FEES: HOW TO CHARGE, COLLECT & DEFEND THEM

Understanding the Legal and Emotional Aspects to Billing and Collecting for Legal Services

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Introduction

We practice law because it is interesting, challenging, we are good at it, and we are professionals. We also practice law because it is our business. As our business, we should rightly expect that fees charged should equal fees collected. And a certain amount of indignancy should accompany those fees that go uncollected. But also a certain amount of blame must remain with the practitioner as to uncollected fees. Did the practitioner follow a Best Practice approach in the fee presentation and collection process?

Little useful information has been written in this area as it pertains to estate planning. This paper is intended to be a starting point as to a Best Practices primer on the fee area as it relates to estate planning.

<u>PRE-MORTEM ESTATE PLANNING: IS THERE ANY OTHER KIND</u>?

Pre mortem estate planning refers to tax planning, Wills, living trusts, GRATs, education trusts, and all other matters that we do for clients while they are living. Bills are sent directly to those individuals who have requested our services, to deal with a topic that is very painful, albeit important -- <u>Where does the Property that I have worked Hard for During My Life go when I Die?</u>

It's not hard to understand why clients are reluctant to engage in estate planning. It is not a fun topic. Re-read the prior underlined sentence and ponder it a bit.

Therefore, even when we add significant value, say, saving $5 million in future estate taxes, a bill currently of $25,000 may seem repugnant. A bill currently for $10 may also seem repugnant. It's the process of what they are doing, not necessarily the value added, that is painful for clients to accept.

With that understanding in mind, what are the best billing practices? To understand the answer, one has to begin thinking out of the box as to practices. We should recognize (or agree) that current billing practices are subpar and done because (of what is known, as will be discussed in great detail below, as a status quo bias) they were done before.

Hypothesis 1: There is nothing rational about consumer behavior. As practitioners, we are often not thinking about our billing practices in the most strategic way.

Hypothesis 2: Practitioners spend about 10 % of the amount they should on billing, and disregard its importance to clients' happiness.

Hypothesis 3: Practitioners delay in billing because they know that clients will often perceive their charges as unpleasant and will be unhappy. Delay hurts further.

Hypothesis 4: The following paradigm is the fault of the practitioner, not the client:

Example 1: Practitioner does an A-B estate plan for a client, and quotes the client an hourly billing rate of $250. The project is done efficiently and within the client's time expectations. The hours spent are less than the practitioner anticipated. The hourly rate is less than others in the area. And the overall bill seems less than what it has been in the past. The clients are still surprised at the amount and unhappy.

Hypothesis 5: Which billing format, attachment 1 or attachment 2, is preferable from a client happiness perspective. Would it shock you if we said that in the vast majority of cases, attachment 2 would be preferable?

Hypothesis 6: Technology has increased the quality, efficiency, and lowered the cost of producing estate planning work product. But this is not reflected in the billable hour concept, nor accepted by clients as an item to bill for. As practitioners, we have not developed a way to charge for technology.

<u>What are we Missing as Practitioners?</u>

We fail to understand that consumers are not rational when it comes to hourly billing for estate planning matters. Many of us think that if hours are correctly reported, the hourly rate is reasonable, and the project is done timely, the clients will accept the bill as "reasonable" or as "good value."

But fundamentally we are missing a tenet of finance law: that the rational consumer does not always make rational choices, but is influenced by his or her own mental accounting,[1] which often changes rational consumers into irrational ones.

For example, the following example illustrates this mental accounting concept.

Example 2: You go to the store to buy your favorite movie on a DVD. It is priced at $14.99. While at the store, your best friend mentions that the same DVD is available for $4.99 at the Walgreen's about 15 minutes away. Will you go to the Walgreen's? Compare this to the situation where you are at the Stereo store and the salesperson says the stereo costs $499. Your best friend says the same stereo is available at $489 at the store 15 minutes away. Will you go to the other store? There's no difference financially, but the results have empirically been shown to be different. The consumer's perceptions are different in both situations, reflecting fairness issues. Conclusion: we cannot assume rationality for our client's economic decisions.

