

Budgets

January 04, 2012

Overview

Despite the variability in most legal work, clients and outside counsel are well advised to discuss a budget for fees and costs concerning the legal representation early in the engagement. This is a subject either party might prefer to avoid, but failure to address this early and often throughout the engagement can lead to surprises, strained relations, and even termination of the relationship and disputes.

Early Matter Assessment

The lynchpin to successful budgeting is a reasonably in-depth early assessment of the matter. Almost every client insists that it conducts these reviews as a matter of course, but very few actually do because most don't wish to spend money for this at the beginning of the engagement. Nonetheless, this may be the best money spent in the entire engagement. It can drive key strategic choices, including the most fundamental decisions of whether to move forward with a transaction at all or whether and when to litigate or settle a dispute.

What should a good early matter assessment involve? It should involve a thorough discussion between the client and outside counsel about the client's business (or personal) goals and legal objectives, the significance and value of the matter to the client's business (or personal) interests, the context of the matter (events leading up to it), the key players (inside and outside the client's organization), and any related or parallel transactions or proceedings (*e.g.*, prior or contemporaneous business dealings between the parties, pending requests for permits or approval for transactions, pending or threatened regulatory investigations or enforcement proceedings).

Outside counsel should be authorized to meet with and interview key persons (decision makers or financial experts in a transaction and witnesses in a litigated matter), to gather and review key documents, and to conduct legal and basic factual research on all key issues. If this is a rush matter, the time for doing this will be compressed. If time permits, this can and should be done in the first 30-90 days of the engagement.

At the conclusion of this investigation and research, outside counsel should conduct a careful analysis of the information obtained and present this analysis to the client. If the matter is litigated, ideally both sides of the dispute should be presented aggressively by different persons on outside counsel's team. Counsel should present this to key decision makers in the client organization who ultimately will make the determination whether or how to proceed with a transaction or whether to try to settle the dispute. This should include business leaders in the client organization rather than just inside counsel.

Budgeting

With the benefit of this early matter assessment, the client and outside counsel will be able to develop a realistic budget for handling the matter. Keep in mind that this process should include consideration of alternative strategies rather than simply pricing one recommended course of action, which will have implicitly ruled out less costly and more costly options. Consider developing "low-case," "mid-case," and "high-case" options in terms of the scope, extent, and dollar cost of the engagement, keeping in mind, however, that each approach will involve a very different set of trade-offs in terms of risk, costs, and anticipated rewards.

Each budget will vary depending upon the nature of the engagement and client preferences. But some best practices apply to all approaches:

- Establish and identify the members of outside counsel's team with as much specificity as possible, and attempt to maintain continuity of this team throughout the engagement. This will enhance certainty in anticipating the cost of services and will also help avoid inefficiency and duplication of effort.
- State all critical assumptions used to prepare the budget, but don't lean on these as a substitute for arriving at reasonably reliable estimates.
- Divide the matter into key stages, and budget activity for each stage. The earlier stages, of course, will be more certain.
- Outline in reasonable detail the activities you anticipate in each stage, identifying the timekeepers, their hourly rates, and anticipated hours for each activity.
- Outside counsel should report monthly how the matter is progressing in relation to budget in terms of (1) the progress of the matter as measured by key milestones in the engagement, (2) the incurrence of fees and costs to date in relation to what was predicted to occur, and (3) the likely progress of the matter in relation to what the budget forecasts.
- Incorporate a "change order" procedure, preferably providing for written agreement by outside counsel and the client to changes to the budget in advance, or, if unavoidable, after the fact.

- Identify any fees or costs (especially for third parties, including experts) excluded from the budget.
- Do your best to anticipate and incorporate amounts for contingencies that might occur, even though you do not currently anticipate they will. You can do this in the form of “worst case” scenario planning, or you can rely on past experience to “round up” the total number to get to a range you have experienced in actual similar, prior engagements.
- Be sure to state whether or when outside counsel might anticipate adjusting hourly rates during the course of the engagement to avoid surprises or misunderstandings when that occurs.

Keeping Within Budget

In most engagements, you will be dealing with another party whose actions can force you to engage in activities you might not have planned to perform. You should strive to anticipate this as much as possible based on past experience and what you know about your particular engagement and other parties to the transaction or litigation. That said, you will still have some surprises you cannot anticipate, which you will have to provide for through the “change order” procedure discussed above.

Nonetheless, you will have more within your control than most clients and outside counsel often consider. A key to operating successfully under alternative fee arrangements or under an hourly rate arrangement disciplined by a rigorous budget will be open and frank discussions between outside counsel and the client regarding management of the matter. Many matters cost more than they should because outside counsel are not given sufficient control by the client over implementation of the engagement. Under an hourly billing arrangement, the client assumes the risk of this. Therefore outside counsel may be inclined to cede control over the matter to a client willing to pay for the privilege. In some cases, outside counsel may feel compelled to perform services that may not be strictly necessary to avoid criticism because the client is unwilling or unable to make necessary decisions on a timely basis about risks and rewards.

A key to staying within a budget, therefore (or, for that matter, to making any alternative fee arrangement work successfully) is for the client and outside counsel to establish at the outset a clear understanding that outside counsel will be able to manage key decisions about staffing and tactics to discharge the engagement successfully. A client cannot reasonably insist that outside counsel be accountable for the fees in the case if outside counsel does not own the responsibility for managing the matter as it progresses. The client must trust outside counsel for this to work, of course, and this will most often occur when the parties have a history of working together successfully. Outside counsel should still confer with the client on all key decisions in the matter, including identification and pursuit of all fundamental strategies. The client will always retain the discretion to intercede in the matter, subject to appropriate revisions in the budget and to outside counsel’s obligations under applicable rules of professional conduct.

Post-Matter Debrief

At the conclusion of any matter, outside counsel and the client should meet to confer about the handling of the matter. This should include a clear-eyed assessment of the parties' expectations at the outset of the engagement, obstacles confronted and overcome during the engagement, and the overall success of the engagement from a strategic and financial point of view. This affords an excellent opportunity to ensure that the terms of the engagement were fair to both the client and outside counsel and to identify and incorporate lessons learned in other, ongoing matters or in later engagements.

Conclusion

Used properly, therefore, a budget may facilitate management by the client and outside counsel of any significant matter, and it should reduce misunderstandings and surprises and thus enhance the relationship between the client and outside counsel.

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