

Cross-Examining the Legal Auditor

James P. Schratz

**Is the auditor really competent
to challenge your firm's billing?**

OVER THE PAST FEW YEARS, abusive billing practices by attorneys have resulted in criminal convictions, civil lawsuits, and an enormous

amount of publicity. For example, Webster Hubbell, the former number-three official in the Justice Department, pleaded guilty in December

James P. Schratz is president of Jim Schratz and Associates, based in Glen Ellen, California, and acts as a legal auditor and expert witness. © 1996 James P. Schratz.

1994 to two felony counts of mail fraud for stealing \$394,000 and tricking the Rose Law Firm of Little Rock into reimbursing him.

Also in December 1994, Gary Fairchild of Chicago's Winston and Strawn pleaded guilty to cheating the firm and five clients out of \$784,000. In October 1992, another Winston and Strawn partner was sentenced to 55 months in prison after pleading guilty to mail fraud and tax evasion. Later in 1992, Harvey Myerson was sentenced to 70 months for defrauding clients at New York's now defunct Myerson & Kuhn.

In California, Bronson, Bronson & McKinnon partner Wilkes Morgan was sentenced to two years in federal prison for embezzling at least \$2.3 million, while a Latham & Watkins partner was reportedly fired for falsifying \$100,000 worth of receipts in 1994.

As an increasing number of attorneys have become embroiled in embarrassing imbroglios with the authorities or their clients, trade journals and other scholarly reviews have begun to address the subject. This growing client concern has in turn spawned an entire new industry—that of legal auditing. The purpose of this article is to provide some basic information on legal audits and suggestions on how to successfully cross-examine the legal auditor retained by the client.

DIMENSIONS OF THE PROBLEM •

Analyses of the problem have ranged from the merely anecdotal to the philosophical. For example, compare Susan Beck and Michael Orey, *Skaddenomics: The Ludicrous World of Law Firm Billing*, 13 *The American Lawyer* 3 (Sept. 1991), and Sissela Bok, *Can Lawyers Be Trusted?* 138 *U. Pa. L.* 913 (1990). Some commentators have focused on the various conflicts of interest inherent in hourly billing as a contributing cause of the problem. See, e.g., Richard C. Reed, "How Did We Get To Where We Are And What Are We Going To Do About It?" in *Beyond the Billable Hour: An Anthology of Alternative Billing Methods*, (R. Reed ed., 1989). Others have focused on improved law office management techniques and better communication between the attorney and client as a cure. See Gary Greenfield, *What Law School Never Taught You*, 12 *California Lawyer* 53 (July 1992). And still others have analyzed the growing body of case law that has established certain basic requirements for ethical attorney billing. See William G. Ross, *The Ethics of Hourly Billing By Attorneys*, 44 *Rutgers L. Rev.* 1 (1991); Joanne Pitulla, *Truth in Billing*, 70 *A.B.A. J.* 120 (Dec. 1992); James P. Schratz, *Resolving the Cumis Quandary: Guidelines for Reasonable Fees*, *Ins. Litig. Rep.* (June 1992); Schratz, *Billing Guidelines and Fee Disputes: A Case Law Review*, 18 *Trial Diplomacy J.* 159 (May-June 1995).

Time Billed for Services Not Rendered

Some recent discussions on the subject indicate that a surprisingly large number of attorneys perform tasks and record time that was never expended on behalf of any client. Ross, *supra*, at 3. Professor Lisa G. Lerman, in her article, *Lying to Clients*, states that nearly all of the 20 lawyers interviewed reported some amount of deception in billing practices. Lisa G. Lerman, *Lying to Clients*, 138 U. Pa. L. Rev. 659, 705 (1990). Professor Ross, in his study, found that 38 per cent of the private practitioners and 40.7 per cent of the corporate counsel believe that lawyers "occasionally" inflate their hours. Based on his survey, Professor Ross concluded that there is no support for the proposition that "the vast majority of lawyers bill ethically and accurately." Ross, *supra*, at 16.

A recent survey of 3,000 business consumers of legal services including chief executive officers, chief financial officers, and general counsels by the Chicago based accounting firm Checkers, Simon and Rosner, found that almost half of those surveyed believed their attorneys were overbilling.

