

Alternative Billing

A senior lawyer at a major Toronto firm recently said:

We've been predicting since the early '90s the absolutely imminent demise of the billable hour and a move to alternate billing, but in any objective sense it hasn't happened.¹

Article after article either predicts or exhorts the demise of the billable hour, with titles like *The Billable Hour Must Die*,² *How to Develop Alternatives to the Billable Hour*,³ *The Billable Hour – Here to Stay?*,⁴ *Alternative Billing for the “Main Street Lawyer”*,⁵ *Clock Ticking for Traditional Hourly Billing*.⁶ But, a leading expert in law office management says that 85% of all legal work done in Canada is still billed hourly, down slightly from just over 90% ten years ago.⁷

Perhaps the most fundamental problem with billing by the hour is that time spent by the lawyer does not necessarily equate to value delivered to the client.⁸ Time is a measure of the lawyer's activity, but it neither measures what the lawyer produces (such as an opinion, a patent search, a pleading filed), nor the benefits for the client (such as the sale of a

¹ Simon Chester then of McMillan Binch, quoted in Ann Macauley, “The Billable Hour – Here to Stay?” (Ottawa: CBA, October 4 2012).

² Scott Turow, “The Billable Hour Must Die” (Chicago: ABA Journal, August 1 2007).

³ Edward Poll, “How to Develop Alternatives to the Billable Hour”
<https://www.cba.org/cba/practicelink/mf/billablehour.aspx>

⁴ Macauley, *supra*, note 1. Mark Robertson and Jim Calloway, “Alternative Billing for the “Main Street Lawyer”” from *Winning Alternatives to the Billable Hour* (Chicago: ABA Law Practice Management Section, 2008).

⁵ Mark Robertson and Jim Calloway, “Alternative Billing for the “Main Street Lawyer”” from *Winning Alternatives to the Billable Hour* (Chicago: ABA Law Practice Management Section, 2008).

⁶ James Eyers and Rachel Nickless, “Clock Ticking for Traditional Hourly Billing” (Australian Financial Review, November 12 2009).

⁷ Richard Stock of Catalyst Consulting, quoted in Macauley, *supra*, note 1.

⁸ Canadian Bar Association, *The Future of the Legal Profession: The Challenge of Change* (Ottawa: CBA, 2000) at 53 *et seq.*

* These Working Papers were drafted in preparation for the final Discussion Paper for Building Block 5, Underexplored Alternatives for the Middle Class.

business or compensation for an injury). Billing by the hour focuses on process, rather than results.⁹

Not every hour legitimately spent by a lawyer on a file is of equal worth.¹⁰ The hour spent waiting for a case to be called is likely not to be as productive as the hour spent advising how to negotiate a complex deal, but both hours may be charged to the client at the same rate.

When the only measurement considered is time spent on the file, it skews the incentives. Hourly billing rewards inefficiency and inexperience.¹¹ The better the lawyers, the faster they can complete the work. Someone who takes twice as long bills twice as much. This “productivity paradox”¹² penalizes both the better performer and the client who must pay the bill.

Hourly billing has also been said to discourage, or at least not reward, innovation. Firms using technology to research the law, or to standardize or systematize routine work can produce the same outcome more efficiently. The innovative firm produces the same or better result for the client in less time, yet hourly billing alone will bring in lower fees.¹³

For clients who want results, paying by the hour can feel like handing their lawyer a blank cheque. It is difficult, even impossible, to budget for many legal matters, and often the final account is an unpleasant surprise. It is hard to do comparison shopping. Sophisticated clients know they may be paying for duplication, unnecessary work and inefficiency.¹⁴ They know they are shouldering most of the risk in big files.¹⁵ And, they realize, at least in a theoretical way, hourly billing creates a potential conflict of interest between lawyer and client.¹⁶

For lawyers, even when they work hard and deliver high quality service as efficiently as possible, their client’s perception may be the opposite.¹⁷ They may, in turn, resent the tyranny of docketing every fraction of an hour, and being driven to achieve always

⁹ David Goehl, *Common Alternative Billing Methods and When to Use Them* (April 19, 2002) 1:14 *The Sugarcrest Report*
http://www.imakenews.com/sugarcrestreport/e_article000064967.cfm

¹⁰ *Ibid*; CBA, *The Future of the Legal Profession, supra*, note 8 at 54.

¹¹ Jeff Gray, “Lawyers finding new ways to get paid” (May 31, 2011) *Globe and Mail*; See also, CBA, *ibid.* at 54.

¹² *Ibid.*

¹³ *Ibid.* at 55.