Translation to the Hourly Rate

A client may perceive an hourly rate of $350 to be "way too expensive" for someone spending an hour thinking about something. Is that rational (probably not, *see* below). In contrast, the client may not perceive a bill for $5,000 for estate planning documents that achieve estate tax savings, creditor protection trusts, management of assets in the event of disability, and so on, as being reasonable.

Meaning, in estate planning (not estate administration or contested litigation), get away from emphasis on hourly billing, and get into the concept of either doing <u>or demonstrating</u> project/value billing as much as possible.

Example 3: It's not rational: I recently spent about an hour coming up with an estate planning wrinkle for a client that saved him about $500,000 on a strategy. If I quoted him an hourly rate of $2,000, and then sent him a bill for $2,000, the client would be upset. If I quoted him a flat fee of $5,000 to try to implement a strategy that would save $500,000, he may have been absolutely fine with this, depending on the framing of the project and resolution.

RELEVANT THEMES

A couple that are relevant to how we bill and charge clients:

Fairness: Value, Value, Value

Consumers like to perceive themselves as being treated fairly, even when the end result or product or cost is the exact same whether they are being treated fairly or unfairly. Think about an IRS examiner who has two identical cases, both capable of yielding either $300,000 or $500,000 for the government, depending on the level of effort the examiner puts in.

To the extent one taxpayer is perceived as "trying to pull a fast one" on the agent, and the other taxpayer is acting reasonably and perceived to be a straight up kind of person, the agent is more likely to audit the Fast Eddie-prepared return more ferociously than the other. Why? Perceptions of fairness.

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[1] In "Mental Accounting Matters," <u>12 J. Behav. Dec. Making</u> 183-206 (1999), Richard Thaler, one of the leading behavioral economists in the Country, explores the concept of mental accounting. Unlike financial accounting, which consists of numerous rules and conventions that can be explored in a textbook, mental accounting rules – a description of the ways consumers perceive their economic choices—can only be observed by behavior and inferring the rules.

Example 4: You're sitting on the Beach at La Semana in St. Marteen's, hot as the dickens. And thirsty. You're buddy says he is going to buy a beer at the hotel and asks if you want one. You say yes; he asks if you care how much it costs, even if it costs $15? You say no because you know it will cost a lot. The place you are staying is expensive, and you expect that they will charge a lot for their stuff. Your buddy decides not to go. Instead, a bum on a push cart comes buy and asks if you would like ice cold Heinekan's…you think yes…until the bum says, "$15." Why should that guy make so much money from me?[2]

Many takeaways from the perception of fairness that consumers need to feel. First, the hourly rate at any amount will rarely be perceived as fair. Yet another strike in the hourly rate's coffin. But there are beauty marks that we can add to the hourly rate; some obvious, some not so.

I am a casual guy, but could never understand (and think lawyers are short sighted when it comes to trends) why our profession would want to be casual. A lawyer in a nice suit connotes value, thereby connoting a certain professionalism that carries with it the expectation that the charge for services will be great. Well groomed, manicured, well spoken; all go hand in hand. *Cf*. La Semana versus the bum example above.

Offices and how they look are another aspect of perceived value. As is the lawyer's professional affiliations, speeches, articles, reputation, other clients as references (careful to preserve confidentiality, very important for estate planners), the substantial level of a typical client.

And, though price should never be a factor in trying to convince a client to use us – "we're cheaper" sounds bad as a marketing technique (ouch!) – letting a client know that the costs for your services will be in the range of what others at your level costs, will add to the client's perception of fairness.

Understanding The Consumer's Value Function: One Big Hurt Is Better Than A Series Of Small Hurts

The loss function is convex, meaning that the marginal pain felt by incremental losses is greater than the pain felt by a larger loss. Specifically, as to the losses, the pain associated with the sum of the parts is greater than the pain associated with the whole. Ponder how this applies to a bill:

1. Every day entry associated with a time is translated into an hourly charge, a loss.

2. A bill with 20 daily time entries results in 20 losses. "Death by a 1,000 Cuts." It is more painful to review than a bill with one entry.

