

TRUSTS & ESTATES

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Taking a Fresh Look At Pricing
In Estate Planning*New model reflects need to re-gain ground amid competition from banks and brokerages.*

BY JOHN D. DADAKIS

IS PLANNING for wealth preservation and transference primarily a legal issue, or primarily an investment issue? The best answer is both, yet the legal community has been losing ground here for 30 years. While firms are ever larger, private client practices are ever smaller. Meanwhile the financial planning departments of banks, brokerages and even insurance providers are now handling much of the planning aspects of this work, often leaving to us only the “scrivener” task of preparing the legal documents.

We lawyers are at a loss in counseling many clients on a continuous basis. Once we understand how and why this happened, we can see a path to again making private client practice a cornerstone of our profession, which in turn will protect client interests and their estates far better.

Why are clients not bringing this business to law firms? And why do more and more law firms not want it? As in most business situations the solution is carefully aligning the needs of the buyer, the client, with the value of the seller, the lawyer who specializes in this complex and essential area. It may sound odd, but this is fundamentally a pricing problem.

Forces at Work

In many ways the shift of estate planning away from the legal profession was one of the consequences of *Goldfarb v. Virginia State Bar*, 421 U.S. 773 (1975), the Supreme Court decision that applied antitrust rules to the way law firms price their services. While that decision had to do with a state bar setting prices for real estate work, the decision was inevitably more far-reaching than that. Effectively *Goldfarb* started the erosion of the “old fashioned” billing practices of trusts and estates lawyers.

The concept of preparing a will for a low fixed



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cost with the idea that the law firm would handle the estate and trust administration work for the “bar-sanctioned” fee (for instance, a percentage of the value of the estate equivalent to an executor’s commission when handling estate administration) was no longer viable as clients insisted on hourly rates for such work. However, even the hourly rate concept was faced with limitations. With estate and trust administration, what was once a sanctioned minimum fee became a cap in the hourly-rate structure. And in the estate planning arena, while hourly rates became accepted, anything over what was suggested in the press as the “going” price, became an area of bedevilment. The ever-higher hourly rates created new disincentives from both the clients’ and lawyers’ points of view.

In other ways the shift of estate planning or so-called “financial planning” away from law firms to other kinds of service providers has been due to the rise of new types of financial institutions, and the liberalization of how these firms may operate, starting in the mid-1980s. Simply, there is competition for the business, exacerbated by the fact that many of the other service providers may give the planning away for free as an enticement to undertake the

professional work for which they are paid.

What has happened has been a blurring of the distinction between wealth preservation/transference, a legal issue, with wealth management/investment, which is not. Investment advisors may be the best resource to assist a client with their investments. An experienced trusts and estates attorney, however, is the best resource to help a client who has investments plan for their management from an estate tax and personal planning perspective. While both aspects are “wealth management” issues, the time has come to unbundle these two quite distinct money management functions in the interests of the clients, as well as the professions involved.

This is more urgent today, as we see confidentiality issues subject to a continuous assault. The recent developments with KPMG, for example, and the continuous tax shelter investigations reveal a need for clients to be well aware of their advisors’ abilities to protect confidential information. Discussions concerning an individual’s wealth planning, including important information about family issues, with accounting and investment advisors will not be protected. It is only the attorney-client relationship which offers that protection.

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While *Goldfarb* may have been the opening strike, something else began happening in the late 1970s which has continued until today—people started living longer and moved more often. No longer could a lawyer offer estate planning as a “loss leader” with the hope of recouping the “loss” by handling the estate’s administration, whether charging on an executor’s fee basis or an hourly rate basis.

Models for Pricing

The hourly rate model, the typical legal fee arrangement today, has its own flaws. First, there is the inherent disincentive to working faster. Second, as the legal work relating to managing wealth transference and planning is being reduced to the role of scribe, firms are under pressure to squeeze the most money out of the least work, which means having senior attorneys perform much of it.

Third, on the other side, is the client stress that every time clients have a question, a thought, or a concern, it is going to cost them money—by the minute—to ask it, and to get some kind of answer, and to respond to the answer, and so on. It is not possible that the typical client will be served most effectively or efficiently this way, even if there is a cap in place. Once the cap is reached, the lawyer is faced with diminishing returns, leading to ill will within an hourly-rate legal services culture. At every point on the hourly continuum, one side or the other is losing.

If the estate model is bad, and the hourly rate is bad, what does that leave? It leaves two other models, both of which are more rational and efficient here. The first of the better models is project pricing. The second is a retainer-based model.