ENTER THE AUDITOR • Consumers of legal services have responded by subjecting attorneys' bills to the unrelenting scrutiny of legal auditors. And as auditors have uncovered abusive billing practices, clients have responded by refusing to pay the attor-

Since the term "legal audit" does not have a precise definition, it is important for the law firm to understand the level of scrutiny its bills are being subjected to.

neys' bills or by filing lawsuits. What is surprising in many of these fee disputes is how ill-prepared the law firm is in cross-examining the legal auditor retained by the client.

TYPES OF LEGAL AUDITS • Since the term "legal audit" does not have a precise definition, it is important for the law firm to understand the level of scrutiny its bills are being subjected to. The following is a brief description of the four basic degrees of analysis that are usually included within the term "legal audit":

- Comprehensive audits;
- Preliminary audits;
- Reviews of fee and expense billing only; and
- Letter reports.

As described in more detail below, central to the first three levels of analysis is inputting the invoices into a computer which allows the auditor to perform various word searches and other functions. Depending on the amount of the invoices, this service

can be rather expensive and some clients opt for the less costly approach of requesting the auditor to manually review the invoices and allocate the time entries to general categories such as "pleadings," "discovery," "conferencing," and so on. Although this type of analysis does not provide the level of detail that the computer analysis provides, it does give the client a general picture of what activities the law firm engaged in.

Comprehensive Audits

The most comprehensive review available is one which includes a review of all fee and expense entries, law firm work product, expense documentation, pre-bills, and time sheets, as well as interviews of key law firm personnel. This on-site audit is the most expensive and time consuming, and many clients decide not to elect it for those reasons.

Preliminary Analysis

Less comprehensive is a preliminary analysis based on a review of all of the firm's fee and expense entries, and a review of whatever expenses, documentation, work product, pre-bills, and time sheets can be provided by the client, but without the on-site portion of the audit. This audit avoids the costs of visiting the law firm and while the auditor does not have the benefit of interviewing the attorneys, a great deal of information can be obtained through a review of all of the documents.

Review Audits

Still less comprehensive is a review of all of the law firm's fee and expense billing without the review of any expense documentation, work product, pre-bills, or time sheets. Although in some instances this type of audit can be beneficial, it lacks both on-site interviews and document review.

Letter Reports

The least comprehensive review is a letter report that simply analyzes specific concerns or issues of the client which can be identified from billing entries or statements.

PREPARING FOR CROSS-EXAMINATION • The basis of any thorough cross-examination of a legal auditor should focus on the following seven questions. As discussed in more detail below, many so-called legal auditors fail to meet the criteria suggested by these questions:

- Do the auditors conduct an on-site review of the files?
- Do the auditors have sophisticated software and the necessary computer system to assist in reviewing the bills?
- Do the auditors review all of the billing entries for both fees and expenses, or merely review a sample of the entries?
- Do the attorneys on the auditing team have litigation experience?
- What is the basis of the methodology of the audit?

- Are the findings of the legal audit supported by exhibits so that someone can determine the basis for the numbers in the report?
- How are the auditors compensated?

On-site Review of the Files

In preparing to cross-examine the client's legal auditor, determine whether the auditor failed to review the work product or interview any of the attorneys or paralegals whose time was billed on the matter.

Did the Auditor Review All of the Work Product?

The most thorough audit involves a review of all work product and interviews of at least some of the attorneys who billed the file. An auditor may have failed to review all work product or interview the attorneys for various reasons, including the client's desire to limit expenses. In cross-examining a legal auditor, focus on whether all work product was reviewed and how much time was spent in this review.

How Much Review Is Enough?

Just as a law firm partner does not need to review all of the work product of a new associate to evaluate the quality of his or her work, a legal auditor need not review all of the work product in conducting an audit. On the other hand, the auditor needs to review a substantial amount of the law firm's work product.