> *Example5: "Consider the case of the pricing policies of the Club Med resorts. At these vacation spots consumers pay a fixed fee for a vacation that includes meals, lodging and recreation. This plan has two advantages. First, the extra cost of including the meals and reaction in the price will look relatively small when combined with the other cost of the vacation. Second, under the alternative plan each of the small expenditures looks large by itself, and is likely to be accompanied by a substantial dose of negative transaction utility given the prices found at most resorts."* Thaler, *infra, at 192.*

What does this mean for our billing? Flat fees are much more preferable because a consumer may get greater transaction utility out of powers of attorney than out of drafting a complicated trust, but when each are broken out, the consumer evaluates each action separately and determines whether each action translates into value equivalent to the cost.

Further, flat fees avoid the marginal pain associated with each hourly "loss."

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[2] Example adapted from *Thaler, infra*.

Thaler notes, not in the context of law billing (interestingly):

"[C]onsumers don't like the experience of 'having the meter running'. This contributes to what has been called the 'flat rate bias' in telecommunications. Most telephone customers elect a flat rate service even though paying the call would cost them less."

Decouple Having to Have the Consumer Assign a 'Value' to Each Hourly Charge

A decoupling device noted by Thaler is the credit card:

"We know that credit cards facilitate spending simply by the fact that stores are willing to pay 3 % or more of their revenues to the card companies…A credit card decouples the purchase from the payment in several ways. First, it postpones the payment by a few weeks. This delay creates two distinct effects: (a) the payment is later than the purchase; (b) the payment is separate from the purchase. A second factor contributing to the attractiveness of credit card spending is that once the bill arrives, the purchase is mixed in with many others," Thaler, infra (emphasis added).

Takeaways for us: credit cards can be used for a service business. But beware of credit card fraud, of which there is no insurance. So perhaps the trade offs are not as positive as we think.

How else can we decouple our services? To the extent we can get clients on a flat retainer, or an annual charge, and include as many services as possible, this will decouple (as will a "project" fee). As a mental exercise, can you decouple one estate planning project into 20 distinct services provided by the documents?

Tax planning

Income tax planning

Creditor protection

Funeral plans

Protection against a child being a spendthrift

Providing for the children's education

Protecting assets in the event of disability

Providing for a child's disability

Providing health care alternatives

Organ donation options

Guardians for the children

Providing for the kids' education

Providing liquidity at a person's passing.

Doing beneficiary designations correctly

Reallocating assets

Funding for college

Preserving tax-free nature of retirement planning

Assessing insurance needs

Getting rid of household stuff

Preserving peace in the barnyard

Give of Yourself

What else can we do? Is “discounting” off the hourly rates or bill effective? *See* attachment 1, what do you think? I couldn’t find a discussion of evidence one way or the other that would have indicated that this is effective.

But one item that is effective, and a bit more subtle than discounting, is that “luxurious gifts can be better than cash,” which according to Thaler, is “well known to those who design sales compensation schemes.”

What are we doing for clients above and beyond providing them services?

Framing

Because people are loss adverse, ponder whether we can achieve better fees by framing fees in the positive, e.g., contingent fees if there are tax savings. For example, if our billing practices were set up so that clients merely had to pay us if they succeeding in achieving tax savings, that would be easier to bill and many of us would now be retired.

> *Example 5: in 1984, for A-B plans, we would describe to clients that if we were able to achieve a tax savings greater than without estate plan, we would be paid 20 % of the tax savings, <u>but only at that point.</u> Most clients would be delighted with this option. Sound bad to you? It should not. Consider the average time to payoff for a client age 65 would be less than 20 years. What’s the current value in 1984 of tax savings in 2004? In 2004, the credit was, say, 1.5 million. So the savings with an A-B plan could be $750,000. 20 % of this amount would be $150,000. Ignoring the friction associated with transaction costs to collect this amount, the discounted present value in 1984 of $150,000 to be received in 2004 at a 5 % discount rate is $56,533 ($150,000/(1+.05)^20). Yes, we would all be done at this point in our practice. Not only that, but those of us who are older could have monetized our practices and sold these fee arrangements in 2004, without having to work another day.*

To the extent bills are detailed in their descriptions, or projects summarized in cover letters, we should not be afraid to frame in the positive versus the negative. E.g., which sounds better: “Draft of trusts to address estate tax issues;” or “Incorporation of estate tax savings trusts.” Or, “Draft of generation skipping trusts” versus “structure of trusts to prevent the payment of estate tax as assets move from generation to generation.”

