Gross Profits? An Introduction to a Program on Legal Fees

Roy Simon
Maurice A. Deane School of Law at Hofstra University

Follow this and additional works at: http://scholarlycommons.law.hofstra.edu/mlr

Part of the Law Commons

Recommended Citation
Available at: http://scholarlycommons.law.hofstra.edu/mlr/vol22/iss3/2

This document is brought to you for free and open access by Scholarly Commons at Hofstra Law. It has been accepted for inclusion in Hofstra Law Review by an authorized administrator of Scholarly Commons at Hofstra Law. For more information, please contact lawcls@hofstra.edu.
GROSS PROFITS? AN INTRODUCTION TO A PROGRAM ON LEGAL FEES

Professor Roy Simon

Do lawyers earn gross profits? That is, do lawyers earn "too much"? A recent survey indicates that a majority of people think that lawyers charge too much,¹ and the percentage of people who think lawyers charge too much has increased sharply in recent years, but is the public right? The Association of American Law Schools (“AALS”) Section on Professional Responsibility organized this symposium to give us some data on that question.² At the live program, held on January 7, 1994, the entire audience consisted of law professors who teach and write about professional responsibility. In this written symposium, we hope to broaden our audience to include lawyers, law students, and other professors.

We liked the title "Gross Profits?" because it gave us a lot of flexibility to talk about topics that are difficult to research in the library and are seldom covered in the classroom.³ Eventually, we decided to focus on lawyer billing practices. But before we ask our three speakers to discuss billing practices, let me describe a number of topics that we could have addressed under the rubric of "Gross

² The Association of American Law Schools is the main umbrella organization for legal educators. Virtually all American and Canadian law schools are full or partial members of the AALS. The AALS holds an annual meeting each January. This symposium was organized by the AALS Section on Professional Responsibility and was held in Orlando, Florida. We are grateful to the Hofstra Law Review for editing and publishing the symposium.
³ Near the start of the program, I asked for a show of hands to indicate whether the professors in the audience spent any time on lawyer billing practices in their courses on professional responsibility, (I made it clear that I was asking specifically about time spent on lawyer billing practices, not about legal fees in general.). Roughly one-third of the people in the audience said they did. However, fewer than ten percent said they spent an entire class on billing practices, and only one person in the audience said he spent more than one class on billing practices. We hope that the information in this symposium will enable professors to spend more time discussing billing practices.

625
Profits?" but decided not to. I mention these "wannabe" topics because they represent areas where fruitful research could be done—especially empirical research, of which there is far too little.

I. WHAT WE COULD HAVE COVERED

Using the title "Gross Profits?" we could have presented a program about any of the following intriguing topics:

Law firm profits. We could have discussed in some detail law firm profits. We could have looked through the National Law Journal's top 250 firms or the American Lawyer "100" to see what types of firms are earning a lot of money. For example, we would ask which fields of law, which geographic areas, what total size, what kinds of clients, and what partner-to-associate ratios produce the highest revenues per partner. Then, using whatever moral compass we follow, we could try to decide whether the partners are earning too much.

Lawyer incomes. We could have looked at the incomes of lawyers in general. The public thinks lawyers make a lot of money, but there is not much hard data. A study of New York lawyers, released in late 1993, found that twenty-five percent of all New York lawyers earn less than $46,000 per year; fifty percent make less than $90,000 a year; seventy-six percent make less than $120,000 per a year; and only twenty-four percent make over $120,000 per year. Does that make lawyers wealthy? We cannot say, but the information accompanying the New York State Bar Association study says that Archibald R. Murray, president of the Association, hopes the findings will combat the image that all lawyers make large sums of money.

Contingent fees. We could have talked about contingent fees. Several topics would have been interesting. For example:

6. Id.
• **Effective hourly rates.** We could have looked at effective hourly rates in contingent fee cases. Professor Lester Brickman of Cardozo Law School, among others, has done a lot of work in this area and he reports that it is routine for certain lawyers on contingent fee to earn $1,000 or $2,000 or even $5,000 an hour.\(^7\) In a few instances, such as asbestos cases (which may be an aberration), Brickman reports effective hourly rates up to $50,000 per hour.\(^8\) That is very good work if you can get it.

