THE LAW SOCIETY
OF NEW SOUTH WALES

COSTS GUIDE
7TH EDITION

CHAPTER 2

SUGGESTIONS FOR SETTING COSTS IN A DEREGULATED ENVIRONMENT

The Uniform Law is a suite of legislation including:

Legal Profession Uniform Law (NSW) ["LPUL"]

Legal Profession Uniform Law Application Act 2014 ["LPULAA"]

Legal Profession Uniform Law Application Regulation 2015 ["LPULAR"]

Legal Profession Uniform General Rules 2015 ["LPUGR"]

Prior legislation referred to:

Legal Profession Act 2004 ["LPA 2004"]

Legal Profession Regulation 2005 ["LPR"]

The Uniform Law applies for instructions first received from your client on or after 1 July 2015 (LPUL Schedule 4 clause 18).

The Uniform Law applies for proceedings commenced on or after 1 July 2015 (LPULAR clause 59).

2.1 INTRODUCTION

The purpose of this chapter is to give practitioners a convenient basis for determining what costs to charge in relation to legal work under the LPUL.

Much of the information in this chapter is based on the experience of others. Recommendations for setting charge-out rates are provided by FMRC Legal.

However you determine an appropriate charge-out rate, the fundamental prerequisite is that you comply with the requirements for disclosure in the LPUL. Failure to comply with the LPUL (Chapter 4, Part 4.3 Legal Costs, Division 3) may effectively negate any fees raised, however "reasonable" they may be. Provided there is disclosure in accordance with the LPUL, the method of charging is effectively a matter for you to negotiate directly with the client.

Time billing is still the most effective means of invoicing clients for legal services. Setting an appropriate hourly rate that provides a reasonable return will be a function of the costs of running a legal practice. These are individual matters and will vary widely from practice to practice.

If you do not have the requisite accounting skills or expertise, it is important to consult your accountant to obtain independent advice about the costs of running your business, likely expenses and profitability.

Similar principles apply whether you are trading as a sole practitioner, corporation or partnership. It is essential to understand the administrative cost of running a practice, and any additional burden imposed by regulatory compliance.

2.2 DEREGULATION DOES NOT MEAN NO REGULATION

Apart from the mandatory disclosure requirements under the LPUL (see Chapter 4, Part 4.3), fees and charges are deregulated in all areas of practice, except for regulated costs in areas such as workers compensation, personal injury actions under the State Insurance Regulatory Authority legislation, probate fees and some litigation matters (see Costs Guidebook Chapter 6 *Regulated Costs*).

Under the LPUL, clients other than commercial or government clients (see LPUL, s. 170) can ask for an assessment of any practitioner's bill. In determining the charges that should apply, costs assessors are obliged to apply the test detailed in section 172 of the LPUL, which states that in determining if the costs are "fair and reasonable in all the circumstances" they must also be "proportionately and reasonably incurred and proportionate and reasonable in amount". (See Bouras v Grandelis (2005) NSWCA 463; Jefferson v National Freight Carriers plc [2001] EWCA Civ 2082; *Lownds v Home Office* [2002] EWCA Civ 365; April Fine Paper –v Moore Business Systems [2009] NSWSC 867.)

It is important that practitioners price their services effectively, correctly budget for revenue and expenses, and control debtors so that they comply with the estimates, and disclosures given to clients.

Practitioners should note that if charges are to be based on a minimum unit of time, this should be made clear to the client in the disclosure document or costs agreement. If it is not done, the practitioner will only be able to charge for the actual time spent.

As work progresses through various stages, costs estimates may need to be amended to meet the practitioner's obligation to disclose where there is any significant change to anything previously disclosed (LPUL, s. 174(1)(b)). Clients may apply for an assessment of the bill up to 12 months after receiving it, even if the bill has been paid (LPUL, s. 198(3)). A client or third-party payer may apply to the designated tribunal for an extension of time to make an application outside the 12-month period, pursuant to s. 198(3) of the LPUL. However, there is no provision for a law practice to obtain an extension of time, and solicitors should be aware of the strict time restriction imposed by s. 198(3). The strict period of 12 months for an Application for Assessment also applies to retaining law practices.

