

Overline:

Headline:

Fees: How To Charge, Collect and Defend

Deck: Understand the legal and emotional aspects to billing and collecting for legal services

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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 in any business, we expect that fees charged should equal fees collected and feel a certain amount of indignation when our bills go unpaid.

Well, attorney, heal thyself. Ask yourself: Did I do everything I should have in presenting and collecting my fees?

Much has been written for lawyers on best practices regarding bill and fee collection. But fees in estate planning are quite a bit different.<sup>1</sup> Pre-mortem estate planning can be a tough sell because it forces clients to contemplate their deaths. Traditional methods of billing for legal services in many ways exacerbates this problem. But other methods are available and tweaks to current practices possible. Behavioral economics offers important lessons that can be adapted to billing for estate-planning services.

Among the most important insights: ditch hourly billing wherever possible, xxxxxxxx

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<sup>1</sup> We should note that although many of the billing principles are the same in pre- and post-mortem matters, there are important differences. The most significant is that detailed billing, which may not be relevant in pre-mortem matters, is significant and required in post-mortem matters because of X, Y and Z. But we'll stick to pre-mortem matters in this discussion.

## **Kill the Messenger**

Pre-mortem estate planning refers to tax planning, wills, living trusts, grantor retained annuity 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: Where does the property that I have worked hard for during my life go when I die?

This is not a fun discussion. Little wonder that clients are reluctant to engage in it. So, even when we lawyers add significant value to their estates, let's say we save them \$5 million in future estate taxes, a current bill even of \$25,000 may seem repugnant. Let's face it, a bill for \$10 may seem repugnant under those circumstances.

It's the process of what they are doing, not necessarily the service we provide or value add, that is painful for clients to accept. (White collar criminal defense lawyers who keep a client out of jail may find clients more grateful and open-handed. Maybe.)

Understanding that we estate planners carry the faint whiff of the undertaker with us, what should our best billing practices be?

First let's all admit that current billing practices are subpar and done simply because they were done before.

### **A New Paradigm**

Here are six hypotheses we've made on the road to finding a new model for estate planning billing practices:

(1) Behavioral economics teaches that there is nothing rational about consumer behavior. As practitioners, we often fail to take this fact into account and think strategically about our billing practices.

(2) Practitioners spend about 10 percent of the amount they should on billing, and disregard its importance to clients' happiness in general and with their estate planners' services in particular.

(3) Practitioners delay billing because they know that clients often experience their charges as unpleasant. But delay only exacerbates the problem.

(4) Perception problems are the fault of the practitioner, not the client. Say a 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. Don't blame the clients.

(5) Which billing format would make a client happier: a detail explanation of services rendered or one line statement? Would it shock you if we said that in the vast majority of cases the simple statement is preferable? (See "name of chart 1," p. x)

(6) Technology has increased the quality, efficiency, and lowered the cost of producing estate-planning work product. But this efficiency is not reflected in the billable hour concept, nor do clients accept that they should be billed for this efficiency. As practitioners, we have not developed a way to charge for technology.

### **What're We Missing?**

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 a good value. But we practitioners fail to take into account a fundamental tenet of economics: The rational consumer does not always make rational choices. Rather, consumers are influenced by their own mental accounting.<sup>2</sup> Indeed, consumers often behave irrationally.

What do we mean by "mental accounting"?

In "Mental Accounting Matters," a 1999 article that appeared in the *Journal of Behavioral Decision Making*, Richard Thaler, one of the nation's leading behavioral economists, explains: Financial accounting consists of numerous rules and conventions that can be explored

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<sup>2</sup> Richard Thaler, "Mental Accounting Matters," 12 *Journal of Behavioral Decision Making* 183-206 (1999).

in a textbook. But mental accounting rules—a description of the ways consumers perceive their economic choices—can only be observed by behavior and inferring the rules.

So, say you go to the store to buy your favorite movie on a DVD. It's 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. Would you travel to the Walgreen's to make the purchase?

Then say you're at an electronics store and a salesperson says a stereo system costs \$499. Your best friend says the same system is available at \$489 at a store 15 minutes away. Would you travel to the other store to make the purchase?

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.

### **The Hourly Rate**

So how does this irrationality and perceptions of fairness translate to their legal bills?

We believe that most clients would see \$350 as way too much to pay for a lawyer to spend an hour just thinking about an estate plan.

Yet the same clients would find it reasonable to pay a much larger bill of, say, \$5,000 for a tangible work product, estate-planning documents that achieve estate tax savings, creditor protection trusts, management of assets in the event of disability, and so on.

That's why we suggest that practitioners get away from hourly billing and, as much as possible, engage in project/value billing for estate planning.<sup>3</sup>

Does it work? Our experience suggests that it does. Lou recently spent about an hour coming up with an estate-planning wrinkle for a client that saved the client about \$500,000 on a strategy. If he'd quoted an hourly rate of \$2,000, then sent a bill for \$2,000, the client would have been upset. If instead, Lou quoted a flat fee of \$5,000 to try to implement a strategy that would save \$500,000, the client probably would be satisfied—depending on the framing of the

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<sup>3</sup> We are not suggesting project billing for estate administration or contested litigation.

project and ultimate resolution. Instead of paying \$2,000 just for an idea, the client was paying \$5,000 for the idea and its implementation.

### **Perception of Fairness**

Consumers are happier when they perceive themselves as having been treated fairly. The product, result or cost can be the same. Indeed, consumers can even pay more or get a worse result. So long as they think they were treated fairly, they will be more content.

