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Headnotes

SKADDENOMICS

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On April 23 of last year Jerry Jackson, a senior associate in the Washington, D.C., office of New York's Skadden, Arps, Slate, Meagher & Flom, ordered coffee, juice, and Danish for four from Skadden's in-house cafeteria to be delivered to a conference room at 9:30 a.m.

When Jackson placed his order he provided a charge number so the food would be billed to a client, the South Florida Water Management District, which Skadden was representing in litigation over pollution of the Everglades National Park. On the form filled out by the cafeteria, the price of his order is listed at $23.80. After the charge was rounded to $24, a hand calculation marked that amount up by 40 percent. The total cost to the client: $33.60. Almost nine bucks apiece for coffee and Danish.

Call it Skaddenomics.

This meal, in a nutshell, represents what's gone wrong with big-firm billing. The very fact that Skadden--a law firm, last we checked, not a restaurant-- would nickel and dime a client by billing it for coffee and Danish, let alone add a 40 percent markup, shows just how far firms have gone in “unbundling” from their hourly rates what everyone used to be able to assume was overhead. And the fact that Skadden executive partner and spokesman Peter Mullen--who oversees operations at what we've repeatedly written is one of the nation's best-managed firms--justifies the exorbitant price of the meal as reflecting Skadden's actual cost can only lead one to wonder if senior associates are staffing his cafeteria. Is this the best that the world's supposedly best-run law firm can do in the way of cost-effective client care?

Despite an initial reaction of shock over Skadden's breakfast bill, most of us probably have a second reaction to it. Part of us likely says, “So what? That's the way these firms do business.” Which is true. Charges like this have become so routine--not just at Skadden, but, as the sidebar on page 94 shows, at firms like New York's Cravath, Swaine & Moore, Chicago's Sidley & Austin, and Los Angeles's Latham & Watkins--that they have become an accepted part of the culture of big-firm practice. An attitude has developed that regards clients as money trees that can be endlessly shaken, and it has become so ingrained that Mullen can defend a whole range of charges with straight-faced sincerity.

Rather than simply acquiesce to this way of doing business, it's time to start questioning the whole ethic behind it, as some tough general counsel have been doing for a while now. The practice of passing every conceivable “cost” on to a client is simply unfair and, indeed, downright unprofessional. Adding hidden markups to those supposed costs is worse. After all, lawyers at Skadden and other big firms are already paid handsomely not only for their expertise, but also for the tremendous resources that they can bring to a matter. So when they start charging for the cup of coffee they sip while offering their expertise, it's just plain greedy. It also borders on sneaky, especially if they mark it up. since it's almost impossible for clients to anticipate what firms will justify as appropriate to pass on.

It's not that these lawyers are crooks. The trouble is more deep-seated than that. These firms actually think these charges are fair and represent good management, and they pass them on with a sense of entitlement, not apology.

The cost to the client is more than just dollars. The need to be vigilant in guarding against such charges undermines the trust that should be at the core of a lawyer-client relationship. It also raises the very ominous question of whether lawyers are equally abusive in billing their most expensive commodity: their time.

MUCH ADO ABOUT DANISH?

Anyone who thinks this is much ado about Danish should consider what happened when internal auditors for the Water Management District began a routine audit of outside legal costs. Early this year, as they combed through Skadden's $6 million in billings on the Everglades case, they asked the firm to justify a range of expenses run up during two-and-a-half years of litigation. Skadden's response was surprising.

In a May 22 letter James Rogers, a partner in the Washington, D.C., office, where the case was staffed, notified the district that Skadden would rescind $526,306 in charges against an unpaid balance of more than $1.6 million. An 11-page statement itemized the credits:

• $262,418 for secretarial staff and $48,138 for word processing staff, both billed at $45 an hour.

• $110,000 in “print tender” charges, based on a 45-cent-per-minute fee for tending to documents as they ran through printers.

• $42,386 for meals gobbled by lawyers and staff in Skadden's D.C. office, as they worked through lunch or into the night.

• $32,523 spent principally to send employees who worked late home in taxis and dial-a-cabs.