2.3 GST

Practitioners will be aware that GST is not part of the "costs" rendered for legal services. As such, if GST is to be recovered, it must be specifically identified in the costs agreement provided to the client – that is, GST will be added both to fees and to applicable disbursements.

In relation to costs fixed by Regulation, clause 27 of the LPULAR sets out that GST may be added to costs, including fixed costs payable for the legal service to which they relate.

If you fail to note in writing that GST is payable, you cannot recover it.

See Chapter 5 of the Costs Guidebook on GST and the discussion re: Boyce v McIntyre (2009) NSWCA 185 (20 July 2009).

Also, see the standard form of costs agreement on the Law Society website (under Professional Responsibility/Costs/Precedents and Forms).

2.4 THE PROCESS OF SETTING CHARGE-OUT RATES

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2.4.1 COSTING AND PRICING LEGAL SERVICES

Knowing the cost of production for each fee earner in the practice is an essential component of determining how you set your fees. This applies equally to hourly rates and fixed-fee matters.

If your practice operates with a profit motive, you need to know what your cost of production is and add an appropriate profit margin. The components of the cost of production are:

- staff salaries (support and fee earners)
- the non-salary overheads of the practice
- the notional salary of the principals in the practice.

This is illustrated below:

$150	Profit	The average profit margin of a legal practice after considering the notional salaries of principals is 10–15 per cent. This example shows that the cost of production for a blended chargeable hour in the practice is $130, and the firm sells its time at a blended rate of $150.
$130	Staff salaries Non-salary overheads Principals' notional salaries	

Based on the above example, there are two implications for the practice:

- To generate the desired profit, the firm must charge and recover $150 for every chargeable hour it produces.
- The cost of producing fixed-fee work will be entirely dependent on the time it takes to conduct the matter. For example, if it takes five hours to complete a conveyance, it will cost the practice $650 (5 hours × $130). If the firm were to take 10 hours to complete the conveyance, it would cost $1,300.

The above example is based on a firm-wide cost of production; however, cost of production attaches itself to an individual, not an activity. When determining the cost of production in the practice, it is appropriate that the fee earners absorb all practice costs – their own salaries, support staff salaries and non-salary overheads. Some people will have a higher cost of production than others due to their higher salaries, or their longer working hours (full-time vs. part-time).

The following information provides a methodology for calculating the cost of production for each fee earner in your practice. This information can be used for setting fixed-fee work, as well as being a tool for determining individual fee budgets.

SAMPLE PRACTICE

STEP 1: DETERMINE FEES REQUIRED TO RETURN A PROFIT AND TO BREAK EVEN

	Retail		Break even	
Profit	$300,000			
Salaries	$450,000*		$450,000*	
Overheads	$300,000		$300,000	
Principal salary	$200,000		$200,000	
Total fees required	$1,250,000	1	$950,000	2

NOTES:

- Profit: Insert the amount of profit you wish to earn in excess of notional salaries paid to principals.
- *Salaries: Include salaries for all employees in the practice (support and fee earners). For the above example: Practitioner salaries are $150,000, paralegal salaries $30,000, and support staff salaries $270,000. Total employee salaries: $450,000.
- Overheads: Total non-salary overheads.
- Principals' salaries: Provide a notional salary for all equity principals in the practice.