• **Risk-to-return ratios.** We could have examined risk-to-return ratios on contingent fees. How many lawyers are charging their standard contingent fees for cases with relatively little risk? For example, how many lawyers are charging their standard contingent fees for obtaining a settlement that is only slightly better than what the defendant offered the client before the lawyer was even retained? How many lawyers are charging standard contingent fees for handling cases such as comparative negligence cases where liability is virtually certain and the only question is the amount of damages? (By the way, although we tend to think of the standard contingent fee as one-third of the recovery, Brickman reports that contingent fees of forty percent or fifty percent are increasingly common, even in cases with minimal risk of non-recovery.)\(^9\)

• **Unethical fee structures.** We could have looked at unethical fee structures. A Florida lawyer, for example, was recently suspended because his contingent fee retainer provided that if he withdrew from a case, he was nevertheless entitled to *quantum meruit* for the time he had spent up to the time of his withdrawal *plus* one-third of the contingent fee received by the lawyer who took over the case.\(^10\) The Florida Bar thought that it was excessive and the Florida Supreme Court agreed.\(^11\)

• **Non-refundable fees.** We could have looked at the ethics of non-refundable fees and minimum fees. For example, we could

---

8. Id.
9. Id. at 1772 n.52.
11. Id.
have discussed the leading case, *In re Cooperman*,\(^{12}\) which was decided by the New York Court of Appeals less than two months before our symposium. Cooperman was charging $5000, $10,000, sometimes $15,000 in non-refundable fees in divorce cases and criminal cases. His retainer agreement said that no matter how little work he did on the case, and no matter what the reason for his withdrawal, his fee was not refundable.\(^{13}\) The Court of Appeals found that practice to be unethical—but the court left open the door for “minimum fees,” which look a lot like non-refundable fees.\(^{14}\) What are the rules on minimum fees and non-refundable fees now? What should they be?

- **Legal fees in divorce cases.** We could have devoted our entire symposium to legal fees in divorce cases. For example, we could have studied New York’s new rules on divorce fees, which became effective November 30, 1993.\(^{15}\) These tough new rules require divorce lawyers to estimate what their total bill will be, and to give divorce clients a lengthy statement on client rights, before beginning any legal work.\(^{16}\) Or, we could have discussed a disturbing but fairly common tactic of some Chicago law firms.\(^{17}\) These firms generate business by taking on new clients in divorce cases and churning the file until the client runs out of money for legal fees. Then the firm withdraws.

- **Statutory fees.** We could have studied statutory fees in civil rights cases to see whether civil rights lawyers are earning gross profits. We could start with the example of *Riverside v. Rivera*,\(^{18}\) where a $33,350 damage award produced a $245,456.25 fee award.\(^{19}\)

---

\(^{12}\) 83 N.Y.2d 465 (1994).
\(^{13}\) Id. at 469.
\(^{14}\) Id. at 473-76.
\(^{15}\) The new rules apply to lawyers representing clients in “divorce, separation, annulment, custody, visitation, maintenance, child support, or alimony, or to enforce or modify a judgment or order in connection with any such claims, actions or proceedings.” N.Y. DOM. REL. LAW § 1400.1 (McKinney 1994).
\(^{16}\) N.Y. DOM. REL. LAW §1400.2-4 (McKinney 1994).
\(^{17}\) John Elson, a professor at Northwestern University whose teaching duties include clinical work, told me about this problem. His clinic litigates a lot of divorce fee cases in Chicago and he reports that this is a fairly common practice. He did not know exactly why courts are letting firms out of cases when they use this tactic of churning the file and then moving to withdraw.
\(^{19}\) Id. at 565.
The award was affirmed by the Supreme Court over a sharp dissent by Justice Rehnquist and then-Chief Justice Burger, who thought the fee was excessive. We could follow up to see whether civil rights lawyers have continued to win such generous fee awards. But we would need to raise the counter-example of *Farrar v. Hobby*, where a lawyer litigated for many years, and won, but was awarded no fee because the complaint sought $17,000,000 but the jury awarded only a dollar. We would also need to look at *City of Burlington v. Dague*, where the Supreme Court held that multipliers for the risk of non-recovery in statutory fee cases are improper. I suspect we would have concluded that civil rights lawyers are not earning gross profits, but empirical work needs to be done.