Determining Which Tasks Consumed the Most Time and Money

With the computer-generated analysis of the invoices as a starting point, the auditor can easily determine which tasks consumed the most time and money and focus his or her analysis in those areas. For example, assuming a total fee of \$1 million, if only 10 per cent of that amount was incurred drafting or responding to written discovery, the auditor should not spend a great deal of time reviewing interrogatories or responses to interrogatories. On the other hand, if the computer analysis reveals that the law firm incurred \$400,000 on a motion for summary judgment, the auditor should carefully review the motion. As a general rule of thumb, in auditing a legal bill of approximately \$1 million, at least 50 to 60 hours should be devoted to reviewing the firm's work product. In addition, a substantial amount of time should be devoted to analyzing the computer-generated audit reports.

Computerized Support Tools

An essential element of any legal audit involves inputting the bills into a computer which allows the auditor to perform various word searches and other functions. This task can be accomplished by obtaining the bills on a disk, and then downloading the information into the auditor's computer, optically scanning the bills into a computer, or manually inputting the bills.

After the bills have been inputted into the computer, each billing entry is reviewed and allocated to various categories.

"Blocked Billing" Inquiries

In this regard, the auditor should be asked how the firm handled its "blocked billing" (the grouping of different tasks within one block of time on a time record.) Because it is extremely difficult, if not impossible, to accurately ascribe the correct amount of time to each entry, various auditors use different methods.

Proportionalization

Some auditors use the "proportionalization" method. For example, if there are five entries in a blocked bill and the total amount of time is 5 hours, each entry is allocated one hour. Other auditors, based on years of experience, estimate the allocation for each entry. The most sophisticated approach is to determine the average time of all itemized entries and then allocate that amount of time to each entry within the blocked entry. For example, assume a blocked entry consists of the following individual entries: "Telephone call with client; research; travel to court; attend hearing; return to office. . . . 7.00 hours." Further assume the computer program determines the average amount of time attributed to all itemized entries of "telephone call with client" is .25 hours. The computer will then as-

cribe .25 hours to that particular entry within the blocked bill.

Are Ascribed Figures Inadequate?

There are numerous problems with any of these attempts by the auditor to deal with this unacceptable billing practice. For example, the auditor may allocate no more than .25 hours to any phone call and describe any amount of time spent on a phone call longer than this as overbilling. However, remember that the burden is on the attorney to demonstrate that his or her entries are accurate, which can be extremely difficult when the attorney has block-billed.

Reviews of All Bills

Some auditors merely review a sample of the bills. This isn't enough. It is imperative that the auditor thoroughly review each and every bill and each and every line entry on each bill. In light of the vagaries of litigation—in which one month may be extremely busy and another month extremely light—just a sample of the bills does not provide an accurate picture.

Is the Legal Auditor an Attorney?

Although this is not an essential requirement, an in-depth familiarity with the litigation process is essential. Years of experience as an insurance claims adjuster or as an attorney, to cite just two examples, would furnish this experience. Someone claiming to

be a legal auditor without in-depth experience in the litigation process may be subject to attack.

Since legal audits focus on the process and not on the substantive area of the law, in-depth experience in the particular area of the underlying case is not required. Nor is it necessary for the auditor to have extensive trial experience, since the auditor merely highlights possible problem areas and should not engage in minute second-guessing of the attorney on various litigation tactics. It is not the role of an auditor to challenge whether a Rule 12(b)(6) motion should have been filed. But to the degree that the auditor is an attorney with trial experience, his or her ability to audit legal bills is increased. An auditor with legal experience will be able to say with authority that a 10-page motion to dismiss should not have taken 300 hours, a four-line letter should not have take two hours to draft or that a single attorney should not have billed for more than 24 hours in a single day.

The Methodology of the Audit

Unlike financial accounting, there are no generally accepted accounting principles for legal auditing. However, most well-respected legal auditors audit against one of two standards. The first standard is contained in the retainer letter or billing guidelines sent by the client to the attorney. If such guidelines are not available, a substantial amount of case law sets

forth acceptable billing guidelines. See James P. Schratz, *supra*. In cross-examining a legal auditor, spend a great deal of time on questions concerning the basis of the legal auditor's methodology.