STEP 2: DETERMINE BASE COST OF CHARGEABLE HOURS

Fee earners only Do not include support	A Salary ($)	B Work hours	C = A/B Cost per work hour ($)	D Chargeable hours	E = C × D Cost of chargeable hours ($)	
Partner	100,000	2,000	50.00	1,200	60,000	
Partner	100,000	2,000	50.00	1,200	60,000	
Practitioner	60,000	1,800	33.33	1,100	36,667	
Practitioner	50,000	1,800	27.78	1,100	30,556	
Practitioner	40,000	1,600	25.00	1,100	27,500	
Paralegal	30,000	1,500	20.00	1,000	20,000	
			Base cost of chargeable hours		234,722	(3)

NOTES:

- Fee earners: List the fee earners only.
- Salary: Salary of the particular fee earner.
- Working hours: This is the annual hours spent at work. Multiply hours per day by number of days per week by 46 weeks of the year, e.g. 9 hours x 5 days x 46 weeks = 2070 hours.
- Cost per working hour: Divide column A by column B (salary divided by working hours).

- Chargeable hours: Budgeted annual chargeable hours. Calculate as per working hours above, e.g.: 5.5 hours x 5 days x 46 weeks = 1265 hours.
- Cost per chargeable hour: Multiply column C by column D.
- Base cost of chargeable hours: Sum of column E.

STEP 3: DETERMINE THE OVERHEAD FACTOR (OHF)

	Retail		Break even	
Fees required	$1,250,000	(1)	$950,000	(2)
Base cost of chargeable hours	$ 234,722	(3)	$234,722	(3)
Overhead factor (OHF)	5.33	(1/3)	4.05	(2/3)

NOTES:

- Fees required: As per calculated fees for retail and break even in Step 1. Note the references to items 1 and 2.
- Base cost of chargeable hours: As calculated in Step 2 at item 3.
- Overhead factor: Divide fees required (1 and 2) by the base cost of chargeable hours (3).

STEP 4: DETERMINE RATES AND BUDGETS

Fee earners only	Charge rates Column C x OHF Retail	 Column C x OHF Break even	Fees budget Column D x rate Retail	 Column D x rate Break even
Partner	$266	$202	$319,527	$242,840
Partner	$266	$202	$319,527	$242,840
Practitioner	$178	$135	$195,266	$148,402
Practitioner	$148	$112	$162,722	$123,669
Practitioner	$133	$101	$146,450	$111,302
Paralegal	$107	$81	$106,509	$80,947
			$1,250,000	$950,000

NOTES:

- Charge rates: For each fee earner, multiply their result in column C at Step 2 by the retail or break-even overhead factor calculated at Step 3.
- The retail rate will show the rate that needs to be charged at the number of budgeted chargeable hours (column D, Step 2) to generate the desired total practice income.
- The break-even rate is the cost of production for each fee earner.
- Fees budget: For each fee earner, multiply their result in column D at Step 2 by the retail or break-even charge rates you have just calculated. This will indicate the fees to be generated by each fee earner.

NOW COMPLETE THE DETAILS FOR YOUR PRACTICE

STEP 1: DETERMINE FEES REQUIRED TO RETURN A PROFIT AND TO BREAK EVEN

	Retail		Break even	
Profit	$			
Salaries	$		$	
Overheads	$		$	
Principal salary	$		$	
Total fees required	$	(1)	$	(2)

NOTES:

- Profit: Insert the amount of profit you wish to earn in excess of notional salaries paid to principals
- Salaries: Include salaries for all employees in the practice (support and fee earners).
- Overheads: Total non-salary overheads.
- Principals' salaries: Provide a notional salary for all equity principals in the practice.

STEP 2: DETERMINE BASE COST OF CHARGEABLE HOURS

Fee earners only Do not include support	A Salary ($)	B Work hours	C = A/B Cost per work hour ($)	D Chargeable hours	E = C × D Cost of chargeable hours ($)	
			Base cost of chargeable hours			(3)

NOTES:

- Fee earners: List the fee earners only.
- Salary: Salary of the particular fee earner.
- Working hours: This is the annual hours spent at work. Multiply hours per day by number of days per week by 46 weeks of the year e.g., 9 hours x 5 days x 46 weeks = 2,070 hours
- Cost per working hour: Divide column A by column B (salary divided by working hours).
- Chargeable hours: Budgeted annual chargeable hours. Calculate as per working hours above, e.g.: 5.5 hours x 5 days x 46 weeks = 1,265 hours.
- Cost per chargeable hour: Multiply column C by column D.
- Base cost of chargeable hours: Sum of column E.

