

How to Face a Triple Threat: The impact of economy, cost recovery and alternative billing on Big Law

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While everyone is talking about the current economic situation and the impact it has had on attorneys, it is only one facet of a three-pronged attack on the operational side of law firms and how they manage the practice of law. The other issues law firms are facing are the changes in the cost recovery landscape, and the increase of alternative fee arrangements. As with the current economic situation, both of these areas represent opportunities for the firms that embrace and adapt to the changes that are occurring in the marketplace.

IMPACT NO. 1: THE CURRENT ECONOMIC SITUATION

Much has been written in the last year about the economy and the impact on law firms with layoffs of partners, associates and support staff. Needless to say, it has forced many law firms to fundamentally change the way they practice law, which has caused a ripple effect through the support services of the firm. Obviously, the support services level of activity (copies, scans, prints, etc.) goes down as the volume of legal work decreases. The firms that have built a high degree of flexibility for equipment and labor into their support services contracts, and have leveraged the use of technology, have fared better than the ones who have not. Fundamentally, any contract entered into on behalf of the firm for support services should contain the following:

- for equipment; the ability to "right-size" (match equipment speed and functionality) throughout the contract for your current conditions. Also, you should have the ability to return equipment that is underutilized or no longer needed without lease buyouts, liquidated damages, early termination fees, etc.
- the ability to decrease volumes or service levels with a corresponding decrease in costs without penalties;
- obviously, competitive pricing and terms based upon your spending;
- the placement of technology to increase the cost-effectiveness and efficiency of the targeted area.

IMPACT NO. 2: CHANGES IN COST RECOVERY

The area of cost recovery has changed dramatically over the last few years as the way firms practice law has changed. Law firms no longer have a copy/fax environment, but rather their workflow has migrated to a print/scan environment. As illustrated in our 2008 Cost Recovery Strategy, a number of firms have unfortunately not yet migrated their cost recovery strategy and philosophy to match this workflow change.

Based upon the survey results, there are a sizable percentage of firms capturing print (as illustrated below -- 33 percent). This trend is more notable in firms with an international presence (interpreted as larger firms) of which 55 percent are currently charging for print.

Although the percentage of firms capturing print has remained consistent since 2006, more firms are now capturing from more devices such as local printers (increase from 38 percent to 50 percent) and multifunctional devices (increase from 75 percent to 86 percent). We attribute this increase to firms abandoning the first-set exclusion mentality and charging for all prints produced. Capturing the items

to be charged is half the battle, even more important is capturing "billable" volume, and minimizing internal and external (client) write-offs.

As part of the survey, results were obtained for the following:

- billable percentage -- the percentage of total dollars/units divided by dollars/units billed to a valid client matter number;
- internal write-offs -- the dollars/units captured by a cost recovery system but being "written-off" prior to making it to a client invoice;
- client write-offs -- the dollars/units captured by a time and billing system, billed to a client but not paid by the client.

Item	Firms Capturing (Percent)	Billable (Percent)	Internal Write-Offs (Percent)	Client Write-Offs (Percent)
Black and White Prints	33	56	12	12
Color Prints	33	39	25	35
Scans	26	66	17	5

In terms of net realization (Billable percent x Internal x client write-offs) the chargeback of scans delivers the highest rate of return followed by black-and-white prints.

To summarize, a number of firms have migrated to the print/scan model. For those that don't, or do not do so effectively, a continuing drop in billable cost recovery revenue will likely occur with the continued migration of copy output to print. They will be faced with increasing overhead costs that will inflate their rates.

IMPACT NO. 3: ALTERNATIVE BILLING ARRANGEMENTS

As more and more firms are faced with clients demanding alternative fee arrangements, either flat fee or performance-based, the impact on the firm's cost recovery revenue must be considered. In almost all alternative billing situations, direct costs and soft cost recovery are not considered part of the compensation, so there is little to be concerned about in regards to the chargeback of these costs. If the client will not reimburse the firm for internal soft-cost recoveries (if they consider it part of your compensation) then we recommend to our clients that they send the work associated with these clients to an outside vendor to generate a direct pass-through of these charges. If a client will not pay for either internal soft-cost recoveries or the direct pass-through of these costs, then firms must choose the lowest-cost alternative. In most situations this will be your internal operation. In summary, your support services operations are under attack not only from the current economic situation but from the changes in trends in cost recovery and the increased usage of alternative fee arrangements. The key points to keep in mind when assessing the situation are:

- maintain as much flexibility as possible in your support service contracts. Renegotiate contracts if appropriate;
- substitute technology for labor as much as possible;
- either develop a firmwide strategy for cost recovery that acknowledges the shift from the copy/fax to the print/scan model or be prepared to radically change your internal support services operation;
- under alternative fee arrangements, know what you are getting reimbursed for and structure your operation accordingly.

Those firms which take charge of their support services, hardware and technology will have a much better chance of surviving the current economic conditions. Revisiting the strategy in response to the print/scan paradigm shift as well as looking at cost recovery and billing arrangements with a fresh eye is beyond wise. In fact, it is integrally important to the financial health of the firm, both now and into the future.

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