- *Monopoly profits*. We could have taken a macro-economic approach and asked whether lawyers are earning monopoly profits. Lawyers are licensed to enter a field that is heavily protected by unauthorized practice laws, and enforcement of unauthorized practice laws is undergoing a revival in some jurisdictions. Even those who graduate from law school must surmount barriers to entry in the form of a bar exam and a character and fitness test—and some have alleged that the bar exam is graded not with an eye to competence but rather with an eye toward controlling the number of lawyers. To make matters worse, non-lawyers cannot share in our monopoly fees because Rule 5.4 of the American Bar Association ("ABA") Model Rules of Professional Conduct prohibits lawyers from sharing legal fees with non-lawyers. (For good measure, the same rule prohibits lawyers from forming partnerships with non-lawyers if any of the partnership's activities include the practice of law.) There is substantial pressure in many quarters to relax the laws prohibiting unauthorized practice, but lawyers are a long way from giving up their

20. *Id.* at 581, 587-95.
22. *Id.* at 570-71.
24. *Id.* at 459.
25. This was the central allegation in *Hoover v. Ronwin*, 466 U.S. 558, 579-80 (1984), in which an applicant who had failed the bar exam challenged Arizona’s method of setting a passing grade for the bar exam. The case was dismissed on grounds that the Arizona Supreme Court was immune from antitrust liability under the state action doctrine established in *Parker v. Brown*, 317 U.S. 341 (1943).
27. *Id.*
exclusive right to practice law and the monopoly profits that go with it.

- The global marketplace. We could have addressed an even broader macro-economic question: Are excessive legal fees crippling America's ability to compete in the global marketplace? During the 1992 presidential campaign, former President George Bush cited a study by the National Association of Manufacturers claiming that American consumers and companies would spend up to $200 billion on legal services during 1992. But Professor Mark Galanter of the University of Wisconsin has extensively researched this figure and has demonstrated that it is wrong. In a recent article in the Denver Law Review entitled *News from Nowhere: The Debased Debate on Civil Justice*, Professor Galanter shows that America does not spend anything close to $200 billion a year on legal services. Galanter concludes, however, that we simply do not have an adequate knowledge base about our legal system, and he decries our ignorance, saying:

Why do we tolerate a knowledge base about the legal system that is so thin and spotty? Compared to the economy or health care or education, research about legal processes, especially civil, is ludicrously thin; so thin that it is perfectly routine for far-reaching policy proposals to be advanced on the basis of tendentious macro-anecdotes and voodoo numbers.

Pertinent to our program here today, Professor Galanter does not spare the law schools. He says:

But what about our vast archipelago of law schools, whose professors and students fill hundreds of journals with the products of legal scholarship? This great flood of scholarship does not provide an adequate knowledge base, because, basically, it is not interested in the working of the legal system.

... Abetted by the bar, law schools have largely defaulted on their responsibility to contribute to knowledge about the working of the

---

29. Id.
31. Id. at 112-14.
32. Id. at 124.
legal process. It is as if we had a medical establishment consisting entirely of practicing physicians and theoretical biologists, with no research institutions like the National Institutes of Health and no public health monitoring facilities like the Center for Disease Control.

In this symposium, we are interested in the working of the legal process. And we have found three people who know a good bit about the slice of the legal process that we will be covering. So let me tell you exactly what we will be addressing.

II. WHAT WE WILL COVER: LAWYER BILLING PRACTICES

We are going to cover lawyer billing practices in hourly rate cases. Our focus will be on why so many people think legal bills are too high, and what people mean when they say the bills are too high. Do they mean that the bills are too high in some moral sense (i.e., "gross" or obscene)? Do they mean that lawyers are billing for unnecessary work, or are billing for work that could have been performed more efficiently? Or, on a more sinister note, do people mean that lawyers are billing for work they did not even do (i.e., that lawyers are submitting fraudulent bills)?

