Making It Count:

Budgeting Success for General Counsel and Legal Departments

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According to Ben W. Heineman, Jr., one of the most important developments in business and law in the last 25 years is the "rise in the role, status and importance of the general counsel."[1] Instead of turning to the law firm senior partner, the CEO and board of a company seek the general counsel (GC) for guidance on "ethics, public policy, corporate citizenship, and country and geopolitical risk."[2] Also on the rise: the pressure GCs and legal departments are under to perform and ensure their legal departments meet expectations, especially budgetary ones. In fact, they are "under more pressure than ever from management to 'sell' their budgets."[3] They are under the same scrutiny to manage their expenditure as any other department head within a corporation.[4] Certainty is a necessity. Furthermore, GCs are under the additional pressure of showing the return on investment (ROI) for their own positions within the company.

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This white paper will provide legal departments with important budgeting know-how, including how to effectively analyze internal budgets, identify cost risk as well as improve the forecast of future matter cost and annual spend.

I. THE VALUE OF BUDGETS

As corporations continue to ask GCs and legal departments for cost reduction and to do more with less, a department budget is an essential tool. It provides the map to fiscal success and can help steer the department through unpredictable litigation waters.

Additionally, GCs' decisions about litigation matters under their departments and other recommendations they make to the CFO and board can have a significant impact on the overall health, finances and reputation of the company. If GCs are tracking individual litigation spend against budget and the department as a whole, then they can offer some level of predictability on costs.

In general, but particularly if an individual matter is spending more against the budget than anticipated, the information will allow legal departments to make strategic, informed decisions on whether it is in the best interest of the company to pursue the litigation further, seek settlement, how to value the settlement and more.

Tracking spend against budgets also provides overall insight into which matters are more likely to go over budget and when; inform decision trees for avoiding risk for litigation and evaluate; incentivize and control partnerships with outside counsel and vendors in terms of cost, value provided and accountability. This insight is key for GCs and legal departments as they work to provide more with less and show value to their company.

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II. BUDGETING BASICS

When defining the budget, it's not simply about scope and relating cost, it's also about defining the framework of the arrangement. Arrangements can include traditional hourly billing or an alternative fee arrangement (AFA), such as a retainer agreement, fixed fees, contingency fees, reverse contingency fees and hybrid fee arrangements, like ACES, capped fees with shared savings and fee collars.[5]

When beginning a budget and clearly defining the scope, determine the boundaries as well as the desired results. Does this outcome align with the company's business goals?[6]

Ensure that both in-house and outside counsel understand and share in these goals.[7] During this communication with outside counsel, it's important to also set matter expectations in order to avoid cost overruns in the event counsel were to try everything in counsel's power to win the

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case. Communicating the company's expectations as to the level of effort and cost to pursue this matter can help identify that this is not a win-at-all-costs matter. Other expectations can be set as well, in terms of who and how much is being charged (number of lawyers being used, level of experience of who can work on this project, what expenses and services the company will be willing to pay / cover). For example, it could be as simple as stating that there are particular items that can be discussed via a simple email message instead of a formal memo that costs more billable hours. All of this can help define inside counsel's goals to outside counsel and, most important, prevent overspending.

After this, develop a step-by-step litigation plan to achieve these goals, which includes identifying the resources — technical and personnel — necessary. Once the litigation plan has been established, create the corresponding budget.[8]

The Association of Corporate Counsel (ACC) advises identifying the portions of the budget that are more within GCs' control and those which are subject to others' control; for example, defensive versus offensive discovery.[9] The ACC also recommends estimating any significant plan elements; organizing the budget in the same way as the litigation plan; itemizing in-house costs; and providing important detail for each cost factor of the litigation plan.

Once the litigation plan and budget are put into play, the spend must be tracked consistently and accurately against the budget. (More on how technology can be applied for successful tracking later on in this paper.)

III. TEAM EFFORT: INSIDE AND OUTSIDE COUNSEL

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In "The Litigation Budget," Jay Tidmarsh examines reasons why litigants overspend and presents arguments for why and how a mandated budget system could be implemented in the United States.[10] His thought-provoking piece considers whether indirect means of controlling costs is working for the U.S. legal system or if cost control will ever be enough.

According to Tidmarsh, one key factor in irrational agency costs is that the "principal is unable to monitor the agent's performance sufficiently." The traditional billing system provides little incentive to curtail attorney costs. In order to provide an incentive to "agents" and align goals, in-house legal departments have experimented with fee arrangements that move away from the traditional hourly billing. Per Tidmarsh, cost-conscious legal departments are also moving work in-house, performing rate comparison, using RFPs and even requiring bidding for their litigation business to reduce costs and increase value from firm attorneys.

Part of monitoring performance against the litigation budget requires constant communication across the attorney-client relationship. Even if a litigant like a corporation has an organized plan of attack and a well-defined budget threshold, it's essential that the plan is clearly communicated and monitored across the entire team of inside and outside counsel, corporate and board members.

