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# Profit and loss: the bottom line

*Time recording and time costing were introduced back in the days when it was slowly dawning on solicitors that they were no longer certain to make a profit simply by working all hours that God sent and charging as much as the matter or client would stand.*

**BY HIS HONOUR MICHAEL COOK**

**T**he profession introduced time costing as it became increasingly clear that not all work was profitable. The aim was to see what work was being run at a profit and at a loss and had nothing to do with charging, or indeed conveyancing, which was still on a fixed scale. But at the same time, conveyancers were exhorted to cost their time to see what profit, if any, they were making.

In the present climate of competitive charging in both non-contentious and contentious work, with costs for the latter being increasingly restricted by being fixed, capped or subject to a predictable matrix, it is as important as ever for a solicitor to know what each area of work is costing and whether it can be charged at a profit.

There is a variety of methods of costing work but the method suggested by the Law Society in its book *The Expense of Time* seems simple and satisfactory to most firms using it. In the contemporary words of *The Solicitors' Journal*: "It recommends a simplified system suitable for near innumerate solicitors. It is a triumph that so many firms have put its provisions into practice".

## **A AND B**

This approach was explained nearly 30 years ago by Brightman J in *Re Eastwood (Deceased)* [1975] Ch 112, ChD, as follows: "The firm submits (a) what is the proper cost per hour of the time spent, having regard to a reasonable estimate of the overhead expenses of the solicitors' firm including (if the time spent is that of an employee) the reasonable salary of the employee or (if the time spent is that of a partner) a notional salary. The firm will also submit... (b) what is a proper additional sum to be allowed over and above (a) by way of further profit costs."

The philosophy was further expounded in *Leopold Lazarus*

*Ltd v Secretary of State for Trade and Industry* (1976) 120 Sol Jo 268, QBD in which Kerr J promoted 'a' and 'b' to 'A' and 'B' and ever since they have been known as the A factor and the B factor. This was also the first time that the expression "direct cost" was used.

The B factor is arrived at by the application of the factors prescribed in the Solicitors' (Non-Contentious Business) Remuneration Order 1994, Part 3 or in Civil Procedure Rules (CPR) Rule 44.5, known as the Seven Pillars of Wisdom.

## **CHARGING RATES**

There is a prevalent fallacy that the A and B factors were abolished in favour of an hourly charging rate. Of course they have not been abolished. Every butcher, baker, plumber and tradesman from Al Fayed to a market stall holder knows what the product cost him or her and what profit he or she is seeking to make – the A factor and the B factor. The legal profession did not invent them. All that has happened is that, at the behest of a former Lord Chancellor, solicitors have fallen into line with the rest of the world and no longer disclose how their hourly rate is calculated between overheads and profit. But the calculation is still there.

A firm of solicitors cannot ascertain if work is profitable by basing its rates on what other firms are charging or by adopting the rates being allowed on between-the-parties assessments of costs. There is no satisfactory substitute for each firm of solicitors undertaking *The Expense of Time* calculation at least annually, for their own benefit and the profession as a whole.

Each firm should calculate its own expense rate for each category of fee earner, the local law society should then conduct a survey of all firms and collate the result to produce the broad average direct costs for the area. These may be converted into charging rates by adding a basic 50 per cent profit mark-up.

The introduction of a charging rate was not as revolutionary as might at first appear. The profit element is still there whether the client or the paying party is told what it is or not. Previously the courts and the parties had the advantage of a bill distinguishing between expense and profit.

The consequence is that, on an assessment of between-the-parties costs, the starting point must be to assume the charging rate includes a standard 50 per cent profit mark-up which the court may adjust up – or down – by applying the CPR rule 44.5 factors.

Otherwise there would be no facility to enable a judge carrying out an assessment to reward skill, effort, specialised knowledge and responsibility, or for him or her to acknowledge the importance, complexity, difficulty or novelty of the matter. The provisions of rule 44.5 would be negated and it might as well never have been written.

#### **SUPREME COURT COSTS OFFICE (SCCO) GUIDE**

It is not the fault of the SCCO *Guide to the Summary Assessment of Costs* that the profession and the judiciary ignore its title and most of its content, and focus entirely on the tables of hourly rates. To regard these rates as a substitute for solicitors calculating their own rates is to put the cart before the horse. The figures in the guide are no more than a simple collation of figures that individual firms of solicitors have calculated.

The figures for each locality are arrived at through a framework of local co-ordinators based on civil trial centres set up by the Law Society to assist in the agreement of local rates. The co-ordinators are responsible for liaising with local law societies and district judges and, thereafter, with the designated civil judge for each trial centre to ensure consistency across the group. The figures are then communicated to the SCCO for publication on its website and in the guide. Unfortunately this simple concept has given rise to much misunderstanding because of the following:

- As the title and the content state, the guide is specifically limited to summary assessments of costs and is intended to provide a simple collation of hourly rates incorporating a 50 per cent profit mark-up appropriate for routine costs to be assessed summarily at the end of a hearing which has lasted no more than a day. It has nothing to do with detailed assessments.

- The guide emphasises that the guideline hourly rates in its table are broad approximations only. The figures are not a scale but are merely a guide for the judiciary, which may be adjusted up or down depending on the circumstances of a particular case. They may be varied locally at any time. They are certainly not carved in stone.

- The guide emphasises that the figures are not intended to replace figures used by those with accurate local knowledge and

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are intended merely to provide a starting point for those faced with summary assessment who do not have that knowledge. Accordingly, where local rates have been agreed, approved and promulgated, everyone does have that knowledge and there should be no need to refer to the guide at all.

- The figures in the guide are almost certainly out-of-date. The ones in the present guide were collated in 2002 and published in January 2003. Since then local rates should have been reconsidered at least once. The SCCO has invited designated judges to submit further figures in November 2004, presumably to be promulgated in 2005.

- The guide no longer purports to provide the figures agreed locally and approved by the designated civil judge for any court or group of courts. Its rates have been massaged into four Procrustean nationwide bands, the figures for which are most unlikely to be identical to those approved locally. It is therefore difficult to discern what purpose they now serve.

#### **GRASS ROOTS**

The message is clear: hourly rates are not imposed nationally from on high – they come from the grass roots. They are the reasonable cost of doing work in a particular locality at a particular time to which is added a profit element based on the Seven Pillars of Wisdom prescribed in CPR rule 44.5. If not, the assessment of costs becomes a bureaucratic exercise, not a judicial one.

*His Honour Michael Cook retired as a circuit judge in May 2003, but still sits regularly in the county court. He is an honorary member, and was the Secretary and President, of the London Solicitors Litigation Association. He was also a founding member of both the Holborn and Westminster Law Societies. When in practice he sat regularly as an assessor with High Court judges on reviews of taxation (now assessments) and advised and represented many firms of solicitors on costs problems, appearing as advocate in several reported leading cases. He is the author of Cook on Costs, general editor of Butterworths Costs Service and of The Litigation Letter, a contributor to Cordery on Solicitors, and a member of the SCCO Costs Practitioners Group.*