¹⁴ Macaulay, *supra*, note 1; Jeff Gray, *supra*, note 11; CBA, *The Future of the Legal Profession, supra*, note 8 at 54.

¹⁵ “Win-Win Alternative Billing Strategies”, Colin Cameron, November 2011
<http://lawprofitability.com/2011/11/24/win-win-alternative-billing-practices/>

¹⁶ Scott Turow, *supra*, note 2; CBA, *The Future of the Legal Profession, supra*, note 8 at 55.

¹⁷ CBA, *ibid.* at 55.

increasing annual billing targets. Many lawyers, too, would like to shift away from hourly billing to some other method of charging for what their services are worth.¹⁸

Alternatives to the billable hour do exist, of course, some well-known, some less so.¹⁹ The simplest is the **flat fee**, or **fixed fee**, where the lawyer is paid a flat fee for performing a specified service. That service can either be to complete the entire file (such as an estate or conveyancing matter) or separate stages of a bigger file (such as initial investigation in a litigation matter, or drafting a separation agreement or arguing a motion in a family law matter: see also *Working Paper #2: "Unbundling"*). This is sometimes called **task-based billing**. The advantage to the client is that the fee is known in advance. It creates incentives for lawyers to become more efficient and to use technology better. These arrangements put some risk on the lawyer: if the task takes longer than expected, the lawyer does not get any more money. This could pressure the lawyer to rush the work, potentially risking the quality of outcome for the client. This type of fee arrangement works best for relatively small, repetitive or standardized kinds of work.

Large corporate clients in the United States have adopted a particular kind of task-based billing, requiring outside counsel to use standardized codes under the **Uniform Task-Based Management System** (UTBMS) when submitting accounts. Although counsel may continue to charge on an hourly rate, they must use UTBMS codes to describe each activity they undertake. Over time, this allows clients to compare the rates charged by different firms to do the same kind of work. This is expected to encourage greater efficiency and lower fees.²⁰

Another common alternative to hourly billing is the **contingency fee**. Under this arrangement, the client only pays the lawyer if the latter obtains a good result. Once again, clients do not pay for time, but only for a successful outcome (*eg.* for plaintiffs a recovery, for defendants an amount saved). The lawyer bears the entire financial risk: no success means no fee. Contingency fees create a strong incentive for lawyers to do their utmost to achieve a good result for the client. Since they do run a high risk, the lawyers expect to receive a substantial proportion of the recovery from the client: 30% is not uncommon. In cases where success is virtually assured, demanding a high share may seem disproportionate and unfair to the client. On the other hand, contingency fee arrangements mean that clients who lack financial resources can still get access to a lawyer's assistance. This type of agreement is much more common for plaintiffs than for defendants.

A related kind of arrangement is the **success fee**. Under this arrangement, the client agrees to pay the firm, say, 130% of its fees if they win in court, but only 70% of the fees if they lose. This, too, puts a lot of risk on the firm, but less than a pure contingency arrangement.

¹⁸ Macaulay, *supra*, note 1.

¹⁹ For a discussion of alternatives to hourly billing, see generally *Overview of Different Types of Lawyer-Client Fee Agreements*, ICBC claiminfo.com, <http://www.icbcclaiminfo.com/node/83>; David Goehl, *supra*, note 9; Susan Van Dyke, "The Mighty Billable Hour: Is it Preferred in a Downward Economy" (Ottawa: CBA, 2009); Macaulay, *ibid.*; *Guide to Value-based Billing*, Association of Corporate Counsel, May 2012 <http://www.acc.com/legalresources/resource.cfm?show=1309263>;

²⁰ *The Future of the Legal Profession*, *supra* note 8 at 57-8.

A relatively common agreement is to combine an **hourly rate and contingency fee**. The lawyer accepts a relatively low hourly rate but gets a bonus if the client gets a good outcome. This reduces the risk for the lawyer and still offers a lower-cost option for the client. Sometimes, the parties might agree to **cap** the total compensation paid under the arrangement. For example, fees plus bonus together will not exceed a certain amount determined according to an agreed formula.

Another common hybrid agreement combines an **hourly rate and fixed fee**. The lawyer does the initial, more open-ended work on a file on an hourly rate, but later agrees with the client on a fixed fee to complete the transaction or matter when the parameters are more clearly known.

Sometimes the lawyer and client establish a budget, and the client agrees to pay an **hourly rate up to**, but not exceeding, the budget ceiling. If the lawyer bills less than the budgeted amount, the client agrees to pay a **bonus** of, say, 40% of the savings under the budget.