Periodic matter reviews on the status of the matter should take place between inside and outside counsel. While this provides insight into the ongoing activity outside counsel is performing on the matter, it also should include discussion on spend. Questions to ask include why are there variances against the budget? And, if so, are there ways to address these costs now, such as having in-house counsel perform some tasks, use associates versus partners and more. If everyone is aware the budget is being approached and an AFA is in place that will curtail outside counsel costs, how is the quality of the work being performed? Is there going to be an increase in spend in the next time period and if so, why? Are there developments that are going to affect the budget as well as decisions that should be made regarding the litigation? Often these decisions can be discussed with a strategic / risk view for the corporation, including from a budget / financial perspective.

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Inside and outside counsel must review spend regularly and work together to provide updates on the status and budget compared to actuals of each matter. They must also discuss unexpected costs in the respective matter's budget. This is where technology can be of great use and importance. Reputable matter budget software that alerts counsel to approaching thresholds can be of great value. Periodic review on individual matters can provide insight and adjustments that help the predictability of that matter.

A final word on inside and outside collaboration comes in the form of a successful real-world example: Pfizer's Legal Alliance Program. The objectives of the program are to "foster trust and collaboration, promote proactive solutions-based lawyering and reconfigure the value paradigm." The alliance includes 19 firms and its structure promotes collaboration among them. This collaboration and focus on relationships translates to better legal outcomes and cost-savings. According to Pfizer's Chief Counsel for the program, trust is the foundation.

> "The notion of creating a long-term relationship goes a long way. We need to have trust in each other because everything doesn't 'match up' if comparing hours to dollars under the old system; there is no true-up. What we do have is a sense that things will be made fair and that we are operating in good faith. We understand that there may be good years and bad years, but the expectation is that overall this will be positive for us and the firms."

IV. FORECASTING: CONTROL OF THE FUTURE

With an understanding of current market pricing for similar services, a GC and legal department can determine if and when an AFA is appropriate.

Rarely does a CEO or corporate management like surprises, especially not ones that cost money. Forecasting — based on current matter spend and what will happen in, say, two-three months — helps organizations avoid surprises. Certainly, AFAs can help to some extent, however, when forecasting spend, information is the most powerful tool a legal department can have.[12]

By using capturing and tracking spending trends to date, counsel is empowered to forecast forward. Trend lines for a case can only forecast what counsel knows historically. There are a number of forecasting models counsel can use to help forecast future spend, including: Moving Average Model, Double Exponential Smoothing Model, Multiple Linear Regression Model, Naive Forecasting Model and Weighted Moving Average Model. More sophisticated forecasting programs will use the best fit model for the data. No matter how sophisticated the model, it is always important to supplement the historical data with actual case knowledge. Are there upcoming events that could dramatically affect the forecast in a dramatic way? Counsel must always evaluate against the spend to date in combination with known events or activities that could diverge from historical spend. When both in-house attorneys and outside counsel share the goals of predictability and certainty, success is possible.[13]

Forecasting not only creates the foundation for a proactive and transparent discussion, but also helps set expectations and align departmental goals with corporate ones. Furthermore, forecasting can identify inefficiencies and help create cost-saving change. This is where forecasting moves into predicting. For example, with enough data, counsel can know how much a patent case involving a certain number of custodians will cost within a reasonable margin of error based on the company's historical information.

The questions a GC is trying to answer guide the metrics being tracked.

V. METRICS: BY THE NUMBERS

A legal department can show its value within a company by measuring its success through specific metrics. In fact, when it comes to the value of adopting metrics, the ACC references the expression, "You can't manage what you don't measure."[14]

The ACC offers a thorough listing of recommended metrics for outside as well as in-house counsel. The questions a GC is trying to answer guide the metrics being tracked. For example, whether a certain lower-price niche firm works better for certain tasks; whether using inside counsel would be more appropriate than outside counsel on some matters; and whether AFAs are helping to curtail costs.

The other metrics, which center on qualitative measures, contribute to gaining insight and control over outside partnerships.

OUTSIDE COUNSEL PERFORMANCE METRICS[15]

- Rate of overall success in achieving client goals (e.g., tracking "wins" where possible, or resolution of matters within expected parameters, or closing within a particular time period, etc.);
- Scores on qualitative measures assessed by in-house counsel, evaluating items such as creativity, responsiveness, efficiency, knowledge sharing, etc.;
- Financial metrics like the percentage of matters for which a full year budget was submitted on time;
- Percentage of matters managed for which forecast updates were submitted on time;
- Actual spending versus budgeted, by matter;
- Comparative costs (what Law Firm A charges to produce a particular piece of work vs. what Law Firm B charges);
- Average blended rate for all law firm attorneys who billed to the client (i.e., divide total fees by number of hours billed, for each matter and across all matters); and other process goals (i.e., goals relating to the process by which the work is completed), including timely completion or submission of:
    - Monthly reports;
    - Early case assessments; and
    - After action reviews / lessons learned.

