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Fees, Facts and Figures – What Lawyers are Charging and Receiving

By Ward Bower

As has always been the case, legal billing is as much an art as it is a science. Bill timing, format, presentation and follow-up will vary for different clients, according to their policies, desires and preferences, and the billing capabilities of the law firm.

However, setting billing rates and quoting fees is a different matter. Hourly rates need to be capable of sustaining the firm economically, yet need also to be competitive within the external marketplace. Fixed fees and other pricing alternatives likewise have to be capable of sustaining the firm, yet still be competitive.

Hourly Rates — Economic Considerations

The average hourly yield necessary to support the economics of a law practice can be determined by dividing target firm revenues by anticipated billable hours. For an individual lawyer, it can be determined by dividing target revenue goals for that lawyer by projected billable hours.

The hourly billing rate to be charged by a lawyer, however, requires an adjustment for time write-offs, billing discounts and uncollectible accounts receivable. A fundamental formula for setting lawyer hourly rates is:

$BR = T \div (R \times U)$ where:

BR = Hourly billing rate for the lawyer
T = Target revenues
R = Realization on lawyer time recorded
U = Lawyer utilization (annual billable hours)

For associate lawyers, T can be computed as:

Average, per lawyer overhead
\+ Compensation and benefits paid to that associate
\+ Profit margin desired (usually 20-30% of collections)

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For a partner, the components of T would be:

Per lawyer overhead
+ "Base" compensation (draw or salary) and benefits (before distributions or bonuses)

Realization (R) is best determined historically for each lawyer, as:

Gross fee collections
÷ "Standard value" of individual time recorded, historically (hours x standard billing rates)

Utilization (U) is simply *expected* billable hours for the year for which the billing rate is being set.

Examples help elucidate the formula.

Associate Rate Computation

Compensation =	$100K
Per lawyer overhead =	$120K
Benefits = 20% of compensation =	$20K
Desired profit (20%) =	$60K
Historical realization =	90%
Expected utilization =	1800 hrs

BR = (100K + 120K + 20K + 60K) ÷ (.9 x 1800) = ± $178

To the extent to which the firm generates an average hourly yield less than $178, its profits will be reduced. To the extent to which it yields more than $178 per hour, more than 1800 hours, or greater than 90% realization, its profit margin on that associate will be higher.

Partner Rate Computation

Base compensation / benefits =	$300K
Per lawyer overhead =	$120K
Historical realization =	90%
Expected utilization =	1700 hrs

BR = (300K + 120K) ÷ (.9 x 1700) = ± $274

TABLE 1 IMPACT OF VARIABLES ON LAWYER HOURLY RATES — 1999

(Spread between median rate for top and bottom groups within each category)

Experience (years of admission)	83%, top to bottom
Specialty (at senior partner rates)	78%
Firm Size	69%
Position (partner or associate)	46%
Geographic Region	35%
Community Population	30%

TABLE 2 Ratio, Senior Partner (25 years +) to Mid-Level Associate

1985	**1.56 : 1**
1999	**1.44 : 1**

Source: Altman Weil Publications, Inc., Newtown Square, PA 19073, 1999.

With a billing rate at this level, the partner's total compensation can be more or less than $300,000, depending upon his or her own economic performance and the profit margins generated on the work done by associates. Ideally, the partner rate will enable self-sustenance at the draw or salary level, and profits earned from the cumulative efforts of associates will supplement that in the form of distributions or bonuses.

As is obvious from the fundamental formula, rates can be reduced without adversely affecting profit by increasing realization of utilization, or by decreasing compensation or overhead. Otherwise, rate reductions will adversely affect profit. Likewise, given a particular billing rate, profits can be increased by decreasing associate compensation or overhead, or by increasing utilization or realization.

This computation of hourly rates by law firm and individual lawyer economics, however, is only half of the process of rate setting. The other half is to position rates in the external marketplace — the second element of hourly pricing strategy.

Hourly Rates —
Marketplace Considerations

Competitive pricing of legal services is difficult due to a dearth of current information regarding billing rates. Anecdotal information can help, but survey data is better. For example, the annual *Altman Weil Survey* of *Law Firm Economics* reports average and median hourly rates and interquartile ranges by various categories. Study of the *Survey* data over multiple years reveals the factors influencing billing rates of lawyers, and the magnitude of the impact of each factor.

As Table 1 indicates, experience as a lawyer (years since bar admission) is more significant than any other variable factor in determining or predicting a lawyer's billing rate. Legal specialty is second in importance, firm size is third and the other factors are less significant. (Generally, rates are higher in larger firms in large cities in California and the Northeast, and lower in smaller firms in small towns elsewhere.