Arrangements that mix **hourly rates and value-based** payment are a way of rewarding lawyers' investment in technology. If the firm can perform a task more efficiently than it used to, the lawyer and client agree to a fee lower than the original fee but greater than simply the time required to do the job now. Both client and lawyer benefit.

Law firms have devised numerous other variations on the straight hourly rate. Under a **blended hourly rate**, for example, the lawyers charge a single hourly rate for all lawyers on the file, even though they would normally bill at different rates. For clients, the overall cost may well be lower than if the lawyers charged their usual rate. The blended rate may make it easier to forecast total spending. Under a straight hourly rate, the monthly totals can fluctuate widely, as senior and junior lawyers come in and go out of the file. For the firm, there is an advantage to push the work down to the person who normally bills at the lowest hourly rate. This encourages delegation and professional development within the firm, but the client may get less attention from the higher paid lawyers in the firm.

Another common option is to offer a **volume discount** to a client who guarantees a certain number of hours of work to the lawyer each month for a minimum period of time. That may be fairer to both parties than simply a **discounted** or **reduced fee arrangement**.

The number of **hybrid** arrangements is limited only by the imagination of the parties. Despite the problems with hourly billing, and the many possible alternatives, hourly billing still seems to remain firmly entrenched. There are many possible explanations.²¹ Measuring time is simple and appears to give an objective metric of work done.²² It permits easy comparison among a firm's associates. Retainers are also easy to establish based on time. Law firms may prefer hourly billing when many factors in a complex legal matter are beyond their control or are unknown, as charging by the hour shields them from risk.

²¹ See generally, discussion in CBA, *The Future of the Legal Profession*, *supra*, note 8 at 55-6; Macaulay, *supra*, note 1. Although the dominance of hourly billing is relatively new, going only 30 or 40 years – see CBA, *The Future of the Legal Profession*, *supra*, note 8– it is the now the *status quo*, and there is considerable resistance to changing the familiar way of doing business,

²² However, this objectivity has been described as “spurious” by some. See, Ann Macaulay, *ibid*.

Hourly billing is deeply embedded in legal culture, and lies at the root of lawyer assessments, promotion to partnership, staffing and cost accounting. A deeper reason why lawyers and clients have not yet abandoned hourly billing is simply that it is often hard to know whether alternative, or “value-based”, billing provides an appropriate or fair measure of what a lawyer’s work is worth. Neither lawyers nor clients have much experience in figuring out how to calculate the value of legal work, other than by measuring time. Those at the forefront of this effort say that the initial experience is very difficult, sometimes even painful.²³

For one thing, change may require the firm to understand the details of its internal cost structure to a degree it has not attempted before.²⁴ Then, the firm has to work out its unique “value proposition”, namely, what it can offer its clients²⁵ that distinguishes it from other law firms. As Colin Cameron says, if you don’t have a unique value proposition, then it’s just about price, and there will always be someone willing to do the same work you do for less.²⁶

Once the value proposition is clear, then the firm can set the price, perhaps even at a premium, for its services to clients. Or, it will have the basis for proposing a success fee if the matter concludes to the client’s satisfaction.

Even this brief description of what is involved in developing an alternative billing proposal shows it is more complex than simply billing by the hour. Those who claim to have done this successfully say that the key is having very open discussions between client and lawyer.²⁷ Each side has to learn how to articulate precisely what they want. For the client, it may be more than simply paying less for legal help. It may be about achieving more predictability in billing. The client may be looking for more specialized service than received in the past. Talking this through can be hard work for both parties.

Law firms report that more and more their sophisticated clients are asking for alternate billing proposals when they negotiate retainers. By and large, clients still usually choose the hourly billing option, but firms are acquiring some experience in developing these proposals, and the conversation is starting to change.

Moreover, some big Canadian firms, such as Norton Rose and Gowling Lafleur Henderson, now earn a significant proportion of their revenue from alternative billing arrangements.²⁸ For Gowlings, alternative fees contribute about 25 to 30% of the firm’s business. For some intellectual property firms, the percentage is even higher, approaching 40%.

As the experience grows and comfort levels increase, the potential of alternative billing as a measure to improve access to justice should become clearer.

²³ *Ibid.*

²⁴ CBA, *The Future of the Legal Profession*, *supra*, note 8 at 60.

²⁵ Colin Cameron, *supra*, note 15.

²⁶ *Ibid.*

²⁷ Macaulay, *supra*, note 1.

²⁸ Jeff Gray, *supra*, note 11.