Formatting Bills

Attachments 1-3 provide sample billing formats, which all correctly report the time and effort on a matter. Attachment 3 is the most detailed, but also the least friendly and most offensive to most estate planning clients. In determining which format to use for individual clients, the question should be asked: which one provides the kind of information that would be useful to the client in addressing the value provided, and therefore the amount of the bill.

Attachment 1 provides an evolving format of what could be useful to the client. Attachment 1-a is an unedited day by day description of the work done, without too much thought of its impact on a client reading it. Attachment 1-b creates a better picture of what was done. Attachment 1-c is a narrative summary of the actions taken. Commentators believe that 1-c is preferable to 1-b, but it should be considered and tried only on a case by case basis.

Pre-Mortem Billing: Macro Takeaway

How interesting behavioral finance is to what we do on a day to day basis. I would theorize that focus on this area could be the single greatest untapped value to us as practitioners. But it does require thought and focus, and effort for which no hourly payment is immediately made. We sometimes become so focused on short term results associated with hourly billing that we miss the retirement forest for the billing trees.

The Best Practice Summation (discussed in outline and power point presentation)

1. Discuss fees during the initial meeting
2. Time that discussion for the tail end of the meeting
3. Determine a fee quote at the first meeting
4. Deliver fee quote in a thought out manner and make sure you believe in and deliver the quote in a way conveying fairness
5. Have client provide down payment or retainer before engagement begins
6. Understand that Fairness matters to clients – clients want to pay for services that they perceive as Fair
7. Many estate planning projects will be perceived as Fair if quoted as a Flat Fee
8. To demonstrate Fairness, make sure that all the component parts, and accomplishments, with the estate planning project are demonstrated throughout the project; also, deliver excellent service; also, de-cliché clichés
9. Divide estate planning BIG PROJECT into sub projects so that value and accomplishments can be more easily understood
10. Value added billing can be considered but must be addressed in the engagement letter
11. Send bills frequently and timely
12. On a bill, do not exceed a quoted fee unless explained and discussed with the client during the project
13. Connote value in the bill itself and descriptions; spend time with each individual bill
14. Make sure to consider the format of the bill that will most easily connote value and which will avoid the Client's Loss Aversion function
15. Decouple services and bill, when possible
16. Discounting is appreciated by clients, in many situations
17. Demonstrate client care throughout the process by prompt service, attention, and non work communications

Attachment 1-a

Harrison & **Held, LLP** 333 West Wacker Drive, Suite 950 Chicago, III 60606-1218 www.harrisonheld.com

Invoice submitted to:

Marc and Cleo Antony
Estate Planning
One Mag Mile
Chicago, IL 60610

Invoice Number: 4950

July 01, 2007

Professional Services

		Amount
5/12/2006 CGW	Draft new wills, powers of attorney for property and health care and living trusts for Marc and Cleo Antony.	
5/15/2006 CGW	Continue to draft new living trusts for Marc and Cleo Antony (dispositive provisions including subtrusts for children; tax and trustee provisions); draft letter to Marc and Cleo summarizing key terms of their new estate planning documents, tax consequences thereunder and asset reallocation issues.	
5/10/2007 CGW	Review summary of proposed estate planning documents for Marc and Cleo Antony; work with Lou Harrison on fine tuning the Antonys' new plan.	
5/30/2007 LSH	Review and analysis of drafts of documents; update to fiduciary provisions; update to generation skipping provisions; transmittal for review.	
6/26/2007 CGW	Review file in preparation for meeting with the Antonys; meeting with Marc and Cleo to discuss drafts of their new estate planning documents and proposed revisions to documents. Begin revisions.	
6/27/2007 CGW	Revising and finalizing living trusts and wills for Marc and Cleo; conference with Cleo regarding fiduciary backups; having documents prepared for execution.	
6/28/2007 CGW	Meeting with Marc and Cleo to execute estate planning documents; prepare for meeting; post-meeting notes regarding issues for follow up.	
6/29/2007 CGW	Draft letters to the Antonys and J. Caesar and send them booklets of the Antonys' new estate planning documents.	