• A series of smaller charges (under $5,000 each) for “PC staff and litigation support,”

copy service staff ($35 an hour), courier service (almost always Skadden employees), library staff ($45 an hour), and proofreaders.

This didn't end Skadden's capitulation. In a three-hour meeting on July 23 district officials presented Skadden lawyers with a draft report prepared by the auditors that called for negotiated reductions in, or credit for, an additional $637,670--this mostly for attorney time spent traveling, preparing expense reports and bills, second-chairing depositions, and getting up to speed on the case.

Here too Skadden caved, agreeing to absorb the full amount.

All told, in May and July Skadden knocked $1.1 million off the $1.6 million owed to it. Yet at no time did Skadden admit that its billings had been improper. Quite the opposite.

As partner Rogers noted in a letter to Florida attorney general Robert Butterworth, “We have determined that our statements for services rendered and costs and expenses incurred were generated in accordance with normal billing practices. . . .”

And on July 31 Skadden sent the Water Management District a 24-page memo in which the firm took issue with the findings in the audit and defended its billing practices. But the memo confirmed that Skadden had agreed to write off all of the charges questioned in the audit. “We wanted to settle this case and get the matter behind us,” Mullen explains.

It's understandable that Skadden wanted to be rid of the matter. The litigation, which was between the Water Management District and the federal government, had become a highly charged focal point of Florida politics. It had cost taxpayers millions, and when Governor Lawton Chiles took office last January, he made it clear he wanted it settled. When Skadden's fees became publicized, the firm became something of a whipping boy. Skadden resigned from the case in May, but the bill had remained unsettled while auditors spent 1,500 hours going over it.

Writing off $1.1 million may have been good damage control. But when Skadden offered its initial credit in May and agreed to a second one in July, it was hardly dealing from a position of strength, given the $1.6 million the Water Management District had yet to pay. If Skadden had already collected that money, it might have taken a harder line. “This is money . . . that's owed to us,” notes Mullen, explaining the firm's generosity. “It would have been different if we'd had it.”

“OTHER OVERHEAD EXPENSES”

The Water Management District tried to keep legal expenses in check when it hired Skadden. In an October 1988 letter the firm agreed to charge reduced hourly rates of no more than $300 for partners, $200 for associates, and $60 for paralegals. The letter also stated, “The firm will bill the district for costs incurred on the district's behalf in the course of this matter. Such costs may include filing fees, copying expenses, long distance telephone, or other overhead expenses which may be properly incurred during the course

of this representation."

But, as Skadden's bills would prove, this agreement offered little protection. For starters, the reference to "other overhead expenses" provided a hole big enough to drive an entire back-office operation through.

Skadden executive partner Mullen concedes that "what is overhead and is not overhead is obviously highly debatable." As he sees it, charges that are incurred specifically for a client can be passed on to that client, whether it's the cost of an airplane ticket or of word processing. Gone is the notion of a client covering simply "disbursements," defined by Webster's as "funds paid out." Skadden's bills assess clients for "charges" as well, a term that should be read as "overhead."

Mullen rejects the notion that clients who come to firms like Skadden and pay top-of-the-market legal fees can expect that those fees reflect the cost of high-volume, round-the-clock support services. "If you build all of [the support services costs] into overhead," Mullen argues, "you'd be inclined to have a higher hourly rate."

This at a firm that already charges $135-$415 per hour for attorney time, plus premiums. And a firm where profits per partner averaged $920,000 in 1990, according to the "Am Law 100" survey.

Big-firm lawyers already earn so much money from their hourly billings alone that it's difficult to understand charges for secretaries, librarians, or printers, especially since these costs are really not variable by client and assignment the way, say, a plane ticket is. It's as if a fancy restaurant like Lutece tacked on charges for "dish and linen rental" to a $150-per-person dinner tab.

The whole thing also smacks of profiteering: taking advantage of clients who have retained a firm for legal services, and forcing them to cough up additional, above-market amounts for support services.

