

## Paralegal Profitability Enhancement

Luciann Leraul, CPA, MBA

The question arises in the minds of attorneys in both small and large firms, "Are paralegals in and of themselves profitable?" We shall examine this question.

### Overhead Considerations:

The profitability of any particular timekeeper or group of timekeepers is measured by subtracting from their gross fee income their salary, benefits, and any direct overhead which can be attributed to that particular class of timekeeper. This particular point of ascribing only *direct* overhead rather than *full* overhead is very important.

Direct overhead includes those items which are closely related to the production unit (in this case paralegal salary and fringe benefits).

Full overhead, on the other hand, simply takes the entire cost of doing business and divides it by the number of full time equivalent timekeepers. The full overhead method ends up ascribing portions of rent on hallways, libraries and copiers as well as a proportionate share of utilities. Since full overhead items are more related to overall firm *capacity* to do client work than actual billing, this measure of profitability for a particular class of timekeepers does not reflect the activities and efficiencies of that class of timekeepers.

Measuring profitability at the contribution margin level (that is, gross fees less direct overhead), provides a measure of controllable, reallocable resources and allows comparison to other classes of timekeepers for purposes of comparing the efficiencies of timekeeper groups.

Returning to our basic calculation, when direct overhead is subtracted from gross fees, the residual is net contribution to profit. In most cases firms have found that, for paralegals, this number is positive, however, possibly not sufficiently positive to provide a favorable return on investment.

### Gross Fees considerations:

Let us turn our attention to the other half of the equation—gross fees. A firm may calculate gross fees in several different ways. Some of the methods used include:

1. Multiplying billable hours (considering all those that are recorded on a time sheet as billable) times standard billing rates; or
2. Subtracting from billable hours those which were written off in the pre-bill stage before multiplying by the standard billing rate; or
3. Ignoring the issue of what has been billed, turning attention to what has been collected.
4. By subtracting from billed hours an historical percentage of uncollected fees (usually in the neighborhood of 10-12%).

### Handling of write-offs:

It may be argued that paralegals exercise little control over the write-off/write-down of their time either in the pre-billing or post-billing write-off phase although they can be adversely affected by the firm's write-off policies. A billing attorney may simply write off the time of the lowest billing rate timekeeper in order to maintain the higher billing rate work on the client's bill. Other billing attorneys may write off the time of others rather than themselves in order to avoid peer criticism for excessive write-offs. In other instances, largely related to the use of automated time

and billing, write-offs may be applied proportionally to all the timekeepers on the particular matter relative to the number of hours each worked on the matter. And some time and billing programs will automatically and arbitrarily make this calculation.

The correct treatment of write-offs, of course, is to write-off the time of the individual who was inefficient in pursuing the matter. If the billing attorney simply wants to lower the total amount of the bill to accommodate the client then the proportional allocation or a write-off to the billing attorney's time for poor client or case management may be appropriate.

Even when accounting inequities are corrected, paralegals continue to appear only marginally profitable. The equation permits only two alternatives to increase profitability—either decrease expenses or increase gross fees.

### **Paralegals' Attributable Expense:**

The treatment of expenses related to the employment of paralegals varies widely in law firms. In some firms paralegals' salaries are below those of legal secretaries. Paralegals are not provided with private offices or cubicles and may not have secretarial support. The other end of the firm spectrum provides all of these trappings of the professional including opportunities for continuing education and participation in paralegal associations. In my experience with paralegals and instruction in paralegal programs, I find that the appropriate mix of support lies somewhere in between treating a paralegal as a clerical and treating a paralegal as a substitute associate.

### **Paralegals' Billable Activities:**

Turning next to the issue of gross fee dollars we find a more fruitful avenue for increasing paralegal profitability. Thomas Hemnes<sup>1</sup> used the term "externalities" to describe the influence paralegals have on the entire law office. To examine the issue of gross fees, first ask what work the paralegals are doing; are they displacing secretarial work; are they displacing attorney work; and/or are they creating new, never before billed-for activities. The answer to this question is that paralegals are probably doing all three. Their profitability then is, as Hemnes pointed out, partially measured by what was previously done by secretaries and not billed for and the attorney level work which paralegals have taken over.

When looking at attorney work it generally seems to be of three types:

1. The attorney did not bill for this activity because it was, in his or her opinion, not of a professional nature or not "worth" the attorney's higher billing rate; or
2. It was billed at a lower rate; or
3. The attorney used the standard attorney billing rate.

In the standard billing rate case, of course, the use of the paralegal at a lower billing rate reduces the total gross fee income of the firm. In the other two instances, the paralegal is likely to generate additional income for the firm. The argument is also made that if "lower level lawyering" is shifted to paraprofessionals, then attorneys will be left with client development and "higher level lawyering" and are thus able to raise their billing as a consequence of providing more expert client services. These displacements of work from other timekeepers or nontimekeepers to paralegals are virtually impossible to measure though every firm recognizes the validity of these concepts.

An easier area to measure and equally amenable to review are the components of gross fee income. Assuming that we are using, as in our discussion above, gross fees collected, the question still remains what comprises these gross fees. There are several options. Hourly fee income, fixed fee income and/or transaction based fee income are all possibilities. Hourly fee income, as we all

---

<sup>1</sup> Thomas M.S. Hemnes, 'Paralegal Profitability Analysis'. 25 LOEM 100 (Summer 1984).

know, is simply charging the client for the amount of time expended in an activity at a particular hourly rate. Hourly rates in law firms have often been set on the basis of generalized legal training and skills. There is a fallacy built into this method. The particular timekeeper may be exceedingly skilled in the client's particular type of matter regardless of the timekeeper's general level of training and legal skill. Also, often the client is ill-equipped to measure legal training and skills and, in fact, is considerably more interested in a positive result in their particular matter.

The point here is, if hourly fee income is standard in the firm and will remain so, that certain paralegal activities which are equivalent to attorney activities be billed at attorney level rates rather than the more common practice of ascribing a single particular rate to a paralegal.

If the firm is not wedded to the hourly billing rate, then the use of fixed fees in combination with paralegals and technology is a highly profitable avenue. The fixed fees must be set in relationship to the value the client receives rather than the general legal expertise of the paralegal. Since paralegals require attorney time and supervision, it is very efficient to assign paralegals to repetitive areas of the law in which they can become highly proficient and trustworthy.

A variant on the fixed fee for an entire matter is transaction based fees. This amounts to assigning fixed sums to particular activities undertaken in furtherance of a matter. Examples include a fixed fee for a set of jury instructions, a fixed fee for opening a file, or a fixed fee for receipt and review of correspondence. Again, if the transaction based fees are carefully set and the work delegated to paralegals, the firm will capture dollars which, in the past, had not been billed at all or had been billed at very small increments of time designed to annoy the client. The use of transaction based fees is well in keeping with the theory that the client buys activity and results rather than the passage of time.

In conclusion, a thoughtful and thorough review of billing practices related to paralegal activities will uncover hidden dollars left on the table.

© Luciann Leraul.