

3. The Client's View of Pricing

If not time based charging, then what? This chapter is a detailed analysis of alternative pricing bases from the point of view of clients. It shows how clients view the most prevalent pricing structures in current use. It concludes that there is no single charging basis that suits the needs of all clients. Whilst solicitors may be able to influence their clients' choice of charging basis to some extent, in a buyer's market at least they have little choice but to accept the client's choice of basis and to manage their work and their profitability accordingly.

PRICING BASED ON EXPENSE OF TIME (UNCAPPED)

3.1 Uncapped time based charging strengthens the client's negotiating hand ...

The widespread acceptance of time based charging owes much to the ubiquity of the hourly charge rate in recent years. Many clients, including highly sophisticated ones, accept the premise that *time is money* in a professional services firm and believe that time based charging is the only way of ensuring *a fair day's pay for a fair day's work*. At the same time there are many clients whose acceptance of time based charging is passive: in other words they are unaware of the alternatives, or feel that they lack the necessary clout to demand a different basis for charging.

But the most sophisticated clients have another, less altruistic, purpose in favouring uncapped time based charging. Such clients, typically experienced buyers of legal services or qualified lawyers in their own right, are able to assess the "fairness" of their legal bills by analysing their solicitors' records of tasks done and time taken.

Time records are fair game for fee negotiation when the matter has been concluded. After-the-event fee negotiations are heavily weighted in favour of the client who, having already gained the value from the solicitor's advice, has nothing to lose by pressing for a reduced price. Most solicitors, meanwhile, feel compelled to give at least some ground in terms of pricing for fear of jeopardising the client relationship.²

This form of fee negotiation has been common in the buyer's market of the 1990s, and has proved to be a very effective means for clients to debunk hourly charge rates which they consider to be artificially high.

² These arguments are explored at greater length in the author's article *Negotiating a Fair Fee*, which appeared in *Legal Business* magazine in November 1993.

3.2 *... but the open ended nature of uncapped time based charging makes budgeting difficult and encourages inefficiency.*

After-the-event negotiation of uncapped, time based fees is a double edged sword for clients, however. If the client agreement is to consist of little more than a list of hourly charge-out rates, the client has no proper means of evaluating the offerings of competing firms. For example the client has no way of knowing whether a firm whose charge rates are 20% above the norm will compensate for the higher rate by taking commensurably less time to do the work, or simply charge 20% more for the same benefits.

At best the lists of hourly rates give some indication of firms' respective positions in the competitive pecking order, but even this information is of questionable value given that the fee rates may be effectively reduced retroactively (by refusing to pay for some of the recorded hours) at the negotiating stage.

Whereas it is a fact of life that the value conferred on the client does not necessarily increase with the amount of work done, uncapped time based billing requires an act of faith on the part of the client that the solicitor's time costs will be fully justified by the result. Such acts of faith are at variance with the budgetary disciplines and constraints under which most clients have to operate.

The lack of discipline inherent in uncapped billing arrangements gives rise to many complaints by clients. Solicitors are not usually obliged to make formal work plans for uncapped matters, arguing (if necessary) that the nature and scope of their work will be largely determined by the progress of the matter. The absence of any formally agreed or documented plan of action can result in an insufficiency of communication between solicitor and client. Common complaints arising from this include over-manning, failure to delegate work to its most cost effective level and the undertaking of tasks which do not contribute to the client objective or whose cost cannot be justified in terms of value to the client.

These factors have contributed to a growing scepticism among clients in recent years about the propriety of uncapped time based charging.

PRICING BASED ON EXPENSE OF TIME (CAPPED)

3.3 *Fee caps assist budgeting and can prompt better work planning ...*

Clients who continue to favour time based charging increasingly recognise the value of fee caps as a useful discipline. Properly applied, caps can help ensure that the client and the solicitor have a shared understanding of the fee constraints, such that the solicitor must address the question of how best to maximise the value to the client on a limited budget.

The benefits of fee capping, from the client's point of view, vary considerably according to how the fee cap is applied. If the client uses the fee cap as a "soft" target - for example if the solicitor informs the client when budgeted time costs are almost spent, whereupon solicitor and client merely agree to revise the cap accordingly - the effect may be almost as if the fee was uncapped.

By contrast, if the cap is a "hard" target - set at, or close to, the true limit of the client's budget, such that any proposed increase in fee will be contested by the client - it is very much in the solicitor's interest to prepare a formal work plan whether or not the client demands one. Solicitors who fail to inform the client at the outset about the main contingencies that might cause the fee cap to be exceeded risk being refused an increase in fee on account of their failure to plan the work properly.

