

Law Firm

MANAGEMENT

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Winter 2010

F&D

Feeley & Driscoll, P.C.
Certified Public Accountants / Business Consultants

200 Portland Street • Boston, Massachusetts 02114
154 Broad Street • Nashua, New Hampshire 03061
1-800-392-6192
www.fdcpa.com

Fixed-fee billing: The wave of the future?

Law firms everywhere are feeling the effects of the down economy, as clients are increasingly looking to their legal fees for relief. Rather than cutting back on services, many clients are demanding that their law firms convert from hourly to fixed-fee billing. The good news for attorneys is that the switch can pay off for both their clients and their firm — *if* the fees are properly calculated.

Why clients like fixed fees

Clients are drawn to fixed fees for several reasons. Perhaps foremost, they take comfort in the certainty that fixed fees provide. The predictability of legal expenses facilitates more accurate budgeting and improved decision making.

Fixed fees also can help assure clients, who may perceive a disparity between their costs and the value they receive in exchange, that they're getting the services they're paying for. Further, the structure allows clients to share the risk of unexpected developments with their attorneys, if not outright shift the risk to them.

Finally, a fixed-fee approach can foster a greater sense of collaboration. The process of negotiating the fee allows the clients to participate in estimating legal costs and determining strategy, while also gaining a greater understanding of everything that's involved with their matter.

Why firms might like fixed fees

Law firms often resist fixed fees, but they stand to reap some benefits from the arrangement, as well. For example, it's not only the client who enjoys greater certainty. Fixed-fee agreements can provide your firm with predictable work and, in turn, regular cash flows.

Fixed-fee billing can also help improve efficiency and allow more appropriate delegation of duties.



And it may help reduce your firm's per-case investment by eliminating unnecessary tasks and requiring better management. The firm will reduce the overhead generated by operating a complicated hourly billing process, too.

Law firms that are willing to adopt fixed fees can even gain a competitive advantage over those that refuse to abandon hourly billing. This flexibility is an effective way for your firm to stand out among a crowded field.

Setting the fee

Fee-setting is generally a two-step process. First, you and the client must agree on the scope of the services to be provided under the agreement. Rather than simply identifying the services to be rendered, your firm also might consider expressly itemizing the services that are *not* included. If the parties expect complicated or shifting circumstances, you might seek a provision that would trigger a contingency fee in specific circumstances. Alternatively, you could request two fixed fees, with one applying in the case of the specific circumstance.

Second, once the scope is determined, the parties must agree on the related costs. Establishing the costs will rely largely on historical cost data held by both the client and your firm. Today's data-mining techniques make it easy to gather information on the range of costs associated with various types of legal services.

Some adjustments to historical data may be necessary, however, because previous bills will primarily reflect hourly rates and, in some cases, the inefficiencies that can result from such rates. In examining earlier billings, you must consider the respective timelines, variable and fixed costs, and direct and indirect expenses.

The fixed fee obviously must exceed your firm's break-even costs for providing its services. At the same time, though, it will likely balance the value of the services with the marketplace's pricing pressures.

To fix or not to fix

Fixed fees are typically most appropriate for commodity-type work, such as zoning matters,

A sliding scale approach

Results matter to clients even more than costs, so some clients might prefer a sliding scale fixed-fee arrangement that rewards or penalizes your firm based on the actual results achieved.

In an intellectual property matter, for example, a client could make a monthly payment at 80% of the fixed fee. If the case is settled to the client's satisfaction (as defined in advance), the client would pay the remaining 20%. But if the results went against the client, the firm would forfeit the remaining fees.

real estate closings and workers' compensation claims. If clients insist on fixed fees for other matters, consider securing a reopener provision that allows your firm to renegotiate the fee before pursuing additional work that wasn't originally contemplated. ■

Social networking

Opting out may no longer be an option



Nothing has changed — and enhanced — law firm marketing in the past decade like the Internet. But some firms approach each new technological development with caution and even fear. Social media, including blogs, networking sites such as Facebook and LinkedIn, and knowledge platforms like Legal OnRamp, are no exception.

If your firm is already connecting with clients and prospective clients via social networks, you likely know the benefits. If, however, you've yet to dip your toe in the water, don't wait any longer. There's really nothing to be afraid of.

The fear factor

The recently published *2009 American Bar Association Legal Technology Survey Report* says that only one in eight firms use social networks. And an informal study published in *Law Practice* magazine found that 45% of law firms block their computers' access to such sites.