Former Water Management District chief counsel Stephen Walker, who negotiated the contract with Skadden, says that he never imagined he'd be charged for things like word processing. If that sounds naive to someone used to dealing with big firms, should clients also take in stride charges for the use of a firm's conference room ($360 for six hours at New York's Shearman & Sterling, according to that firm's March 6 fee petition in the Laventhol & Horwath bankruptcy proceedings)? Can we imagine that even the most savvy general counsel will say to a Skadden partner, "Okay, four hundred dollars an hour sounds great. But does that include the print tender charge and coffee while you're working on my stuff?"

Law firms regularly exalt their professional--as opposed to merely business--relationships with their clients. Yet bills are often, at best, traps for the unwary, and, at worst, downright deceptive. (For an example of really sneaky billing, take a look at what Cravath hid in its $323,230 bill for "professional services," submitted in the Chapter 11

proceedings of General Development Corporation [see sidebar, page 94].)

It should be noted that when it comes to disclosure Skadden is hardly the worst offender. Even if things weren't clear at the time it was retained, Skadden's monthly bills to the Water Management District offered a fair amount of detail, and when the district requested further backup, it was readily provided by the firm. As executive partner Mullen points out with a bit of exasperation, “These [charges] showed up in every bloody bill we sent them . . . and they paid them.”

It was those pesky auditors that finally gave the game away.

PROFIT CENTERS

No one is suggesting that firms should absorb every cost they incur while representing a client. When Mullen talks about passing on client-specific expenses, such as airfare or word processing, it's safe to say that a lot of clients would debate him on the word processing, but all would agree to pay for the plane ticket.

But would clients let firms tack a surcharge onto travel costs, so they pay $500, for example, for a $400 flight? It seems they might, given the markups they allow--knowingly or not--for a host of other charges.

John Walker, Jr., Latham & Watkins's managing partner, readily admits that in the eighties his firm added surcharges to such things as overnight mail, photocopying, lexis, telephone calls, and faxes, just to make more money. He blames New York firms for starting these practices and says that Latham felt compelled to do the same. “We saw the trend,” he says, “and felt we had to follow or we'd be leaving money on the table.” The firm went about it with typical Latham efficiency. Its phone system, for example, automatically recorded calls with a surcharge over actual cost. (The amount of the surcharge varied, Walker says.)

But three years ago, Walker says, Latham decided to stop making a profit from most services. “It created confusion for the client, so we took the profit or surcharge off almost all these items,” Walker says. Latham still earns a profit on its copying and faxes because, Walker explains, “we think clients understand that it happens and there's no confusion.” But he adds, “I don't like it,” and says the firm is considering charging these services “closer to cost.”

Skadden, Mullen insists, does “absolutely not” make any profit off of its charges and disbursements, and both he and Skadden's managing director Earle Yaffa defend the cost of a range of items billed in the Everglades litigation:

• A $1,490 lexis bill for the month of January was marked up 25 percent to $1,862. But lexis, Mullen notes, is subject to sales tax. On top of that, Yaffa argues, Skadden incurs costs for amortization of PC terminals and printers, telephone connection time, hardware and software maintenance, and training attorneys to use the service.

• Fax charges included not only the cost of the phone call, but also a $2.50-per-minute "fax charge." Thus a document sent on January 2 from D.C. to West Palm Beach cost the client $13.80, of which only $1.30 reflected the five minutes of phone time. A 31-minute fax sent two days later cost the client $7.51 in phone time plus a $77.50 fax charge.

Mullen explains that Skadden bills clients for new technology, and that as the technology moves from the exotic to the routine, Skadden reduces or eliminates charges for its use. In fact, Mullen notes, the outgoing fax charge has recently been reduced to $1.10 a page. And, he adds, Skadden doesn't charge for incoming faxes. (New York's Dewey Ballantine charges $1.50 a page for this.)

• Skadden billed $15 or $22 a trip for its own messengers to make pickups and deliveries within D.C. One regular recipient of $22 deliveries was the Sierra Club Legal Defense Fund, located just ten blocks from Skadden's office. Christine Irzyk, the Defense Fund's office manager, says she can send an outside messenger to Skadden for $4.45. Skadden's messenger fee, Mullen explains, incorporates such costs as salaries and car fare. But he acknowledges, "Maybe we should take a look at that."

