

SETTING FEES

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TO THE chagrin of most clients, the pricing of legal services has never been easy to understand. Unfortunately, for some lawyers, pricing is a mystery to them too - their fees more the result of guesswork than business-like calculations.

Knowing how to set fees in today's market isn't just a novice's elementary concern. Alan Marshall, director of the practice advisory service for the Law Society of Upper Canada, says many veteran lawyers, though busier than ever, find themselves earning less, largely because they have neglected to update their fees in keeping with costs. He recommends fees be reviewed at least annually and even quarterly in periods of high inflation.

But "ignorance" in pricing legal services is changing, largely because of market demands. More clients, particularly corporations, are asking for hourly rates instead of fixed fees, forcing firms to be more precise about costs. Computers bring a new level of sophistication to the law office in tracking time and tasks. And constantly increasing overhead expenses make it essential that lawyers track their "real costs".

In an informal survey of large and small law firms, most managing partners or administrators admitted the profession is far behind the business world in pricing. At budget time, firms establish hourly rates for partners based on the expected number of billable hours in a year (on average, 1200 hours) and projected costs and earnings. Many firms find lawyers can bill for about five or six full hours a day. While the calculations of income are on an hourly basis, the option of charging a fixed fee is open to most partners for individual cases if the bill reflects the value of the time spent.

In reviewing existing fees, however, many partners admitted they just look at

last year's fee and decide by committee whether it's time for an increase. As one said: "Law firms by and large aren't good at cost accounting."

Some partners balked at the suggestion that firms keep in mind a profit margin. But Alan Marshall advises lawyers to consider just that. He says fees are really just overhead plus income expectations or projected profit.

Marshall says the average practice should aim for a net profit of 50 percent of gross income, with variances of 10 percent either way depending on the type of legal service rendered. Obviously, this isn't the guideline for every firm. For example, Marshall suggests a lawyer with a commercial practice would have a higher overhead cost than a criminal lawyer, and a lower profit margin. But the commercial lawyer also charges more. As a rule, experience has shown that overhead is at 50 to 55 percent of gross income in the average practice.

Many lawyers, however, particularly veterans, are afraid to increase their fees for fear of losing clients. Law firms could certainly learn something about competitive pricing from other businesses. The first thing to do in evaluating your price is to look at what competitors are charging. This also means evaluating the quality of service offered by your competitors in relation to their fee - in other words, value for money.

Once you've gathered all the information on the market, you're ready to consider whether your fee should be increased. It's here that many businesses lose their objectivity and become worried about clients leaving. Pricing strategists will tell you there are several myths or pitfalls managers of service-oriented firms frequently fall into. First, the price of a service shouldn't be tied to its cost. The question is what's the value of the service being supplied. It

may only cost \$20 per hour to produce, but it's worth \$175 to the client.

The second pitfall is thinking clients will leave for the competition. At the root of this misconception is the belief that all legal services are "price sensitive". Price sensitivity is only an issue for similar products. For example, someone selling an orange at 50 cents will do better than anyone selling an orange at \$1 because the two products are alike.

Most legal services aren't price sensitive because of such things as the lawyer's skill. Pricing strategists know clients won't leave for the competition simply because of a price increase if there's still a perception of value for money.

The final point to note is something many businesses forget when setting prices: the higher your price, the lower your break even becomes. Although you may lose a client or two over a higher price, what's charged to the remaining clients more than makes up for the loss.

Setting fees for individual cases is more difficult. Fixed fees are somewhat arbitrary in most firms and, as one lawyer said, "there are no magic formulas" on the horizon. Some firms have a billing committee that approves amounts billed for any major account. One Toronto firm calls for a member of the billing committee to initial any fee over \$1000. Yet, there's still a debate over which is better: hourly rates or fixed fees.

David Rogers, of Rogers Bereskin & Pare in Toronto, believes the fixed fee is probably the best deal for both lawyer and client because everyone knows what to expect in the end. He says it also allows lawyers more flexibility than hourly rates in determining a service's value.

But, the hourly rate is appealing for

some clients. It also can be more difficult for law firms to get a handle on. A Toronto law office manager (who asked not to be named) says these hourly-rate clients often have experienced in-house counsel who tend to be "more mathematical" about legal costs. For example, he remarks, "they say you can't fly anywhere over four hours unless you fly economy; you can't have more than one lawyer at a meeting. They say we want to know who's working on this, year of call to the bar, etc."

This manager says he ensures the hourly rate reflects all the costs that a client may or may not incur. He admits that makes hourly rates unfair to some clients since they may end up paying for services they didn't use. But, the law firm can also be burned with hourly rates if everything hasn't been added in. For example, the rate may not adequately cover the cost of paying a secretary double time to come in on weekends.

A growing problem with fees is that most law societies restrict what can be billed out directly to a client. For instance, one law office manager contends that a client who needs a lot of typing should pay more than a client who needs no typing. But most law societies consider internal services a part of overhead not to be billed out directly. That rationale goes back to the days when fees included everything from advice to typing to postage stamps.

With law offices using advanced technology, many managers and lawyers believe the law societies will have to re-

consider their position on what can be billed. For example, one manager wonders what you charge clients for a database of contract precedents. When the database was first created it may have taken a lawyer 10 hours. The next time that type of contract has to be done, the lawyer may only spend two hours on it. How do you accurately bill out the cost of that to clients? As he puts it: "The more advanced the technology becomes, the easier the job gets and the more difficulty we have in figuring out how much to bill!" He sees the advances in technology as an argument for a return to value billing and a move away from hourly rates.

Some lawyers hope computers will soon make it easier to determine a client's bill. A picture of what's yet to come is in the Toronto law office of Robin Macrae. His small practice is praised by a law society auditor as being one of the most business-like, thanks to an elaborate computer system.

Macrae, who serves clients in corporate and securities matters, says the "engine" of his practice is a database that records the exact time he spends on every activity within the law firm, from typing a document to making an account entry. What makes his system different from most others is that every minute in the day is billable to a file, even non-client activities. For example, the buying of books and periodicals is an assignment in a docket file. Macrae calls these files "phantom" clients that enable him to determine his true costs or time spent during any part of the working day.

Although his system isn't complete, he hopes soon to be able to run his office so that almost nothing can be done without using the computer system. Although it sounds complicated, Macrae insists he and his staff won't be pushing keys all day to get work done. The computer will be programmed to automatically execute many time-consuming office functions with the push of just a few buttons.

For instance, if Macrae wants to authorize an expense, he simply hits a few keys, setting the computer off onto a series of tasks that eventually result in a cheque being printed. Also, client information will be at his fingertips all day. He'll be able to tell how much time he and his secretary spent on a file and bill accordingly.

The result, says Macrae, is that he'll be able to accurately bill clients based on real time and vary his rates according to the value of tasks done. Also, Macrae says once the system is running, he'll be able to accurately predict how much time a particular task will take based on other client records within the database and quote clients a more competitive fee.

But, surprisingly, Macrae is still setting his fees based on what others charge. He says it'll be a few years of testing before such an elaborate system will be able to dictate his fees. When it's ready, he hopes it will make his practice more marketable to clients since they'll only pay for the exact time spent on their file. ●