So why are law firms so reluctant to jump into social media? Many firms are understandably concerned about privacy, worker productivity and misuse of social networking sites. But such fears are probably misplaced. In this age of smart phones, employees can circumvent blockage

policies by using their own Web-enabled devices at work. And unless you provide social media policies, attorneys and staff are just as likely to make firm-damaging statements online from their home computers as they are from their office computers.

A policy is essential

To protect your firm and safely harness the potential of social media, create a code of conduct that helps attorneys and nonattorney staff use online networking tools productively. Your code should prohibit:

- Violating client confidentiality, including doing anything prohibited by your firm's existing confidentiality policy,
- Jeopardizing client relationships by, for example, making statements that could have adverse effects on specific clients or cases,
- Giving legal advice that might establish an attorney-client relationship, and
- Making statements that can be construed as violating law firm advertising rules.

Warn employees against communicating anonymously — making, for example, hostile or inflammatory comments on blogs or forums. Such comments can always be traced back to their source.

In general, staff who identify themselves online as employees of your firm should be polite and respectful and refrain from participating in work-related gossip. They also should make it



clear that any views they express are their own, not those of the firm, and refrain from using firm logos or service marks that might imply that their opinions are “official.”

Social strategies

There are just as many social media “dos,” of course. For example, do choose to focus on particular networks, such as LinkedIn, which is used primarily for professional networking and can help attorneys reconnect with former colleagues, classmates and other potential clients or referral sources.

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Plaxo's Pulse platform, on the other hand, offers a mix of personal and professional networking capabilities and is a powerful tool for idea-sharing. Attorneys can provide clients with a central place to read their legal blogs and Twitter posts regarding developments in their practice areas, and even view their YouTube videos of conference presentations.

Other sites you may want to consider include:

Legal OnRamp. Designed for lawyers, the site hosts forums, blogs, calendars and other features that enable private-practice attorneys, in-house counsel and law students to interact and share ideas. Your firm's attorneys can use it to distribute conference agendas, white papers and other discussion-generating, reputation-building documents.

Facebook. Primarily a social network, the site can help members make and maintain relationships with friends and family. But law practices can set up firm accounts for professional networking purposes.

Twitter. Twitter posts are limited to 140 characters each — long enough to make

firm announcements, report legal decisions relevant to your clients and provide “live” commentary at conferences and other events.

Don't neglect the old

Although these new networking strategies may seem foreign at first, most are simple to

master — and well worth the time of your attorneys and marketing department. Just remember that, as you adopt the new, don't neglect the “old.” Ensure that your Web site remains user-friendly and well maintained, and that you've prominently posted links to your firm's social media accounts on it. ■

Make sure your employee reimbursement plan satisfies the IRS

Law firms that compensate their employees for expenses incurred in the course of employment generally deduct those reimbursements as business expenses, rather than reporting them as wages on the employees' Forms W-2. But the IRS permits such deductions only for reimbursement or allowance arrangements that qualify as “accountable” plans.

Criteria for an accountable plan

For a plan to be accountable, your firm's employees must satisfy three requirements. They must have:

1. Paid for or incurred deductible expenses while performing services as the firm's employees,
2. Adequately accounted to the firm for these expenses within a reasonable period of time, and
3. Returned any excess reimbursement or allowance within a reasonable period of time.

To adequately account for their expenses under the second requirement, employees must provide the firm with substantiation of their travel, mileage and other employee business expenses. For example, they must supply receipts and a statement of expenses, account book, day planner or similar record where the employee entered each expense at or near the time it was incurred.



For the third requirement, an excess reimbursement or allowance is any amount a firm pays an employee that exceeds the business-related expenses for which the employee has adequately accounted. If your plan advances money to employees, the third requirement will be met only if the advance is reasonably calculated not to exceed the amount of anticipated expenses and the firm makes the advance within a reasonable period of time.

Defining “reasonable period of time”

The IRS has recognized that a reasonable period of time depends on the facts and circumstances.

Generally, however, it will deem actions that occur within the following time frames to have taken place within a reasonable period of time:

- The firm gives an advance within 30 days of the time the employee incurs the expense,
- The employees adequately account for their expenses within 60 days after expenses were paid or incurred, and
- The employees return any excess reimbursement within 120 days after expenses were paid or incurred.