• Skadden's 18 cents a page for photocopying is less than what some other firms charge, Mullen notes. And the fee, Yaffa points out, reflects not only the incremental cost per copy, but also things like cost of the space occupied by the copy center and the electricity that runs it. As for the $35 an hour for copy center staff, Yaffa says that it is charged only when a client places extraordinary demands on the copy department.

It's true that some other firms charge more per copy. For example, in its March 1991 fee petition in the Drexel Burnham Lambert Group Inc. bankruptcy, Cahil Gordon & Reindel asked for 20 cents a page. But Davis Polk & Wardwell's petition in the same matter asked for just 13 cents a page, an amount Davis Polk's fee application said "reflects applicant's actual costs for inside copying, with no profit factor." But even Davis, Polk's charge looks high next to the amount charged by "facilities managers"--companies that operate copy centers at firms and supply equipment and labor. One such outfit, New York's Archer Management Services, charges firms 3-9 cents a page for copies.

• The $45-per-hour charge for word processors and secretaries, Mullen says, reflects not just their salaries and benefits, but the cost of the equipment they use. In fact, Mullen claims, $45 is below Skadden's actual cost.

• And how about that $23.80 breakfast for four from Skadden's own cafeteria, which was then marked up to $33.60? Mullen maintains that the 40 percent markup was simply a calculation done to bring outdated food prices up to an amount that would reflect today's costs. "The cost analysis of the food hasn't changed in a number of years," Mullen explains, "and they really should have gone back and changed the basic price of the food," rather than shown an old price with a markup. (Legal Times, a Washington, D.C., publication that is owned by American Lawyer Media, L.P., reports that it can order the same food from a nearby café for $18.80, which includes a delivery charge, sales tax,

and, presumably, a profit.)

WHO NEEDS EFFICIENCY?

“Cost” is a somewhat elastic concept, and Mullen's definition seems expansive enough to make him a candidate to run a Hollywood studio. But if Skadden really is losing money when it charges secretarial time at $45 an hour, and if its cafeteria can't deliver coffee, juice, and Danish for less than $8.40 a person, that only points to another problem: When costs are passed on, there's no incentive to do things prudently or cheaply.

It makes no difference to Skadden, for example, that one associate on the Everglades case regularly treated himself to $30 and $40 dinners at D.C.'s Old Ebbitt Grill when he worked late, while some of his colleagues ordered more modest fare from Hunan Dynasty; in either case, the client picked up the tab.

And when things get marked up so that firms make a profit off of them, there's actually a reverse incentive to be economical. Why send something by Federal Express when you can make a fortune faxing it?

Not that economic incentive--or a lack of it--should be the only force driving a firm's consideration of which expenses get billed and at what price. Lawyers should also consider what seems reasonable and fair to bill--not very scientific, but concepts that most lawyers are used to dealing with.

Using those guideposts, one can argue, for example, that a firm should not typically bill for any expenses--including meals or taxis home--for lawyers who work late. Often these “overtime” charges are only overtime because another client's work was being done between 9 a.m. and 5 p.m. And, in a matter like the Everglades litigation, where lawyers worked full time just on that case, the overtime work is already a boon to the firm's bottom line: If lawyers only worked 9 to 5, Skadden would have to take on fewer clients so work could be spread among more lawyers and get done during the day. Instead, Skadden attorneys work 14-hour days. In return for the tremendous efficiencies of working lawyers long hours (and thus needing to hire fewer of them), shouldn't Skadden foot the bill for leeding them?

LAWYER TIME: THE GREAT INSCRUTABLE

Can we presume that the culture of client abuse that permeates the world of in-firm services and disbursements doesn't affect how lawyers bill for their time? Since professional fees obviously dwarf these charges in almost any matter, this is a key question for a client. Yet it is the hardest one to answer.