A complex tracking system can lead to confusion over what tasks fall under which categories.

Insight and pattern identification play a large role in why metrics speak to both the department level and individual litigation budget. Invoicing systems track at the task level, so in order to truly gain insight into the overall costs of the matters, a GC should roll up the actuals. Invoicing systems track at the task level but in order to truly gain insight into the overall costs of the matters, a GC should roll up the actuals into the main cost drivers or cost buckets. Example areas to track as cost drivers are Depositions, Motions, Trial Prep, Managed Review and eDiscovery. They may vary from company to company, but a GC should allow the actuals versus budget to focus on where most of the money is going and how a legal department could improve this process.

Cost drivers or cost buckets allow for clarity and insight into inefficiencies by grouping similar cost relating to actions. Additionally, counsel will gain insight into how those actions change over time or differ with case type. This information will inform appropriate deal structures for each type of case. In the other direction, complex tracking systems that add more data points or bill codes will make it difficult to realize where savings can be afforded. Furthermore, it becomes extremely difficult to manage as counsel has to train and gain compliance from all outside counsel to adopt and adhere to these new standards. An increased number of bill points will also make it more difficult to change over time or compare against historical data. Repeatable processes generating high-quality relevant data will support the department's efforts to show value in the near term and provide a well of data to reference in future analysis and forecasting.

INDIVIDUAL IN-HOUSE COUNSEL PERFORMANCE METRICS[16]

Knowledge is power, and knowing what a company spent in the past for a desired outcome will help inform what the matter should cost.

- Amount of outside counsel spending (in dollars) managed per in-house attorney;
- Number of full-time equivalent resources managed per in-house attorney (take total number of hours billed on all matters managed by that attorney, and divide by 2,000);
- Percentage of matters handled internally, without any outside counsel involvement (and value generated, i.e. what would outside counsel have cost?);
- Percentage of matters managed for which next year's budget was submitted on time
- Percentage of matters managed for which forecast updates were submitted on time
- Actual spending vs. budget, by matter;
- Success in predicting total cost resolution range for a matter (e.g. compare Early Case Assessment projection to actual results);
- Other process goals . . . timely submission of:
    - Monthly reports;
    - Early case assessments;
    - Mock trials; and
    - After action reviews / lessons learned.

Metrics such as these will help the GC and legal department demonstrate measurable success to management

VI. NEXT STEPS FOR METRICS: REPORTING AND BASELINE

Once a department has gathered the metrics, there are two key steps to take with the data prior to analysis.

Reporting

Budget and matter software continues to be refined and offer GCs a number of valuable ways to filter data for analysis. Examples include spend versus budget, matter, matter type, litigation exposure by matter, firm, AFAs, cost driver and, perhaps one of the most important, inside versus outside spend. Each reporting type offers GCs key insight that can be applied to budgeting efforts.

More data can translate into better insight and predictability.

Baseline

It's extremely valuable for a legal department to look to past performances to gauge the cost and efficiency of current and future work. Knowledge is power, and knowing what a company spent in the past for a desired outcome will help inform what the matter should cost.[17] A GC and legal department can review past successful cases for parameters like "number of cases, case importance, risk level, amount of spend, hours worked, staffing levels, and duration."[18]

IX. ANALYSIS AND POSITIONING

Once all relevant data has been collected, the analysis can begin. The subsequent knowledge enables a GC to enjoy a firmer footing and greater control of the process with outside counsel.

Once a GC has evaluated a firm's performance — rate, value added, outcomes — the information can provide leverage and incentives. It also opens up work to RFPs and bids from other firms. Billing policies and guidelines can be negotiated with confidence.

A GC can take action on rates by reducing them, gaining volume discounts and seeking AFAs, fixed fee or monthly retainers as mentioned previously when discussing benchmarks.

A GC should remember that this information is power, and he or she should not be afraid to move work from one firm to another, especially if the data analysis reveals it's in the legal department's best fiscal interest. Niche firms can be employed for specialized work at lower prices. In short: A GC can gain more leverage by reducing the number of firms the legal department works with.

In addition to evaluating and streamlining relationships with outside counsel for the best ROI, a GC should evaluate whether in-house or outside counsel should do the work and specifically for which matters. It's important to know when and how often to engage outside counsel.

A GC needs to be aware of internal head count and consider the importance of growth. In order to effectively show management the ROI of an in-house legal team, the proper reports must be generated, including showing spend versus budget, and the cost savings due to legal department decisions and process changes evident.

A strong budget can strengthen a GC's position.

CONCLUSION

It is essential that a GC and legal department convey the strategic role they play within a company. By doing so, the legal budget transforms from a "cost" to an "investment in sustainability," and can make it easier for the CEO and management to accept the proposed budget.[19] Furthermore, a strong budget can strengthen a GC's position.[20]

According to David Moran, "legal budgeting is an art if you have the right intelligence." It takes the right tools to mine the right data and the proper application of that data to create a sound budget — one that enables the legal department to contribute to the long-term success of its company.

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