Scope of the Auditor's Experience

To the degree the auditor has reviewed attorneys' fees and conducted audits in various geographical areas of the country for an extended period of time, his or her ability to evaluate the law firm's bills and work product increases. Similarly, the auditor's range of experience with both relatively simple cases and large, complex matters can also be a fruitful area for cross-examination. An auditor who litigated cases around the country or supervised other attorneys throughout the United States, and in the process reviewed hundreds, if not thousands, of legal bills has much more of a basis for his or her findings than a nonlawyer who has only supervised insurance defense cases in one geographical area.

Documentation for Conclusions

A well-respected legal auditor will support his or her conclusions with substantial back-up information. Give great care to the audit reports and the exhibits. It has occurred on numerous occasions that the legal auditor proved to be much more familiar with the bills than the law firm. Also take great care to compare the invoices to the audit report and the ex-

hibits. For example, unless the auditor has a strict quality control program it is possible, if not likely, that mistakes have been made inputting the bills into the computer. This can seriously undermine the credibility of the audit report.

Compensation

This is an area ripe for investigation. Some legal auditing firms are compensated on a contingency basis—a percentage of the amount of money that they shave off the legal bill. This raises serious conflict of interest problems. Other auditors review bills with the understanding that they will be retained as the attorney to represent the client in a lawsuit against the law firm for overbilling. This also raises the specter of conflict of interest. Some auditors either implicitly or expressly offer a 20 to 30 per cent reduction in the bills in their advertisements while other auditors guarantee in writing that the client will be satisfied with the audit. Trustworthy and independent auditors are compensated in one of two ways: based solely on an hourly basis or as a percentage of the fees audited.

The Auditor's Clientele

Well-respected, independent auditors are retained by both law firms and law firm clients to review the bills and to opine whether the bills are reasonable. This helps the auditor to retain objectivity and prevents accusa-

tions that the auditor is acting as a hired gun for a client looking to reduce a bill.

Articles and Scholarly Research by the Auditor

The law in this area is growing rapidly and an auditor should be questioned about efforts to remain current with the latest case law. Devote a great deal of time to questioning the legal auditor on all articles, speeches, seminars, and courses the auditor has written, created, or participated in. This in turn requires research into the case law on acceptable billing practices for cross-examination purposes.

Has the Auditor Been Quoted Lately?

In addition, a few auditors are routinely quoted as experts by such highly respected publications as *The Wall Street Journal* or *The New York Times*, or their work is cited by the courts. Attorneys preparing for cross-examination should be fully aware of all such references.

Preparing for Cross-Examination

With the foregoing as a conceptual basis for cross-examination of the client's auditor, the following are some additional suggestions for preparing for the cross-examination.

Get the Auditor's Report

Obtain a copy of the audit report as soon as possible. Sometimes the expert refuses to turn over the report,

claiming the attorney-client or work product privilege. When the auditor has also been retained as the attorney for the client in a lawsuit against the firm, the auditor may refuse to produce the report, claiming attorney work product. In such cases, the law firm should seek to preclude the audit from being introduced into evidence through a motion in limine or should file a motion for summary judgement that, absent the report, there is no evidence of abusive billing.

Depose the Auditor

In an unusually high number of cases, often because of the expense involved, the firm does not depose the auditor. It is surprising how frequently law firms have little, if any idea about what the auditor's testimony at trial would be.

Use the Internet

Counsel are beginning to exchange information about expert witnesses on the Internet, America OnLine, Counsel Connect, and other services. The law firm should avail itself of this inexpensive avenue of discovery.

Obtain Copies of Correspondence

Some insurance companies are notorious for delaying payment to their experts which sometimes results in correspondence between the expert and attorney or client which can be quite helpful. For example, in a bad-faith lawsuit against an insurance company for failure to pay defense costs, correspondence from the expert which demonstrates the carrier is continuing such a scheme can be persuasive.

CONCLUSION • Given the admission of overbilling by a significant percentage of the legal profession and the corresponding belief by clients that they are being overcharged, auditing legal bills is likely to occur with increased frequency. Law firms which find themselves in a fee dispute need to recognize the wide variations in the quality of service provided by the legal auditing profession and adequately prepare for the day their bills may come under attack. By applying some of the suggestions discussed in this article, you will be better able to determine if the legal auditor who is questioning your firm's bills is truly competent to do so.