It's often impossible to look at a printout of time records and decide whether time spent on a task was reasonable. Researching and writing a brief, for example, may require six hours, or sixty. It is not something an auditor can evaluate. Only the in-house attorney assigned to the case can really monitor that, and even he or she will often have a hard

time telling from a time entry how much time was devoted to a particular task.

A typical entry in the Everglades bill notes seven hours spent “working on summary judgment [motion]; reviewing McVicar transcript; reviewing documents; working on expert production.” Is that six hours spent on the summary judgment motion and one on everything else? The other way around? Who knows?

Skadden itself acknowledged how inscrutable time records are in the response it filed on July 31 to the Water Management District's internal audit report. “Our time details,” the Skadden response notes, “generally may list a long series of tasks performed by an attorney on a given day and normally do not break out the exact time spent on each task.” In a somewhat bizarre turnabout, Skadden then used this fact as a basis for attacking the auditors' conclusions about how much time Skadden spent on such things as travel, administrative work, second-chairing depositions, and getting up to speed on a case. (Skadden also defended the time it billed in each of these areas.)

In essence what Skadden and other firms are saying when they submit bills for their time is, “Trust us.” Indeed, the very nature of hourly billing, which rewards lawyers for how long they take to solve a problem, requires a client to trust that lawyers will act with maximum efficiency. But given the way firms bill things like secretarial time and messenger trips--let alone the way a respected firm like Latham snuck a profit surcharge onto its telephone “disbursements”--why should any client trust the way lawyers spend their time? Again, we are not talking about conscious fraud, but about a mind-set that has no regard for economy. If big-firm lawyers have lost all perspective on the cost of the ancillary services they offer, how can anyone assume that they suddenly gain perspective when it comes to their primary service of lawyering?

Take Skadden's time records for last January in the Everglades litigation, for example, when 13 lawyers plus paralegals ran up $477,161 in billings just in that month. A lot of time was billed for work on a summary judgment brief addressing the question of whether the federal government waived sovereign immunity under the Clean Water Act. How much time is impossible to tell from the time records alone, but Mullen says it was 17 lawyer days. Seventeen days to produce what turned out to be a 20-page brief?

And how about the time Jerry Jackson put in during January? The senior associate racked up an astonishing 371 billed hours. That's an average of 12.4 hours on each of the 30 days he worked during the month. Can anyone be fully effective putting in hours like that? (Jackson was coming off a 294-hour month in December.)

Abner Cooper, an in-house attorney for the Water Management District, says he was pleased with Jackson's work and praises Jackson's technical knowledge of the case. Mullen, for his part, bridles at the notion that one can measure the time needed to produce a brief by its number of pages. And he's absolutely right: That brief may be worth every hour put into it. The point is that Skadden and other big firms have given their clients cause to wonder. Every client who gets billed $22 to send a messenger, when an outside company can do it for less than $5, has a right to worry that a brief that took 17 days to

write should have taken seven.

MAKING MONEY THE OLD-FASHIONED WAY

No doubt Peter Mullen and his cohorts at other big firms think they are being good managers when they convert every single operation of their firm into a profit center (or a cover-our-cost center, if you buy into Mullen's cost accounting). But it's not good management. Because it changes the way clients have to think about their lawyers. Retaining a top-flight firm becomes like checking into a fancy hotel, where, in addition to sky-high room rates, you find yourself having to pay a surcharge or a tip every time you turn around.

That poisons a professional relationship. And while firms may have been able to get away with it in the eighties, in today's maturing market-place clients will be able to find service providers who care passionately about service that's not only good, but also economical. Clients are also starting to force the issue with tough written billing policies that cover everything from how matters are staffed to what they will and won't pay for (see The Am Law Model Billing Policy on page 96).

Corporate counsel who don't like the “everything plus the kitchen sink” approach to billing have found they can do something about it. They're setting specific rules about how matters should be staffed and what they will and won't pay for. And, according to 20 in-house lawyers interviewed for this article, they're finding that firms--major firms--are toeing the line to get their business, especially in this economy.

After reviewing eight companies' written billing policies, we created a model policy using actual excerpts from six. (Following each item is the name of the company from whose policy it was taken.)