Intertwined with these questions are parallel questions about expenses. In hourly rate cases, lawyers universally bill not only for their time but also for their expenses.

These are very current topics. Let me provide some examples:

At the time of the symposium, I picked up the Wall Street Journal and found a major story on how corporate clients were trying to control legal fees. Summarizing a new survey by Of Counsel, a newsletter for the legal profession, the story reports that companies "are increasingly asking outside law firms to bid for legal work, a development that lawyers are none too enthusiastic about." The survey indicates that one-third of the large clients surveyed are asking law firms to submit proposals for prospective legal work, and sixty percent of the firms requesting proposals think they were working very well—but only twenty-nine percent of law firms thought that these proposals were working very well. Why the difference? Partly

33. Id. at 124-25.
35. Id.
36. Id.
because the law firms have to do a lot of work for free to produce a proposal. The net result is lower fees, both because of competition for the low bid and the free work included in the proposal.

Also at time of the symposium, I was given a free copy of the Los Angeles Daily Journal and I came across a front page story about a criminal fraud trial accusing a law firm of systematically padding bills, as in the book (and movie) The Firm. The scheme worked like this: the managing partner at a workers’ compensation defense firm concluded that the lawyers in his firm were not billing all of the time they were spending, so he devised a system that would recapture “lost” time. If an attorney billed .2 hours, the managing partner automatically bumped it to .3 hours, and if an attorney billed .3 hours, the managing partner automatically bumped it up to .4 hours. The theory was that the attorneys recorded less time than these things actually took. The managing partner did not deny that he had bumped up the recorded hours, but argued that it was justified as a more accurate reflection of the time spent than the recorded hours.

Shortly after the symposium, the American Bar Association’s Standing Committee on Ethics and Professional Responsibility released a formal ethics opinion on billing clients for fees and expenses. The opinion advised that a lawyer who spends four hours at the courthouse attending motion arguments for three different clients on the same day may not bill each client for the full four hours (i.e., the lawyer may not ethically bill twelve hours for only four hours of work). A lawyer who spends (and bills) ten hours drafting a research memorandum for one client may not charge a second hourly rate client the same ten hours for the same memorandum if it takes less than ten hours to update the memo. In sum, the Ethics Committee said:

[a] lawyer who has undertaken to bill on an hourly basis is never justified in charging a client for hours not actually expended. If a lawyer has agreed to charge the client on this basis and it turns

38. Id.
40. Id. (“A lawyer who spends four hours of time on behalf of three clients has not earned twelve billable hours.”).
41. Id. (“A lawyer who is able to reuse old work product has not re-earned the hours previously billed and compensated when the work product was first generated.”).
out that the lawyer is particularly efficient in accomplishing a given result, it nonetheless will not be permissible to charge the client for more hours that were actually expended on the matter . . . . This is not to say that the lawyer who agreed to hourly compensation is not free, with full disclosure, to suggest additional compensation because of a particularly efficient or outstanding result, or because the lawyer was able to reuse prior work product on the client's behalf. The point here is that fee enhancement cannot be accomplished simply by presenting the client with a statement reflecting more billable hours than were actually expended.  

On the subject of expenses, which play an increasingly important part in law firm profits, the Ethics Committee opined that a lawyer who receives a discount from a court reporting firm or other vendor must pass the discount along to the client unless the client consents otherwise, and that—absent a specific agreement to the contrary—services like photocopying, computer research, and on-site meals may be billed to clients only at the cost of the services plus the reasonable overhead associated with those services.  

The ABA's opinion on fees and expenses generated a good bit of press, including a fairly sarcastic op-ed column from sociologist Amitai Etzioni asking why lawyers needed to be told these things at all.  