Table 2, however, shows that rate differentials between senior partners and associates are converging.

Setting rates for individual lawyers in a firm requires not only calculating the appropriate rate based on firm and lawyer economics but also positioning the rate within the marketplace by virtue of the firm's desired competitive basis and position. If the strategy of the firm is to compete on price, rates should be set lower than the perceived market. If the strategy is high value-added (depth in specialties; highest

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quality, sophisticated delivery; high levels of efficiency; etc.), rates should be set above the perceived market.

Ultimately, clients (not lawyers) determine hourly rates and legal pricing by what they choose to pay for legal services. In less sophisticated, "commodity" areas of practice, clients will shop on the basis of price and refuse to pay high rates. In highly sophisticated areas of practice and/or matters of substantial economic impact, clients will pay more for quality. In some cases, clients will pay more for a "brand-name" (usually larger, better known) firm. Studies have shown that brand-name recognition is worth a 10% to 20% premium in legal fees.

Alternative Pricing

Legal work billed hourly is subject to ever more intense client-induced price competition and revenue restraints, through intense scrutiny of detailed bills. Clients today not only are resistant to fee increases, most are seeking discounts from standard hourly rates charged to other clients. They also require detailed billing and scrutinize bills for duplicated effort, efficiency, and the number and levels (partner, associate, paralegal) of fee earners performing each task. Task-based billing (required by many corporate clients) enables the buyer's creation of sophisticated databases to monitor performance and compare the cost efficiency of different firms on similar matters. Pure hourly billing also reduces the opportunity for premium fees, even where results are spectacular, and penalizes the law firm for efficiency.

As a result, law firms should look at opportunities to bill on bases other than time, where appropriate. Contingent fees, pre-negotiated results fees, and percentage fees are being used, increasingly, in appropriate situations. But for many firms a fixed or flat fee provides the greatest opportunity for alternative pricing across the widest range of matter types, from routine divorces, incorporations and business transactions (loan closings, commercial contracts, etc.) to routine litigation (tort claims defense, employment litigation, etc.).

Everyone wins in fixed/flat fees that are set properly. The client enjoys certainty of the total fee (versus the uncertainty of total hourly fees), and the ability to compare law firms on a more meaningful standard (total legal fee). The law firm can even increase its margins/profits through efficiency, process reengineering, cost reduction, substitution of capital (technology) for labor, etc. It also can require payment, whole or partial at the outset of the matter, improving cash flow and realization, and, therefore, profits.

> **"... legal billing is as much an art as it is a science.... However, setting billing rates and quoting fees is a different matter."**

The challenge to the law firms lies in setting the fixed fee. If it is too high, the client may go elsewhere. Too low, and losses are a result.

There are two primary methods for setting flat fees — prospective and retrospective. Both can be employed together to get the best and most accurate result.

The prospective method involves matter budgeting based on hourly rates set by the rate formula and estimates of time involved in each step or phase of the matter. The retrospective method involves resurrection of detailed billing information on completed matters of the type involved and setting the fee in relation to that experience.

Fixed or flat fee pricing does not guarantee a "profit" on every matter. Typically it results in some very profitable matters (early resolution, routine transactions, etc.) and the occasional loss (unexpectedly complicated transactions, the "case from hell," etc.). However, even with the fixed or flat fee, clients will often agree to protect the law firm from the "case from hell" by agreeing to pay hourly above the flat fee once time value invested in the matter exceeds the fee by a reasonable number (often 20% to 50%). The matter will still be a "loser" for the firm (matter realization under 100%), but its losses will be cut.

The law firm's ideal payment schedule in a fixed or flat fee arrangement is, of course, 100% up front. Clients, however, prefer a payment schedule for obvious reasons. Timing of fixed fee payments is a matter for negotiation with the client at the point of engagement.

Retainers

Whether working hourly or on another basis, payment up front helps ease cash flow and sorts out clients unable or unwilling to pay before the firm has made its investment of time and money in the matter. Replenishable retainers can be used in time billing situations almost like progress payments in fixed or flat fee matters.

Conclusion

Legal billing is truly an art requiring good judgment and even creativity regarding bill timing, format, presentation, follow-up and collection. However, applying fundamental law firm economics and marketplace benchmarking to the process of rate and fee setting assures that the client is charged fairly and the law firm earns the profit necessary to sustain its operations, invest in future growth and compete in the important dual marketplace both for clients and for legal talent.

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