This psychological phenomenon works in the reverse as well. If people perceive themselves as having been treated unfairly, they get angry even if they get the same result. You know this to be true. Just think about an Internal Revenue Service 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. We all know that odds are if the agent perceives one taxpayer as trying to pull a fast one over him, and the other taxpayer as acting reasonably and honestly, the agent is more likely to audit Fast Eddie's return more ferociously.

The "perception of fairness" factor operates in all settings. Imagine you're sitting on the Beach at La Semana in St. Marteen's, hot as the dickens. And thirsty. Your buddy says he is going to buy a beer at the hotel and asks if you want one. You say "yes," and he asks if you care how much it costs, even if it costs as much as \$15? You say that you don't mind. The hotel at which you're staying is expensive, so you expect that it'll charge a lot for beverages. Your buddy decides not to go. Instead, a teenager with a push cart comes buy and asks if you would like ice cold Heineken. "Yes," you think, until he says he wants to charge \$15 for the drink. You don't buy the beer because you feel the kid's overhead is low, so he shouldn't be charging so much.<sup>4</sup>

So what does the "perception of fairness" theory teach lawyers?

Once again, we have an argument against the hourly rate. Because no matter what the rate or total charged, it rarely will be perceived as fair.

Still, we have to stick with the hourly rate, we can dress it up to make it more appealing. There are many ways. One is quite literal: Lawyer, dress thyself well.

I am a casual guy but never understand why anyone in our profession would want to dress casually in a professional setting. Present yourself like the expensive hotel, not the teenager

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<sup>4</sup> Example adapted from Thaler, *infra*.

on the beach selling beer. A lawyer in a nice suit connotes value, suggesting a certain professionalism that carries with it the expectation that the charge for services will be substantial.

Be well groomed, manicured, well spoken.

Make sure your offices are equally presentable.

Back up these appearances with evidence of your professional affiliations, speeches given, articles written, reputation made, and other clients serving as references (careful to preserve confidentiality, very important for estate planners).

Price should never be a factor in trying to convince a client to use your services. “We’re cheaper” is just about the worst marketing technique you could use.

It is smart, however, to let clients know that the costs for your services will be in the range of what others at your level costs. That will add to the client’s perception of fairness.

Some would even argue that you charge more than your peers, the better to convince clients that you think you’re worth more. Martha Stewart made her start selling cookies and charging gourmet prices for them.

I prefer to stick with delivering a superior work product at a fair price.

### **Pull the Band Aid Off Quickly**

People experience the marginal pain caused by incremental losses as greater than the larger pain felt because of one big loss.

When it comes to lawyers’ billing, therefore, a bill with 20 daily time entries feels like 20 losses to the client. Such a bill is more painful for clients to review than a bill with one entry. (See “name of chart 1,” p. x.)

Thaler the behavioral economist explains this phenomenon: “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.”<sup>5</sup>

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<sup>5</sup> *Supra* note 2, at 192.

What does this mean for our billing? Flat fees avoid the marginal pain associated with each hourly “loss.” Thaler notes: “[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.”

Even when using flat fees, avoid breaking items out. Free consumers from assigning a value to each charge. Consumer may get greater transaction utility out of powers of attorney than out of the drafting of a complicated trust, but when each of these items is listed separately on a bill, the consumer will evaluate each separately and determine whether he got his moneys worth for each.

Thaler notes how credit cards employ this “decoupling” device: “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.”<sup>6</sup>

Here’s a thought: Credit cards can be used for service businesses. It is possible to let clients pay for legal services with credit cards. One caveat: we need to beware of credit card fraud, for which there is no insurance

How else might we decouple our services from our charges? Consider flat retainers, annual charges, along with project fees.

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

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<sup>6</sup> *Supra* note 2.

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 to make the whole billing process more palatable?

Is discounting hourly rates or a bill effective? I couldn't find evidence one way or another.

But one concept we might incorporate into our billing item clearly does have in impact, although it's more subtle than discounting. Thaler notes that "luxurious gifts can be better than cash." This phenomenon is, says Thaler, "well known to those who design sales compensation schemes."

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

Because people are loss-averse, ponder whether we can achieve better fees by framing fees in the positive, that is as 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 succeeded in achieving tax savings, that would be easier for us to bill and many of us would now be retired.

For example: In 1984, for A-B plans, we would describe to clients that if we were able to achieve a tax savings greater than without an estate plan, we would be paid 20 percent of the tax savings, but only at that point. Most clients were delighted with this option. Sounds like a bad deal for the lawyer? It isn't. Consider that less than 20 years is the average time until the lawyer receives a payoff for a client who's 65 years old. Consider, too, 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. Twenty percent 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 percent discount rate is \$56,533 ( $\$150,000/(1+.05)^{20}$ ).

Bills handled this way would allow us all to retire early. Indeed, 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 have detailed descriptions or projects summarized in cover letters, we should frame services in the positive rather than the negative. For example, clearly it's more appealing to say "incorporation of estate tax savings trusts" instead of "draft of trusts to address estate tax issues." Also, clients would likely prefer to read that they are paying for you to "structure of trusts to prevent the payment of estate tax as assets move from generation to generation" rather than simply for you to "draft of generation skipping trusts."

### **Make the Time**

Behavioral economics has great lessons to reach us practitioners. But thinking about how we can translate these lessons into our billing practices takes time and focus—and nobody is paying us immediately for that effort. Yet in the long run it may pay off handsomely. Let's not miss the retirement forest for the billing trees.

