facts of history never change, but the memory of history often changes. And revised collective memory often contributes to genuine reform. CL