STEP 3: DETERMINE THE OVERHEAD FACTOR (OHF)

	Retail		Break even	
Fees required	$	(1)	$	(2)
Base cost of chargeable hours	$	(3)	$	(3)
Overhead factor (OHF)	$	(1/3)	$	(2/3)

NOTES:

- Fees required: As per calculated fees for retail and break even in Step 1. Note the references to items 1 and 2.
- Base cost of chargeable hours: As calculated in Step 2 at item 3.
- Overhead factor: Divide fees required (1 and 2) by the base cost of chargeable hours (3).

STEP 4: DETERMINE RATES AND BUDGETS

	Charge rates		Fees budget	
Fee earners	**Column C x OHF Retail**	**Column C x OHF Break even**	**Column D x rate Retail**	**Column D x rate Break even**

NOTES:

- Charge rates: For each fee earner, multiply their result in column C at Step 2 by the retail or break-even overhead factor calculated at Step 3.
- The retail rate will show the rate that needs to be charged at the number of budgeted chargeable hours (column D, Step 2) to generate the desired total practice income.
- The break-even rate is the cost of production for each fee earner.
- Fees budget: For each fee earner, multiply their result in column D at Step 2 by the retail or break-even charge rates you have just calculated. This will indicate the fees to be generated by each fee earner.

2.5 ALTERNATIVES TO TIME BILLING

The "billable hour" is facing a challenge from fixed fees, project costing and negotiated budgets as a basis for determining client fees. This is because charging by the hour may not be the best way for a practice to charge costs to a client. It is only one of the factors that will determine a fee. For example, it may be that the time spent in completing a matter is excessive, or the total costs are excessive in relation to the value of the matter. Ultimately, there is discretion over the fee, and it will depend on the circumstances of the retainer.

The fundamental issue is to know and understand the hourly expense and charge-out rate of each fee earner in your practice. This is crucial management information that will contribute to what billing option you choose.

The vast majority of bills rendered annually by legal practices in New South Wales use time billing. Research supports the view that this form of billing is preferred in this state. Very few of these bills result in practitioner–client assessment or referral to the Legal Services Commissioner. Therefore, experience suggests that time billing works.

Commercial and government clients (formerly referred to as "sophisticated clients") often prefer time billing to other methods because it gives them a means of assessing both the time spent on a matter and the hourly rate charged for the service. The definition of a commercial or government client should be carefully considered under s. 170 of the LPUL which states that Part 4.3 does not apply to commercial or government clients apart from provisions relating to conditional costs agreements and contingency fees (see ss. 181(1, 7 & and 8), 182, 183 and 185 (3, 4 & and 5) of the LPUL).

Time billing depends on accurate time recording. Several time-recording software packages are available, but all depend on accurate input. There is always going to be "leakage" – that is, where events occur, or where legal work performed is not accurately recorded or omitted. The aim of the practice should be to minimise leakage.

On average, approximately 15 per cent of time worked is never recorded. This should be considered in setting the appropriate hourly rate for the practice. For this reason, it may be useful to analyse the type of work in your practice and calculate the "average" the cost of doing a particular style of legal work. It may give you some indication of the time "usually" taken for a matter to be completed.

This approach may not work so well for litigation, where uncertainties of time and preparation can lead to a variation in costs. In the case of litigation, you will have to continually review costs as a matter progresses. The LPUL requires that costs be reviewed where initial estimates provided to a client have significantly changed (LPUL, s. 174(1)(b)).

Hourly rates and time billing should not be confused with the client's (and the practitioner's) determination of "value" in the billing process. This is clearly a very discretionary matter and can be resolved by a discussion between both parties.

It is no longer practical to refer to a "common price" for certain work. The "price" will very much depend on the size, style and location of the practice, and its clientele.