Keep in mind that your firm must give a periodic statement (at least quarterly) to its employees asking them to either return or adequately account for outstanding advances, and they must comply within 120 days of the date of the statement.

Many firms avoid the headaches associated with advances by instead reimbursing employees weekly or monthly for out-of-pocket expenses expended on the firm's behalf. To receive

reimbursement, employees must submit expense reports with attached receipts and adequate documentation.

Reporting reimbursements

Firms with accountable plans based on actual expense reimbursement or a per diem or mileage allowance need not report any amount on employees' W-2s if an adequate accounting is made and any excess is returned.

If an adequate accounting is made but the excess *isn't* returned, you must report the excess amount as wages.

Protect yourself and your people

Expense reimbursement, whether in the form of actual expenses or allowances, can prove costly if your firm doesn't maintain an accountable plan. Any reimbursement will be subject to employment tax for the firm and both employment and income tax for the employee who receives it. ■

The pros and cons of having nonequity partners

If yours is like most law firms, your staff includes at least one partner who keeps stalling on the retirement decision or an associate who's not quite partner material. On the one hand, the person is productive and likable, but on the other hand, he or she isn't quite making the grade to be an equity partner. So, what do you do? Many firms have discovered that establishing "nonequity partners" can make everyone happy.

How does a nonequity partner differ?

While the criteria for becoming an equity partner vary widely, the most common characteristics of an equity partner are that the partner has capital

invested in the firm, shares responsibility for the firm's debt and has the ability to vote on partnership/ownership issues. In contrast, nonequity partners have no capital invested in the firm, aren't liable for the firm's debts and can't vote on ownership-related matters.

Additionally, it typically takes a supermajority of existing partners' votes to elect or dismiss an equity partner. Firm management, on the other hand, is typically given the authority to elect or terminate nonequity partners.

Nonequity partner compensation is set much as it would be for an associate, with a salary and performance bonus. But unlike an associate,



a nonequity partner may attend partner meetings and even have access to firm financial information.

Why add the nonequity status?

Single-tier, full equity partnerships in a law firm are as old as the profession, but two-tier firms continue to gain popularity. For many years firms were governed by the old “up or out” rule. If an associate hadn’t made partner in seven or eight years, it was time for him or her to move on. One problem with this rule is that it has caused firms to get rid of some highly productive and profitable associates who probably didn’t make partner simply because they weren’t successful rainmakers.

Another reason for the trend toward nonequity partners is that partners have become more willing to pull up stakes and move their practices to another firm. Although the new firms are happy to have the additional billings, they’re often reluctant to make someone a partner if they haven’t practiced with him or her. At the same time, they realize they’ll be unable to attract these recruits *without* the promise of partnership.

Moreover, many law firms now have associates who don’t want full equity partnerships. Many younger lawyers see their tenure at a law firm as an opportunity to gain experience and training, earn a good living and then move on. The idea of a career-long “marriage” doesn’t interest them as much as it did preceding generations.

These issues have forced firms to look outside the traditional structure for more flexible organizational styles.

What are the benefits?

The advantage of a two-tier partnership lies in its flexible organizational approach. It’s important for many people’s egos to have the title “partner,” and many clients need to see the word “partner” after their attorney’s name to have full confidence in him or her. Nonequity partnerships can help your firm hang on to that valuable associate who’s being courted by a competitor or provide a safe haven for a partner who, while winding down, isn’t quite ready to retire.

Many law firms now have associates who don't want full equity partnerships.

Two-tier partnerships also offer a way for partners from other firms to make a lateral move in. Joining a new firm as a nonequity partner for a period of a year or two gives both parties time to judge whether the fit is a good one.

This flexibility can, however, also work against you. For example, there may be numerous reasons why an associate will never become a partner. Making him or her a nonequity partner simply because he or she has been at the firm for a certain number of years will just make the situation worse. So while the criteria may not be quite as high as for equity partners, it’s still important to select nonequity partners carefully.

Think it through

Although setting up nonequity partnerships within your firm has certain advantages, keep in mind that making the switch to a two-tier partnership structure will create its own set of headaches. Make sure all the angles are thoroughly vetted before making any changes. ■



FEELEY & DRISCOLL, P.C.
 Certified Public Accountants & Business Consultants

200 Portland Street
 Boston, MA 02114-1709

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K. Jennie Kinnevy
Director of Law Firm Services
 Call us at 1 (800) 392-6192
 or email us at info@fdcpa.com