By discussing and agreeing work plans with their solicitors, clients can pre-empt many of the problems set out above and with respect to uncapped work, and have greater confidence that their solicitors' expense of time will be cost-effectively applied.

Fee caps can also help clients to evaluate the offerings of competing firms. For courses clients can gain a much clearer indication of their options in terms of price and value for money by selecting solicitors according to the quality of their work plans and the level at which they think the fee might be capped. However, the general reluctance by solicitors to produce work plans suggests that this form of evaluation might not be sustainable in the event of the recurrence of a sellers' market, such as that of the late 1980s.

3.4 ... but too rigorous application of fee caps can undermine service quality.

Clients observe that though solicitors frequently exceed agreed fee caps, they rarely under-cut them. Work done, in other words, usually increases to fit the fees available. To the extent that this is true, fee capping is tantamount to fee fixing, but giving the solicitor some latitude to appeal against the fixed fee in the event of cost over-run.

Too rigorous application of fee caps may work against the client's best interests. Most solicitors' lives are so much ruled by time recording and billing that they cannot easily give priority to non-chargeable work. Accordingly when the expense of time exceeds the agreed cap, the quality of the work may be unwittingly compromised.

There is a further danger that the client may be less attentive in monitoring and controlling capped work, mistakenly believing that the fee cap is a firm guarantee of value for money within budgetary constraints. Whilst this should not be a problem if the solicitor is working to an agreed plan, it can have serious consequences for the client in the absence of an agreed plan. For example, if the cap has already been exceeded before the client intervenes to question the firm's approach, the matter becomes a damage limitation exercise with potentially detrimental consequences for both client and solicitor.

FIXED FEES (WITHOUT REGARD TO EXPENSE OF TIME)

3.5 *Fixed fees force solicitors to focus on work planning and risk management ...*

In theory at least, fixed fees make life extremely easy for the client. They uphold the classical free market principle that, in a competitive market place, the amount the client pays may bear no relation whatsoever to the solicitor's costs in providing the service. Accordingly the client has the right to expect a pre-defined set of benefits for a pre-defined cost, and the management of expenses and profits are matters for the firm's own determination.

Fixed fees are an attractive option to clients because, on the face of it, they make budgeting extremely easy. Shopping around becomes a simple matter of assessing competing firms' prices in the light of their respective service features and benefits.

In contrast to open ended charging arrangements, the client is able to gauge value for money in precise terms and in particular to assess whether any firm's pricing premium is justified. In contrast to capped, time based arrangements, the firm bears complete responsibility for managing the work and delivering agreed benefits on budget. The client, in other words, is free to concentrate on the quality of the result without having to worry about whether the solicitors are making cost-effective use of their expense of time.

Some clients also believe that fixed fees are an extremely powerful way of making reluctant solicitors think hard about their approach to their work, in the knowledge that they alone must bear the risk of setting too low a fee. Fixed fee agreements may be heavily hedged about with exclusion clauses, but in contrast to the more *laissez faire* practices of time based charging, the exclusion clauses must be drafted in specific terms: the solicitors will have to carry the can for any cost over-runs that were not correctly pre-empted at the outset.

3.6 *... but fixed fees, like fee caps, may cause service quality to be compromised.*

Ironically it is solicitors' own problems with fixed fee agreements (which we shall consider in the next chapter) that are the main cause of clients' reticence about demanding fixed fees. More sophisticated clients in particular, who are aware that their solicitors' systems are heavily dependent on time costing, see fixed fees as equivalent to fee caps but with none of the flexibility for re-negotiation. In other words, they fear that their solicitors may simply lose interest in matters where the expense of time exceeds the fixed fee.

Such clients accept the assertion by many solicitors that it is not possible to fix a fair fee until the scope of the work is fully revealed, and contend that time based charging remains the fairest system for "innovative" work, or matters whose scope may not be correctly gauged at the outset. But clients and lawyers in the US in particular, have made considerable strides in overcoming this problem by fixing fees on a task-by-task basis (e.g. in litigation terms: pleading, discovery, etc) as the true scope of each task becomes clear.

Clients' concerns about fixed fees do not apply to services which clients regard as "commodities" by virtue of their relatively predictable nature and/or relatively limited calls for specialist expertise. Nor are relatively routine but specialist services necessarily immune from fixed fee agreements either. Bulk buyers of such services tend to insist on fixed fees in exchange for an agreed volume of work, on the basis that cost over-runs in some matters will be compensated by under-runs in others.

