

# How Law Firms Can Minimize Write-Downs

As realization rates slip, UnitedLex's Nancy Jessen explains how law firms can limit the work they have to write off.

By Nancy Jessen

October 10, 2017

Empowered by an increasing demand for legal services—particularly among Am Law 100 firms—more and more law firms have successfully increased both their standard and negotiated billing rates over the past year, according to a recent Thomson Reuters Peer Monitor Index report. This bodes well for law firms, as increased demand leads to increased revenue, profitability and job growth. But it also begs the question: If demand and revenue are both increasing, why, then, are law firms experiencing the biggest six-month decline in collected realizations in four years?

The answer is simple, yet unfortunate: Any profitability gains that law firms have realized from rate increases or productivity improvements have been eroded due to excessive discounting and write-downs, the Peer Monitor report shows. So, while law firms have been able to secure higher billing rates, the point becomes moot once the client receives the monthly invoice and the write-downs begin. On average, law firms collect less than 89 cents of every dollar billed at their negotiated rates.



Nancy Jessen, senior VP of legal business solutions at UnitedLex

intentionally—indeed, they are the bane of every partner and practitioner. The problem is that while lawyers excel at logic, critical thinking and legal strategy, admittedly they are not

Write-downs are not a new phenomenon. The practice is as old as the practice of law itself, to the point where it has become an integral part of law firm business culture. It's not that over-servicing and write-downs are done



the best project managers. Their overwhelming desire is to be responsive, available and attentive to their clients' needs, and to protect their clients' interests. However, in the heat of the moment, budget assumptions are easily forgotten until the moment has passed. By then, it's too late—one cannot undo work that has already been done. In order to preserve the client relationship, firms may proactively choose to sacrifice revenue and profitability by writing down their time and expenses or may simply wait to see if the client complains.

But with all the technology and best practices available to help manage law firms and improve efficiency, are such choices even necessary?

The key to preventing revenue leakage is to understand the cause or source of these write-downs and come up with ways to minimize or avoid them all together. Two of the best ways to avoid overbilling and write-downs are 1) setting realistic goals and resource requirements and 2) over-communicating with clients.

- Budget for success: Treat the legal engagement process as you would any other business deal. Create a concrete statement of work (SOW) and have all parties approve it before starting work or as reasonably soon as possible. Be upfront about billing rates, level of effort, assumptions,

staffing requirements and realistic budget projections. Don't create a budget based upon the best-case scenario as a ploy to win a client—the most likely result will be a dissatisfied client and a considerable write-off. Similarly, don't create a budget based upon the worst-case scenario, which can lead to an over allocation of funds to the detriment of other important, but discretionary projects.

In order to budget effectively, firms need a detailed process for analyzing past legal matters to determine how long various projects take, what are the key activities, and what are the variables that can drive costs up or down. When budgeting for legal matters, the same scrutiny and process should be applied to expenses, both those that the firm incurs directly and external vendor costs: Make sure you fully understand their approach to cost-heavy activities such as e-discovery or contract review services, and find out what steps they take to maximize efficiencies and minimize costs.

- Communicate consistently: Legal teams should have frequent conversations about budget and ongoing activities with clients. In my experience, the No. 1 cost-savings activity is having explicit discussions with the client about the SOW before starting work and throughout the engagement to prevent miscommunications and overbilling. Understandably, most firms dislike and avoid these conversations. They sell themselves on their expertise and fear that asking too many questions, or asking for clarification on the SOW, will create the impression that they don't know what their clients need. However, these discussions should be a natural part of business, and they are far less awkward conversations than the ones in which clients demand a write-down.

Having a well-documented SOW and budget is only effective if lawyers communicate consistently about the status, potential deviations from the plan, and options for refining either the scope or budget. Case in point: An Am Law 200 firm was constantly losing money on an account. Upon analyzing the actual account activity and comparing it to the projections in the SOW, the firm's assumptions were spot-on in terms of the number and duration of projects, staff hours needed and other costs. The breakdown occurred because the client got used to dealing with the firm's partners for all matters—not just for its high-end litigation. Instead of delegating the low-complexity work to mid-level associates, as per the SOW, the partners simply did the work themselves to show responsiveness, provide good service and preserve the client relationship. No one at the firm was actively monitoring or enforcing the terms of the SOW, and the firm's overbilling led to significant write-downs and lower realization rates. Had both the client and the firm been monitoring adherence to the SOW, these negative outcomes would not have occurred.

Monitoring and adhering to the approved SOW can be challenging, given the voluminous and often unpredictable nature of legal work and litigation. Oftentimes legal teams feel there is no time for such administrative tasks. But to minimize write-downs and demonstrate respect for the client's budget, they must make the effort a priority either for themselves or other members of firm.

One proactive way to address this challenge is to create a special project management role within the firm that is solely responsible for the financial well-being of the account—monitoring billing, ensuring compliance with project SOWs, interfacing with clients on budget status, etc.—so that the legal team can focus on legal strategy and client service. If this is not feasible because of the added overhead costs, at the very least the firm's billing department can provide financial information that the attorney-in-charge reviews with clients during separate monthly calls to discuss budget status, not legal status—a true separation of church and state. The intended result of these calls would be to flag impending overages to the client before they become an issue.

This added transparency within the firm leads to greater efficiencies and more intra-firm communication/collaboration, and ensures that everyone is aligned with the goal of contributing to the firm's business and financial goals. This kind of internal transparency can lead to greater transparency with clients and vendors as well.

Ultimately, though, the mitigation of write-downs will require a change in law firm culture. The prevailing mindset that discussing finances is crass and detracts from the art of legal delivery only serves to preserve an antiquated status quo. This causes law firms to avoid dedicating the time necessary to fully scope the legal effort and have open, business-oriented conversations about the price of their services.

At the same time, law firms will also have to counter the common client expectation that firms will readily write down fees and expenses as a matter of course. Law firms provide a valuable and necessary service, and should be appropriately compensated for their time, expertise and contribution to their clients' success. Similarly, firms should compete for client work based on the above criteria—not simply price. We have found that clients are more than willing to pay more for quality services if they understand that underlying assumptions and effort required to accomplish their objectives.

When activities are agreed upon and budgeted for in advance, it minimizes the occurrence and amount of write-downs. Nothing can completely insulate law firms from unexpected activities or client requests, but when law firms and their clients are in alignment and constant contact, together they can forge a more mutually beneficial financial relationship.