To help you think about how you might "package" your fees, some alternatives are described below.

2.5.1 HOURLY RATE

Definition: A fee charged for every hour worked by a firm in relation to a matter. The charge-out rate might be for practitioners only, and include all overheads and support staff salaries, or rates might be established for every person who works on the matter, including clerks and paralegals. Discounts might be offered for high- volume or regular clients. It is important to ensure that only actual time spent is charged according to the work done. The unit of time should be small enough to record actual time spent accurately. The unit of time can vary from one minute up to six minutes or pro rata. Software packages can be adjusted accordingly. As suggested above, care should be taken in the input process, and some training is required for new time recorders, particularly having regard to the common leakage rate experienced across practices.

Suitable for: That depends on the client's relationship with the firm. With this proviso, it will be more suitable for firms in matters where the extent of work required is unknown at the outset of the retainer (for example, in complex litigation).

Advantages: Recovery of expenses with a profit margin for all work performed, provided the set hourly rate reflects adequately the costs of the practice.

Disadvantages: Possibility of disputes over the number of hours worked. Focus on charging rather than value for the client. It may breed inefficiency and lead to the perception that a legal service is not value for money. The use of hourly rates needs to be carefully managed, and must be transparent from the client's perspective. The client may need to be encouraged to focus on aspects other than "time", such as results and outcomes.

2.5.2. FIXED FEES

Definition: Standard fee for common defined services; may be collected in a lump sum in transactional matters, up front or on completion.

Suitable for: Any matter where the steps in the transaction are well understood by the practitioner (for example, Local Court appearances) or where the transaction consists of standard steps (such as with conveyancing, incorporation and wills). Consequently, it is useful where the firm specialises and can estimate the work involved in a type of matter with some certainty.

Advantages: A high level of consumer acceptance, and a low potential for client disputes if the fee and the service to be provided are adequately communicated. The profitability for the firm is defined for each service. It rewards efficiency.

Disadvantages: Reduced profitability for the firm if the service subsequently becomes complex. This may become apparent in litigation, where a fixed fee may not take account of all contingencies, some of which may be unknown.

2.5.3 PROJECT RATE

Definition: Similar to a fixed fee, but an agreed fee for a particular service. The fee is established and agreed on at each occasion. It may be more suitable for commercial work.

Suitable for: Any matter where the steps and work can be defined at the outset of the matter (for example, in drafting contracts).

Advantages: See fixed fee.

Disadvantages: See fixed fee. It may prove inaccurate if contingencies are unknown when the rate is set.

2.5.4 HOURLY RATE WITH CAP

Definition: As for hourly rates, but with the client and practitioner agreeing to a maximum total bill.

Suitable for: As with hourly rate, but where the work required can be estimated with some certainty. Requires a careful definition and disclosure of what work is to be done so that a charge can be levied for any additional work outside the original brief.

Advantages: Client costs disputes are less likely than with a straight hourly rate. It rewards efficiency.

Disadvantages: Requires that the firm estimates the maximum work required or builds in a margin for uncertainty. Any inefficiency reduces profit.

2.5.5 BLENDED HOURLY RATE

Definition: A uniform hourly rate averaged amongst the staff associated with a project; depending on the time each is likely to be involved. It may result in a reduced recovered hourly rate for litigation work, where following the assessment of a party/party bill, there is a reduction for items such as supervision and attendances where multiple staff members have been involved.

Suitable for: See hourly rate.

Advantages: Possible marketing perception that lower hourly rates will apply when "averaged", and simplification of billing.

Disadvantages: See hourly rate. Also, the overall quality of work could be affected if assigned to less qualified staff members, without senior supervision. Profitability may decrease if senior staff members are required for longer than estimated. Upon review, a test of what is "fair and reasonable" may result in disallowance of multiple attendances by multiple staff, so careful management is required.