The Am Law Model Billing Policy

This document sets forth rules for all law firms retained by the company. If there are occasions when some of the policies seem inappropriate, you should bring your concerns or special requests to our attention before accepting an assignment.

BUDGETING

1. If it appears likely that legal fees for a matter will exceed $10,000, outside counsel shall submit an initial budget, estimating fees and costs. Outside counsel shall notify the company if it becomes apparent that the budget is being or will be exceeded. **Hewlett-Packard Company**

2. The budget should specifically identify the work expected to be done, the identity and billing rate of each attorney and paralegal to be involved, and the amount of time the work is expected to take. We expect this budget to be updated quarterly without reminder from us. **Campbell Soup Company**

EXPENSES

1. Disbursements will be reimbursed at the firm's cost, except for certain disbursements that will not be paid unless agreed to in advance by the company. Unless authorized in advance by the company, the following charges are not acceptable:

• Secretarial or word processing services (normal, temporary, or overtime);
• Photocopy expenses at more than 10 cents per page;
• Any other staff service charges, such as meals, filing, proofreading, regardless of when incurred;
• Computer time (other than computer legal research specifically authorized in advance by the company).
Bank of America National Trust and Savings Association

2. Photocopy costs in excess of $2,000 for a single job should be authorized in advance by the company. **Rohm and Haas**

3. Disbursements should not include local telephone expenses or office supplies. **Campbell Soup**

4. If your firm customarily makes separate charges for [secretarial, word processing, library, and other clerical time], the billing arrangement must be specifically approved in advance by the company. We expect that the hourly rates of firms that bill separately for secretarial services and the like will be less than those of competitive firms that cover all overhead in their billing rate. **Pacific Telesis**

5. Unless otherwise approved in advance by company counsel the company does not pay charges for . . . time spent in preparing bills. **Rohm and Haas**

6. It is expected that expenses for lodging, meals, and transportation shall be at reasonable rates and that counsel will exercise prudence in incurring such expenses. **Hewlett-Packard**

7. The company will not reimburse the costs of first-class travel and expects that travel arrangements will take advantage of any cost-effective discounts or special rates. **Bank of America**

8. Invoices shall be accompanied [by] itemization of disbursements and costs (long distance calls, photocopying, transcripts, expert witnesses, court costs, et cetera) and travel and living expenses shall be itemized separately on the attached form to indicate travel, lodging, business meetings, meals, taxis and limousines, and other expenses (specifically detailed). **Hewlett-Packard**

STAFFING

1. While we recognize that staffing changes may be necessary from time to time, the company will not pay for the “downtime” or learning time that may result from such a staffing change. We do not believe it appropriate to pay legal fees for the training of your personnel. **Campbell Soup**

2. Your firm has been retained because of your expertise. The time you spend educating junior lawyers in the substantive law applicable to the matter assigned should not be included in your billings. **Bank of America**

3. We expect that only one attorney from your firm will attend meetings, depositions, and arguments, although a second person may be needed for trials and major hearings. **The Dow Chemical Company--litigation retainer**

4. Only in unusual cases can travel by more than one attorney be justified. Pacific Telesis

5. Charges for attorney time during travel is normally not reimbursable and will only be paid if such time is actually used in performing services for the company or as otherwise arranged with the company. **Hewlett-Packard**

6. The maximum number of hours the company will pay per day for any individual (except during a trial) is ten. **Dow--litigation retainer**

[Firm name] agrees to these terms as a condition of accepting this assignment.
(Signature)

There are firms that really do believe in a relationship of trust between client and lawyer that includes the rendering of a forthright bill that says, in effect, “Here's where we're making our money on our smarts and experience, and here's where we're getting reimbursed for absolutely necessary, no-frills out-of-pocket costs.” Firms that have departed from this tradition will find it much harder to rest on their laurels as providers of top-flight legal services. In the years to come they'll have to establish themselves as cost-effective and fair billers as well.

Because these days clients don't want to buy Jerry Jackson his coffee and Danish, let alone allow Peter Mullen to mark it up 40 percent.