Fixed fees are likely to become increasingly prevalent in the years ahead, particularly if Government seeks further streamlining of the Legal Aid system and as more and more specialist expertise moves into the realms of expert systems. (The issue of expert systems is considered in greater detail in Chapter 5: *The Future of Pricing*.) Furthermore clients' concerns about fixed fees, which concerns stem largely from the inadequacy of firms' present pricing systems, are likely to abate as firms develop proper pricing systems and discover the competitive advantages of offering fixed fees.

FEES BASED ON "SUCCESS" (CONTENTIOUS & NON-CONTENTIOUS)

3.7 *Success fees enable clients to gain still greater control over value for money ...*

Success fees come in a number of different guises. The most famous, or rather infamous, form of success based work is US-style, speculative litigation, in which the law firm funds the action in exchange for a substantial share of the proceeds in the event of a successful outcome. Clients in these cases can readily assert that such initiatives by lawyers grant access to justice to people who must otherwise suffer in silence for want of the necessary financial backing. Many lawyers and clients, meanwhile, are strongly opposed to such actions on the grounds that they too often encourage spurious litigation without due consideration given to the merits of the claim.

But success fees, potentially at least, can also be based on a more balanced sharing of risks between client and law firm. Nor are they by any means confined to contentious work. Some clients observe that they were subject to informal success fee arrangements during the M&A boom in the 1980s, when their lawyers seemed to charge more of their time costs in successful deals than in unsuccessful ones.

Success fees, like simple fixed fees, are attractive to clients in theory. They enable greater control over value for money insofar as fees increase in line with value conferred on the client. They enable the client to budget for a range of outcomes.

They also force external solicitors, so often accused by clients of being uncommercial, to take a commercial view of the transaction at the outset rather than being tempted to get "on the clock" without due regard to the client's commercial interests. Some clients go on to argue that the external solicitors' increased risk participation makes them "put their money where their mouth is", "keeps them on their toes", and increases their "membership of the team" and their willingness to communicate openly with the client.

3.8 ... *but success fees often provide meaningless incentives and threaten to increase costs across the board.*

As with fixed fees, according to many clients, the theory of success based fees does not translate into good practice. Experienced clients contend that their lawyers' interest in a success based matter at any time is governed by the lawyers' current rating of their chances of success. This may even result in a decision by the law firm to "cut its losses" just when the client's need is greatest, or to drive the transaction through in pursuit of the success fee without proper regard to the client's best interests.

Questioned about success fees, many clients come back to the view that solicitors should be rewarded according to the quality of their advice rather than the outcome ("a fair day's pay for a fair day's work"), and that success fees can only compromise solicitors' objectivity and integrity. Whilst solicitors can *break* the deal, after all, it is said that they cannot *make* it, and accordingly incentives based on outcome are surely meaningless.

Some clients go on to argue that commercial risk management is a matter exclusively for the client and that it would be unfair and unwise to seek to lay it off onto outside parties. In fact, some suggest, such off-loading of risk can lead to sloppy thinking in client organisations, such that questionable opportunities are pursued simply because the solicitors can be relied on to shoulder a substantial share of the risks. Such transactions may cost the client organisation less than full blown deals, but their costs must nevertheless be subsidised from profits.

Clients also fear that success fees increase external legal costs across the board, since the costs of failed matters must be subsidised out of mainstream work. Accordingly if success fees were to become prevalent, the costs of a firm's adverse success based outcomes would ultimately be passed on to all its clients in the form of higher charge out rates.

These arguments notwithstanding, solicitors should not be tempted to dismiss success fees lightly. Aggressively commercial clients in particular are strongly in favour of rewarding their professional advisers according to the successes they achieve on behalf of the client, and may be inclined to dismiss the reservations expressed here as nothing more than esoteric obfuscation. Also success fees, like fixed fees, will become easier to manage as firms' pricing systems are improved, to the point where firms may be able to gain competitive advantage by offering innovative, variable fees based on success that help clients to overcome their scruples.

3.9 *Solicitors must be willing and able to offer realistic alternatives to time based charging.*

Whether or not time based billing is, as many solicitors and clients believe, the best of a bad lot of possible charging methods, the fact remains that 1980s inflation dealt a fatal blow to its credibility in the minds of many clients. Furthermore, so many solicitors have now come to accept client demands for fixed/success fees that such bases for charging appear set to be a continuing feature of the legal business environment for many years to come.

Solicitors who wish to succeed in the new competitive environment can no longer afford to take it for granted that time based charging will be acceptable to clients. All firms must ensure that they are able to set realistic fixed fees and manage their profitability within them.