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LAW FIRMS

The Art of Projecting Budgets for Litigation Alternative Fee Arrangements



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Predicting the future has become a critical skill for lawyers—at least when it comes to budgeting for case work. Clients want as much certainty as possible for planning and allocating legal expenses, which inherently carry uncertainty. Consequently, clients routinely ask for fixed-cost alternative fee arrangements (AFAs), requesting law firms help shoulder the “uncertainty” burden.

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This shift in fee arrangements means lawyers must develop a new set of skills, in addition to their legal expertise. When an AFA is used, it’s critical for law firms to employ precise planning and budgeting practices because any miscalculations in an underlying fixed-fee arrangement can directly impact the value proposition for the client and the firm. In recent years, we have crafted numerous AFAs for civil litigation matters, which involve some of the most unpredictable work in the industry. However, by deploying a few basic strategies to mitigate risk and avoid pitfalls, firms can increase their chances of executing effective and successful AFA arrangements for their clients.

Developing AFAs From the Bottom Up

The key question at the outset is simple—what will it cost? Estimating correctly starts with planning. The primary way to develop an AFA is to build from the bottom up by estimating costs and resources devoted to each component of the work. For that reason, it is very important to understand the client’s goals and strategic needs at the outset of this process. Three of the primary categories involved in budgeting are attorney tasks, document costs associated with document review, and technology and data costs. Though not the only costs incurred by civil litigation matters, these are the primary drivers of expenses in our experience.

Cost planning must be an all-encompassing process when building an AFA proposal; any oversights can widen the gap between projections and realized expenses, so lawyers must take great care to lay out all tasks involved on the front end to ensure the proposal aligns with the actual work. This requires fully scoping out the matter to reflect all aspects of the work during the life cycle of the case and communicating this roadmap to the client.

It is critical to be specific and concrete—make a spreadsheet and set out what motions, events, and tasks are expected. Then project hours per task for partners, associates, and staff. This might include drafting motions, conducting interviews and/or depositions, performing fact development, participating in meetings,

negotiating with regulators or opposing counsel, and trial. The amount of time dedicated to each of these tasks will vary by matter. Costs will also depend on the level of seniority, and thus the hourly rates, of the attorneys responsible for each task. In our experience, it is often better to base projections on the number of attorney hours needed to complete the work multiplied by blended hourly rates (one for partners and one for associates) rather than assuming specific attorneys for each task.

Projecting the time needed for document review is, perhaps, the most critical element when building an AFA. Document review is an integral and substantial part of any civil litigation matter, and it provides the basis for much of the fact development and discovery—and it often accounts for the vast majority of hours worked. On some matters, a given day may involve work by three senior attorneys and 30 document reviews. Errors in estimating the pace of the document review work can quickly compound.

Factors to consider when estimating document review costs include the size and scope of the review and the relative complexity or difficulty of the documents involved. Because these factors may be unclear at the outset, estimates frequently rely on basic assumptions about the work—often, most importantly, how many documents per reviewer per hour. It is best practice to provide clients with a detailed list that explains the assumptions being made when projecting each matter's costs and to give the client updates if those assumptions change.

Technology and data costs are also important for AFA estimates.

We use a variety of factors when making these assumptions and analyze the work based on some basic questions such as: Does the review include long, complex accounting documents or difficult computer code? Or are the documents relatively straightforward emails and other communications? Are there ways to re-purpose work product or conduct review in a more targeted, efficient, non-linear manner? Similarly, the complexity of the protocol used by document reviewers will affect how quickly the materials are processed—for example, how many boxes does a reviewer need to click before moving to the next document? In-depth assessment will obviously require more time than a brief review of each document.

Technology and data costs are also important for AFA estimates. These include costs associated with collecting, processing, hosting, and producing data. These costs depend largely on the volume of data involved and how it will be used. As with estimating the scope of a document review, projecting data volume and storage is often more art than science. With limited initial details about a civil litigation matter, firms must exercise caution when making projections because data sources are plentiful in the 21st century and unexpected troves of information may be uncovered. Many matters now require collecting data from cell phones, social media, and other sources beyond traditional electronic communications and documents. Oftentimes, the best real-

ity check is to assume data costs as a percentage that varies with review costs—if you are projecting high review costs but low data storage costs, for instance, something may be wrong with the estimate.