In the Spring of 1994, several months after our symposium, Associate Attorney General Webster Hubbell resigned amidst charges that before he joined the Department of Justice he had overbilled his clients back in Arkansas by hundreds of thousands of dollars. Mr. Hubbell's hero-to-zero resignation added nothing new to the intellectual aspects of billing theory, but it did add a powerful anecdote to the stories we can tell about the penalties for questionable billing practices.  

Finally, the August 1994 ABA Journal ran a feature article entitled *Greed, Ignorance and Overbilling*, which discusses sixty-hour days, double billing, criminal convictions for overbilling, and other

---

42. Id.
43. Id.
44. Id. For photocopies, for example, the lawyer may charge both the actual cost of each copy plus overhead items such as the salary of the photocopy machine operator.
misdeeds of lawyers suffering from "greedlock" (my term).\textsuperscript{48} The article also discusses the small but growing number of lawyers who make a living by auditing legal bills.\textsuperscript{49} We are fortunate that John Marquess, one of the most prominent legal auditors, was able to participate in this symposium. His article, filled with surprising illustrations of unethical conduct from actual legal bills, is likely to trouble and provoke you.

Lawyer billing practices are something of a mystery. The only people who know whether lawyers overcharge are the lawyers who send the bills, the clients who receive the bills, the people who audit the bills, and the scholars who study the bills. Lots of people send and receive legal bills, but little scholarly research has been done about billing practices because lawyers are seldom willing to disclose their billing practices (would Macy tell Gimbel?), and the confidentiality rules probably prohibit lawyers from showing scholars copies of actual bills.

One exception is a 1991 survey of billing practices by Professor William Ross of Cumberland School of Law.\textsuperscript{50} Professor Ross collected data about overbilling from 272 private attorneys and 80 in-house lawyers, from law firms and companies of all sizes, in many geographic locations.\textsuperscript{51} A whopping ninety-two percent of the lawyers who responded believed that lawyers intentionally inflate their hours, and sixty-five percent knew of specific instances of padding.\textsuperscript{52}

Another exception is a 1990 survey of lawyers by Professor Lisa Lerman of Catholic University School of Law.\textsuperscript{53} This article presented gripping stories of the ways in which lawyers lie to their clients about legal bills.\textsuperscript{54} Professor Lerman's article attracted widespread attention in the popular press, including a column by \textit{New York Times} legal writer David Margolick.\textsuperscript{55} As a result, Professor Lerman has been a lightning rod for other attorneys who have wanted to talk about deceptive billing practices. Professor Lerman is taking part in

\textsuperscript{48} Id.
\textsuperscript{49} Id. at 65. The story prominently mentions Philadelphia legal auditor John Marquess, who takes part in this symposium.
\textsuperscript{51} Id. at 5.
\textsuperscript{52} Id. at 93.
\textsuperscript{54} Id.
\textsuperscript{55} David Margolick, \textit{At the Bar; Spot Quiz: What Are You Punished for as a School-child but not as a Lawyer?}, \textit{N.Y. Times}, Mar. 18, 1994, at A22.
this symposium, and will tell us some fascinating stories about overbilling and what might be done to curb it.

Finally, and fittingly, we have a client on our symposium panel to discuss legal fees from a client’s perspective. This is no ordinary client. This is Citibank Credit Corporation, the people who bring you Citibank’s MasterCard and Visa cards. The corporation spends $33 million each year on legal fees. The entire legal budget is overseen by one man, Duncan MacDonald, who is Vice-President and General Counsel of Citicorp Credit. Mr. MacDonald is taking part in our symposium, and will give us the views of a client who works with some 2,000 different law firms around the country each year.

Thus, our symposium brings you the perspectives of a client, an auditor, and a scholar. At the end, we add the questions and comments of the audience, including comments by several of the most prominent scholars in the field of legal ethics. (At the AALS Annual Meeting, the word was that the live symposium was highly provocative and that the comments from the audience got hot and heavy.)

The only perspective we are not giving you is the perspective of the lawyers who send the bills. I guess the lawyers—and their bills—will have to speak for themselves. Let us hope that this symposium will spur all of us, including lawyers, to learn more and to think more deeply and more carefully about lawyer billing practices.