Subtotal of charges	$3,682.50
Courtesy Discount	($182.50)
For professional services rendered	$3,500.00

Timekeeper Summary

Name	Hours	Rate

Canella G. Woyar (CGW)	10.40	325.00
Louis S. Harrison (LSH)	0.92	330.00

Attachment 1-b

Harrison & **Held, LLP** 333 West Wacker Drive, Suite 950 Chicago, III 60606-1218 www.harrisonheld.com

Invoice submitted to:

Marc and Cleo Antony
Estate Planning
One Mag Mile
Chicago, IL 60610

July 01, 2007 Invoice Number: 4950

Professional Services

		Amount
5/12/2006 CGW	Initial outline of distribution provisions to be included in estate planning documents, and outlining terms of credit shelter and marital trusts, for Marc and Cleo Antony. Determination to use Will/living trust format for the estate plan.	
5/15/2006 CGW	Draft distribution provisions for credit shelter and marital trust, to incorporate tax and creditor planning; work on terms consistent with decisions at meeting.	
5/10/2007 CGW	Draft trusts for children, including spousal and creditor protection features; work on trustee provisions in documents, including successor trustees, and means to appoint successors when none are named. including subtrusts for children; tax and trustee provisions). Draft letter to Marc and Cleo summarizing key terms of their new estate planning documents, tax consequences thereunder and asset reallocation issues.	
5/30/2007 LSH	Review and analysis of drafts of documents; update to fiduciary provisions; update to generation skipping provisions; transmittal for review.	
6/26/2007 CGW	Meeting with Marc and Cleo to review and discuss drafts of their new estate planning documents and proposed revisions to documents.	
6/27/2007 CGW	Following meeting, update and finalize living trusts and wills for Marc and Cleo to incorporate different distribution provisions, protective tax and creditor provisions for children. Follow up phone conference with Cleo regarding fiduciary backups; preparation of documents in final form.	
6/28/2007 CGW	Meeting with Marc and Cleo to execute estate planning documents; prepare for meeting; post-meeting notes regarding issues for follow up.	
6/29/2007 CGW	Calendaring key dates for review plan documents, to finish on funding and beneficiary designation update; Work and review of closing book to make sure no additional items needed. Work on document book to Cleo and Antony.	

Subtotal of charges	3,682.50
Courtesy Discount	(182.50)

For professional services rendered $3,500.00

Timekeeper Summary

Name	Hours	Rate
Canella G. Woyar (CGW)	10.40	325.00
Louis S. Harrison (LSH)	0.92	330.00

Attachment 1-c

Harrison & **Held, LLP** 333 West Wacker Drive, Suite 950 Chicago, III 60606-1218 www.harrisonheld.com

Invoice submitted to:

Marc and Cleo Antony
Estate Planning
One Mag Mile

Invoice Number: 4950

July 01, 2007

Professional Services

Amount

5/12/2006 CGW Initial outline of distribution provisions to be included in estate planning documents, and outlining terms of credit shelter and marital trusts, for Marc and Cleo Antony. Determination to use Will/living trust format for the estates plan; 5/15/2006 CGW _ Draft distribution provisions for credit shelter and marital trust, to incorporate tax and creditor planning; work on terms consistent with meeting; 5/10/2007 CGW Draft trusts for children, including spousal and creditor protection features; work on trustee provisions in documents, including successor trustees, and means to appoint successors when none are named. including subtrusts for children; tax and trustee provisions). Draft letter to Marc and Cleo summarizing key terms of their new estate planning documents, tax consequences thereunder and asset reallocation issues; 5/30/2007 LSH Review and analysis of drafts of documents; update to fiduciary provisions; update to generation skipping provisions; transmittal for review; 6/26/2007 CGW Meeting with Marc and Cleo to discuss drafts of their new estate planning documents and proposed revisions to documents; 6/27/2007 CGW Following meeting, update and finalize living trusts and wills for Marc and Cleo to incorporate different distribution provisions, protective tax and creditor provisions for children. Follow up phone conference with Cleo regarding fiduciary backups; preparation of documents in final form; 6/28/2007 CGW Meeting with Marc and Cleo to execute estate planning documents; prepare for meeting; post-meeting notes regarding issues for follow up; 6/29/2007 CGW Calendaring key dates for review plan documents, to finish on funding and beneficiary designation update; Work and review of closing book to make sure no additional items needed. Work on document book to Cleo and Antony.

Subtotal of charges	$3,682.50
Courtesy Discount	($182.50)
For professional services rendered	$3,500.00

Timekeeper Summary

Name	Hours	Rate
Canella G. Woyar (CGW)	10.40	325.00
Louis S. Harrison (LSH)	0.92	330.00

Attachment 2

Harrison & **Held, LLP** 333 West Wacker Drive, Suite 950 Chicago, III 60606-1218 www.harrisonheld.com

Invoice submitted to:

Marc and Cleo Antony
Estate Planning
One Mag Mile
Chicago, IL 60610

Tax ID

April 28,2008

For professional services rendered $3,500.00

Attachment 3: Illustration of a Not so Good Bill and Consideration of Its Impact on Client

Attachment 3.pdf

Attachment 4: The White Paper Techniques For Preferable Billing

Focus On

1. Fairness matters in billing. People are not necessarily looking for the lowest cost provider, or a certain amount for a project (clearly everyone wants a project done within their budget), but rather want to be billed for what they perceive as fair.

2. Fairness can be achieved by providing a cost for the overall project, or specific parts of the project, versus on an ad hoc hourly basis.

3. Hourly billing for estate planning will be met with antipathy no matter how presented--people view billable hourly rates as unfair.

4. People would rather incur a one time pain, say $X as a one line bill for a project, than repeated pains (say hourly charges that add up to $Y, even though $Y is less than $X).

5. Hourly bills can demonstrate the amount of time that was put into a project and that people actually worked on substantial elements of a project. Hourly bills conversely can create that people "overworked" a project even though that was not the case.

Change When Flat Fees are Possible

6. Therefore, reduce the bad client reception and reaction in an hourly bill. A shift to flat fee for defined projects wherever possible. To make certain that the client knows that substantial efforts will be undertaken, spend time (how much?) in the outlining of the many aspects of the estate planning project in a detailed cover letter -- what is included, what is not included. See page 7.

Change When Flat Fees are Not Possible

7. When not possible, format the bill to report effort and day, but not time. See attachment 1. When billing for entries, connote value.

8. Make sure bills are sent timely, tied to work product within fee quote.

9. Make sure engagement letter is specific and signed.

Justifying the High Cost of Legal Services

Understand that Estate Planning is different than other areas of the law. Corporate planning clients are not paying out of their pockets. Litigation requires that clients be interested in results.

In estate planning, clients are paying out of their own pockets for an event -- mortality -- that is really unpleasant. What are we doing to justify that we are worth the cost of the service?

10. Results are what we focus on; and that is a good start

11. Reputation

12. Speeches/articles/teaching/professional affiliation. How much are we touting this

13. Generic congratulatory letters from clients

14. Ambience of the lawyer's office and demeanor

15. Client Entertainment and Gifts

Can We Decouple Cost from Billing

16. Retainers

17. Credit Cards

18. Success Fees

Use Billing to Encourage Some Behavior and Discourage Others

19. Bill for Teleconferences

20. Bill for emails

21. Bill for travel time

22. Bill for social time in conferences

Understanding the Legal, Ethical and Emotional Aspects to Billing Practices and Collecting for Legal Services:
<u>Best Practices In the Estate Planning World</u>

By: Lou Harrison

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7-1 PPT