2.5.6 CONDITIONAL FEES

Definition: A fixed fee, established at the start of a matter, payable only on "successful completion", which must be defined. Section 181(7) of the LPUL specifies that a conditional arrangement is not permitted in criminal proceedings or family law proceedings. There is also preclusion in motor accident matters (see clause 8 of the Motor Accidents Compensation Regulation 2015) and a limit in work injuries damages matters (see clause 103 of the Workers Compensation Regulation 2010). It should be remembered that the maximum premium the practitioner can charge in litigation matters only is 25 per cent on the legal costs (excluding disbursements) otherwise payable (see LPUL, s. 182(2)). The limitation to 25 per cent does not apply in non-litigious matters.

It is important that the conditional costs agreement clearly defines what will be regarded as "success". The practitioner should also decide and agree with the client whether disbursements are to be paid by the client, even if fees are not to be charged.

Suitable for: Litigation; certain insurance matters.

Advantages: For the client: if there is no win, there is no payment to the practitioner. It allows deserving cases to be heard, with less risk for the client. For the practitioner: it develops business which might not otherwise have been generated. Results are rewarded.

Disadvantages: There is no certainty of income or recovery of expenses in a case. The practitioner bears a proportion of the risk. There may be a significant delay between the time work is performed and payment is received. Careful management is required to ensure that large amounts of work in progress are ultimately recoverable, with a premium for interest, to reflect cost and managing the practice. These considerations should undoubtedly be reflected in the hourly rate where time billing is the preferred option.

2.6 DEBTOR CONTROL

Remember, you cannot claim interest on your outstanding unpaid fees and disbursements unless:

- your disclosure document or costs agreement provides for the charging of interest
- your bill refers to the right to charge interest and the rate of interest.

However, if the costs agreement does not deal with the charging of interest but the bill includes a claim for interest and has been given in accordance with Chapter 4, Part 4.3 of the LPUL, interest can be charged on unpaid costs 30 days after the bill is given.

Interest is not recoverable unless your bill is issued within six months of a matter concluding (see LPUL, s. 195(5)). This and the law practice's liability for GST makes it vital that practitioners introduce an effective mechanism for debtor control. Possible ways to achieve this include:

- billing quickly after the work has been done
- billing on an interim basis (perhaps monthly) rather than at the end of the transaction
- obtaining money in advance for disbursements and counsel's fees
- quickly taking steps to apply for assessment of costs or issuing debt recovery proceedings if bills remain unpaid for an unacceptable period of time.

Under the Uniform Law, where instructions are received on or after 1 July 2015, Applications for Assessment by a law practice must be made within 12 months of the bill being given or the request for payment being made – see ss. 198 (3) and (4) of the LPUL. There is no provision for the law practice to obtain an extension of time to make an Application for Assessment to have costs assessed.

2.7 CONCLUSION

As already indicated, the hourly rate is being challenged by other forms of billing. You need to exercise care when considering alternatives to hourly rates, to ensure your agreement accurately assesses the likely outcomes and associated expenses, and includes the potential for variation or further negotiation.

Setting appropriate hourly rates is relatively straightforward once your cost structure is understood. No-one has so far provided a consistently better means of costing work, especially for litigation.

Whatever method you ultimately adopt, or support, your agreement should accurately reflect the costs to operate your own business. It should comply if it is not covered by the exceptions, and it should clearly state the method for determining the fee.

Under s. 174(3) of the LPUL, if a disclosure is made under subsection (1), the law practice must take all reasonable steps to satisfy itself that the client has understood and given consent to the proposed course of action for the conduct of the matter and the proposed costs.

Whatever method you adopt for setting fees, it is important to review your operating costs annually. This enables you to consider any increases in fixed overheads, such as wages and rent, as well as any increases in operating expenses occasioned by the growth of the practice or changes in the commercial environment. For smaller practices, it may be useful to do this in conjunction with your accountant. Together you can review the recent history of the practice to ensure that billing rates are accurate and that they reflect the costs of running the practice and providing a return to the proprietors.

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