Challenges to Developing an AFA

Throughout the AFA process, the overarching concern is that unforeseen tasks will increase lawyers' workload beyond assignments laid out in the agreement. With experience, firms can develop accurate estimates for specific attorney tasks, but a judge's unexpected denial of a motion can send a team back to the drawing board, adding hundreds of hours of unbudgeted work. Or discovery may broaden after an enforcement agency expands the focus of an investigation. Or previously unaccounted-for data could expand the document review workload.

Creating accurate estimates for document review can also result in a significant hurdle during the AFA drafting process. A faulty assumption about the time needed to review each document can throw off workflow. Even a 10–20 percent increase (say 60 seconds, instead of 50, per reviewed document) can drastically prolong its duration. One method used by firm eDiscovery experts is sampling of the data to gauge complexity and gather insight into data sets to make more accurate representations. Predicting the existence of unexpectedly complex documents, though, is not easy, but it will have a major impact on the final expenses for the matter.

Similarly, problems may crop up with technological and data costs, where underestimating the volume and the resources needed to collect, process, host, and produce data can lead to large expense increases.

How to Address the Challenges

There are a few different approaches firms can take to avoid obstacles and limit uncertainty. First, a best practice in AFA drafting is not only to use the bottom-up approach, but to compare cost estimates against actual expenses from similar prior matters. In this hybrid strategy, it is important to develop a comprehensive bottom-up approach that accounts for all complexities and uncertainties. The resulting estimate should then be compared to the actual costs from a similar matter. This provides a reality check and adjustments can be made based on how similar matters played out in real-world conditions. After developing the hybrid estimate in this manner, it's also necessary to make final adjustments based on any unique attributes the matter has. Technology and data analytics are extremely valuable when using this approach. Our firm tracks how budgets evolve in AFAs and offers extensive technological tools that provide financial modeling and can help predict the costs and hours required for a given matter.

An essential prerequisite to a successful AFA is building a team that can work within that AFA.

Firms can also build contractual safety valves into the AFA to address remaining uncertainties. The most straightforward option is to require a pool of funds to cover unanticipated costs. Another option is to draft an

AFA that allows for renegotiation if certain key assumptions are not met. Finally, AFAs can be drafted to proceed in stages, based either on tasks, such as through a motion to dismiss, or on a periodic basis, and to allow adjustments if necessary after relevant milestones have been reached.

In our experience, using the latest technologies available to streamline document review and increase efficiency, including predictive coding tools, can help in managing document review costs when uncertainties arise. An experienced legal project manager can be very helpful in scoping all phases of discovery that touch document review—processing, hosting, technology, review and production. Through the use of integrated methodologies and sophisticated analysis and technology, lawyers have increased ability to facilitate more efficient, cost-effective hosting options and strategic document review.

An essential prerequisite to a successful AFA is building a team that can work within that AFA and educating that team as to the plan for working within that AFA. If a law firm does not seriously consider this step, the risk of departing from the AFA increases significantly. Again, the assistance of a legal project manager can be key to monitoring how the work is tracking with the budget on a “real time” basis and they can raise red

flags when changes arise so that adjustments can be made before the AFA goes off course.

Unfortunately, litigation is not always predictable and there can be surprises along the way. Therefore, it is critical to keep the client fully informed over the life of the matter as to how the matter is progressing. The firm should propose regular reporting of actual-to-budget spending and regular status reports. This open communication ensures the client knows where the matter stands and if the AFA needs to be adjusted, either up or down, so there are no surprises at the end of the billing period.

Conclusion

AFAs are becoming increasingly popular because they provide certainty and security in the delivery of legal services to clients. As more law firms offer AFAs for civil litigation matters, these fixed-fee arrangements will only grow more commonplace. For attorneys, that means projecting accurate estimates for AFA expenses is now a critical skill that must be learned and honed. This can be achieved through careful scoping and the application of a comprehensive bottom-up approach using prior matters as a benchmark, collaborating with the client to ensure alignment of goals, and harnessing the capabilities of technology. The result will be an effective, successful AFA that works for both parties.