Project-based pricing is premised on a flat fee. Many of us end up in a project-based pricing model, albeit by default. How often have we quoted a client a range for the ultimate fee in preparing a will and found the client only “hearing” the lower end and us acquiescing to the lower fee? By charging a flat fee, we take the risk of time and therefore such fee arrangements need to be calculated on known deliverables—the agreed-upon work. After years of experience, don’t we know the average effort of such agreed-upon work, such as preparing a will for husband and wife?

Let me say that this method of billing is no different from that done in the construction industry, where variables, such as weather, can play a role. And there is nothing to prevent a well-disciplined practice to implement justified “change orders,” when clients do change the extent of the agreed-upon work. Consulting firms have used project-based pricing for decades without going out of business. Whether a law firm arrives at the project fee by referring to its hourly rates, and estimating how many hours of which resource will be needed on average—which is exactly how management consulting works—or some other method, will vary with the firm. But once the price is arrived at, there are no surprises. The client pays X and receives Y. The firm receives X and manages against delivering Y, often at higher margins than the similar hourly work would

have been. (Due to the need to provide oversight in the implementation of a project-based pricing such higher margins are totally justified.)

With this method, a client knows exactly what she will get, and does not care (in the sense of billable time) how long it takes. In fact, the more efficient you are, the better the outcome for both you and the client. She may also not care who in the firm does the work where she is not interacting with that person. Project-based billing allows for the development of younger associates without questions from the client about conferences and duplicative work that inevitably arise when clients are sent an hourly-rate bill. It is here that the client and attorney will be aligned in a more beneficial relationship.

The flat fee model only functions well where the work can be completed on a project basis. In the case of a client of even moderate means, perhaps a net worth of \$500,000, a firm may charge \$2,500 to do a will. That may seem like a lot of money to the client when presented with it. However, it is just 50 basis points, or 0.5 percent of their estate, charged once or twice in a lifetime. The same client is probably used to higher commissions in other areas of life. Selling a

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house carries a commission rate of 3 to 6 percent. Most mutual funds charge fees of more than 1 percent, every year. And the money spent on good estate planning could save the estate a huge multiple (and I am not talking of taxes, but in the proper distribution of a non-taxable estate to family members.)

Meanwhile a client with a dramatically higher net worth, for example, \$25 million, has different issues. For this client, the retainer model supplements the project model. The \$500,000 person probably needs no oversight of his planning issues. The \$25 million person needs continual legal support, and not necessarily in a predictable way. The best way to manage a large or very large estate planning situation is to do so continually over time. The sole use of the project model fails at this approach both economically and psychologically.

A retainer, however, closely tied to a “service level agreement” (again borrowing an established consulting concept) is geared to providing needed services over time, resulting in a more continuous relationship with your client. The \$25 million estate needs to be managed through not only crafting legal documents

up front, but then monitoring the administration and results. In addition, such clients have many more wealth ownership and transference issues that require discussions with experienced counsel. And the client can—and should—call on the attorney whenever she has a question, without fear of the dreaded hourly rate.

If we use the example of a \$50,000 annual retainer, this is just .002 percent of the \$25 million estate. Compare that to the charges of a venture capital fund, a common investment vehicle at this level (2 percent of the capital commitment—not the amount invested—plus 20 percent of the profits!). And it is a tiny fraction of what a full-time on-staff personal counsel would charge. Yet it is precisely that level of service that can be delivered by an attorney to that client, at that pricing level with this model. With the increasing scrutiny on the administration of family limited partnerships and other estate planning vehicles, such a service model is necessary for a client with significant wealth. The lawyer’s continuous role on oversight will assist the client in preserving the much desired tax savings, as well as peace of mind.

Whether individuals “want” lawyers to help plan their estates, and whether law firms “want” to do the work, are complex questions, but there is no doubt about three things. First, legal work should be done by legal professionals. Deciding whether or not to buy a particular stock issue is not fundamentally a legal question. Understanding the tax implications and inheritance issues about that stock, once purchased, is. In those situations where assurance of confidentiality is important, only attorneys may offer it.

Second, the pricing method for this work needs to offer a satisfactory situation to clients, who should feel they are getting value, and lawyers, who should want the work and get satisfaction from having done it. Third, the pricing methods pre- and post-*Goldfarb* to the present have not worked well, unless the goal was driving attorneys out of the trusts and estates business.

The conclusion reached, and which I think will become increasingly evident over the next few years, is that value alignment, economic rationality, and that most elusive aspect of business, law and life—common sense—suggest that the best way forward is a blend of a flat project pricing model, together with a retainer-based “personal general counsel” model. Today, there is more wealth in private hands than ever before. It is time that the legal profession aligned itself with the services expectations of those who have it, so that they, and their heirs, may keep more of it.

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