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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

The Cost, And Ethics, Of Doing (Legal) Business

Law360, New York (August 14, 2013, 6:10 PM ET) -- According to a recent joint report by CEB, a research and advisory-services company, and TyMetrix, a unit of Wolters Kluwer that creates legal billing software, law firms increased their hourly rates an average of close to 10 percent between 2010 and 2012. This trend is an indicator of why corporate legal spending is so high. However, those who take the time to analyze their legal bills could attest that it's the line items that the law firms are charging for (not the rate) that are creating these exorbitant legal fees — and causing significant distress.

One of the more contentious line items is the practice of some firms that charge for "overhead" items, because such charges fall into a grey area regarding the ethical guidelines that bind lawyers. And it is when law firms appear to cross these ethical guidelines that their character is sometimes called into question, and the client-lawyer relationship is strained. That is why it is imperative to transparently discuss legal fees upfront and throughout the process and progress of a matter so there is no question as to the lawyer's priority – providing legal value versus making an undisclosed profit.

Defining Overhead

According to ABA Formal Opinion 93-379, "A lawyer may not charge a client for overhead expenses generally associated with properly maintaining, staffing and equipping an office unless a contract construed in the circumstances indicates otherwise."

However, these charges are still regularly passed down to clients by some firms. Most firms do so upholding certain traditions, (such as billing for postage) while cynics say it's an avenue to maintain profit margins by reducing expenses. Either way, clients should not have to pay for the law firm to grow or maintain its business unless the client is fully informed and has consented on an informed basis to absorption of such firm expenses. Clients should always see the value in the services that are being performed, and must have such expenses explained with transparency.

The problem is that overhead is a very ambiguous term. Its ambiguity lies in the range of services that falls under the umbrella of the cost of doing business.

On one end of the spectrum, overhead could be seen a bit more obviously. This would be when a firm requires reimbursement for certain expenses in order to do business when taking on a case: such as filing fees or the cost of retaining an expert to provide testimony. Some firms, however, go so far as to include secretaries' salaries, and dubious "scanning" charges in a listing of expenses, or charging clients for the use of conference rooms or the passing on of late night meals. These particular expenses may be viewed as "essential to the case" by some, but others believe that ongoing expenses should be absorbed by the firm, and addressed in the firm's rate.

Are these charges ethical? Some would say yes, others would say absolutely not. Because

of this ambiguity, it is up to the law firm to develop a transparent relationship with the client to be sure they understand the value they will be receiving from each of these charges so they can deem for themselves what is considered the cost of doing business and what is the cost of providing superb legal counsel. The firm should allow a client an informed choice.

Clients should always know what they are paying for in advance. If the retainer agreement is general and vague, the client cannot anticipate these potential charges, and the lawyer-client relationship is later damaged when the client feels taken advantage of by the lawyer who is supposed to be providing support.

When Overhead Becomes Blurry

What becomes more difficult is when a firm charges for certain other types of expenses, which appear to be part of what most offices spend in order to stay open. For example, overtime. If a law firm takes on a matter and overtime is paid to clerical staff or the firm is forced to take on temporary workers, should that additional salary be charged back to the client?

Some say yes because it's an added expense due to the work required to provide legal value. I would argue that it is technically not chargeable because it is the firm that decides how to staff its offices. If the firm has too few people on staff or takes on too many matters at once for existing staff, then the overtime is a symptom of a problem with their staffing practices, and was not required just for that specific case. When a law firm takes on an assignment that is within their wheelhouse, they should, or are at least should be expected to, have the bandwidth and a staff that is capable of performing it.

Law firms that handle large, complex cases typically advertise themselves and represent themselves as ready, willing and able to take on those cases, which means working nights and weekends. It is not unusual for them to do that kind of work, and therefore they should be staffed as such.

On those same lines, another difficult-to-judge line item that I personally think falls in the overhead category is project management. Lately, there has been a trend where law firms bring in a nonlawyer to help coordinate certain aspects of large litigations, and selling project management services to clients at a separate hourly rate.

While these charges could be considered necessary costs to handling a specific case, whether they are necessarily providing direct value to the client is debatable.

Client Transparency

On the other hand, an analysis of what comprises the cost of doing business can be vague and indirect. For example, a firm arguably has an obligation to inform a client when the services that the firm is providing [such as e-discovery] could be accomplished more efficiently, and less expensively, if it were delegated to an outside vendor rather than performed in-house. The ethical conundrum is not whether a firm is wrong in charging for a process, but rather potentially opting for the more expensive route that financially benefits a firm, when the client is unaware of more affordable options.

The question becomes, is it ethical to charge multiples of what it would take an outside vendor to capably perform the same tasks?

Transparency and Fairness

All of these issues work together and are derived from the same basic concept: when you

hire a law firm you should know, in advance, what you are paying for. Both parties should be transparent, the agreement should be clear, and it should always provide the most legal value.

Fortunately, the debate on billing ethics can be avoided when a lawyer is able work together with a client to create a fair and transparent billing process. If the client is completely aware of the services that are being performed, what his or her options are, and exactly what he or she will be charged for throughout the process, then there is no question as to what should be billed and what should not.

Below are a few tips that legal counselors should consider to develop a closer relationship with their clients by improving the transparency and fairness of their billing practices.

1) **Be Transparent.** Lawyers should take the initiative and go through EXACTLY what the client will be charged for, item by item: disbursement type, charge, and rate for all time chargers. It is of the utmost importance to be explicit with each item, and explain all aspects to a client.

2) **The Client Should Not Be Surprised.** Provide good faith estimates to clients as to what the overall cost of the litigation will be, and do so throughout the process should anything change. This way, clients have an understanding of the different elements of the bill. The lawyer should be updating that estimate as they go through litigation, maintaining accuracy and adjusting for inevitable changes.

3) **Get On The Client's Level.** Make sure to adjust the presentation of the legal fee process to the sophistication level of the client. A lawyer should never take advantage of the client's emotional state or lack of experience.

At the end of the day, a lawyer's billing ethics and the health of the lawyer-client relationship starts and ends with transparency.

—By David Paige, Legal Fee Advisors

David Paige is founder and managing director of New York-based Legal Fee Advisors. Over the course of his 25-plus-year career, Paige has advised Fortune 1000 companies on complex and high-stakes billing issues and helped them develop the methodologies for reducing outside legal costs.

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