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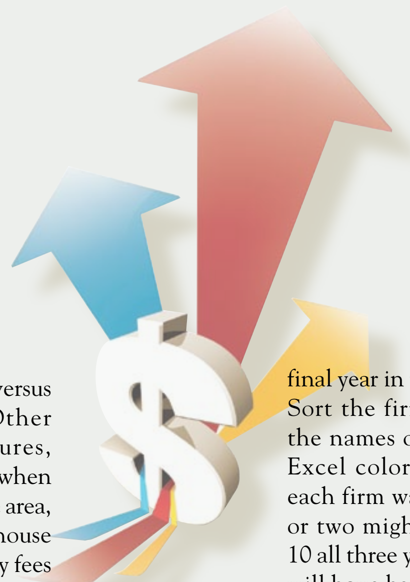
Law Department Management

The Money Flow

Analyzing spending data on outside counsel.



BY REES W. MORRISON

ANALYTIC reports on outside counsel spending help law departments determine how efficiently their money is being spent. The common practice is to prepare yearly reports that contain three areas of information: the amount of money spent on law firms in aggregate, the amount spent on the law firms hired most frequently and the absolute number of law firms paid, a measure referred to as convergence. But that trio of reports is a bare minimum.

To truly gain insight into how the money has been spent, other methodologies are available. These methodologies serve a law department in numerous ways. For example, one method allows a law department to understand how consistently it has used certain firms; other methods determine how much money is spent on litigation versus non-litigation activity. Other perspectives on expenditures, included in this article, arise when examining activity by practice area, by size of billing firm, by in-house counsel who approves bills, by fees compared to disbursements, and by consistency of law-firm use over time.

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More sophisticated breakdowns and presentations of data about what has been paid to outside counsel spending will pay off. The following 10 methodologies are dependable techniques to learn more from your data. For each technique I also offer suggestions on what can be done based on the analysis and the resulting insights.

1. Firms Paid the Most Over Three Years. A general counsel should look at how consistently the law department has used its primary firms during the past three years. When a law department understands how consistently it has used certain firms, or conversely how it has scattered its spending, it is in a better position to negotiate favorable rates or concentrate its spending. A law-firm usage map, which can be done with Excel, helps organize the information.

Identify the 15 firms on which your department spent the most for each of the past three years. List all the firms, one per row, and the amounts paid them during the year. Then make the same list for the next year in the two columns to the right, and for the final year in the final two columns. Sort the firms alphabetically by the names on each year's list. In Excel color each year in which each firm was in the top 10. One or two might have made the top 10 all three years. Another handful will have been in two of the three years, and so forth.

This map of consistent usage shows vividly how consistently the department has turned to its primary law firms. The total spending on those firms may account for half or more of the department's external spending during those years.

2. Spending by Practice Area. A thoughtful law department should know how much it spends by type of matter. The crudest breakdown differentiates litigation and non-litigation spending. Typically litigation accounts for something over half of all payments to outside counsel.

With a more granular breakdown by practice areas—such as HR, real estate, corporate securities—a law department can look for trends over time and perhaps fine-tune its internal staffing. If enough is spent in an area of law each year—on the order of $400,000 or more—it may be cost-effective to hire a lawyer to handle that area of law and replace the more expensive outside counsel with the less expensive inside lawyer. A general counsel can also see whether the department spends enough in a certain practice area over a two-or three-year period to consider a competitive bid. Unless the total comes to $500,000 or more, a full-scale competitive bid process does not make sense. Finally, with this detail of breakout, a law department will know how many different firms it uses in each practice area.

3. Cost Structure of Law Firms by Size. Another analysis focuses on the correlation between the number of lawyers in the law firms that a department retains and the amount of money the department spends on the firms. In that regard, a large manufacturing company recently gathered data of the company's law firms and found a clear correlation between hourly rates and firm size. The analysis revealed that the average rates for law firm partners grew as the number of lawyers in a firm grew. Larger firms charged higher average partner rates. Based on the company's data, each additional 100 lawyers raised the average partner rate $13. Thus, on this large set of data, if rates of a 500-lawyer firm averaged $400 for its partners, rates at a 600-lawyer firm would average $413 an hour per partner.

A similar analysis of associate rates from the same source found a narrower rate spread. In other words there was less variability in the associate billing rates. With the use of the same methods to correlate size of firm and average partner rate, the data showed that each additional 100 lawyers meant a $7 increase in average associate rates. There is a price to be paid for the use of large law firms, and until a law department looks at its own spending habits by size of law firm, it may not appreciate that fact.

4. Expenditures by Inside Managing Attorney. A fourth analysis breaks down the spending on law firms by the inside lawyer who approved the invoice. Usually one or two lawyers ride herd on the largest portion of bills. Some lawyers are better at managing the costs of outside counsel than others, but it requires an analysis of bills, done over a period of time, to identify them. Those in-house lawyers who are lax may need to be prodded and helped.

When a department focuses on approving lawyers, it has a better handle on the lawyers who make the most difference in spending. Perhaps they need more training, more support, or a lighter load of invoices to review. An analysis by approving lawyers also overlaps with an analysis by spending per area of law because the approving lawyers are usually practicing within an area of law.

5. Fees Compared to Disbursements. Some law departments look at their outside counsel bills and analyze the fees paid them as compared to the disbursements paid them. Law firms differ considerably in how much they spend on travel, lodging, photocopying, and other out-of-pocket charges. Disbursements per fees charged may not tell much because both out-of-pockets and professional charges vary. Calculating disbursements per month gives a different understanding of outside counsel spending and a basis for comparison among firms.

To cite one example, some law firms have recently ended the long-standing practice of charging clients the costs of electronic legal research. Previously, firms resorted to a discounted "pay-as-you-go" method with its electronic research vendors, and then billed clients for the actual (discounted) charges incurred. Once firms selected one of the major electronic research providers as their single-source provider and negotiated fixed-price contracts, some of them took the next step of including the cost of electronic research in their lawyers' billing rates.

The guidance that comes from this perspective may inform the outside counsel guidelines of a law department or the rules that it invokes through its electronic billing software. Law departments should push their firms to manage disbursements and try to have firms use preferred vendors and national contracts.

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6. Speed of Billing and Payment. Some law departments look at how timely their firms produce bills. The furthest extreme of timeliness is when a law department can look at hours billed directly and immediately on the law firm's time and billing system. On the flip side, general counsel ought to heed their own promptness in paying bills. If lawyers sit on bills and the sign-off procedure is slow and clumsy, the department loses valuable management information. The law department wants bills delivered promptly. Despite that, I have not felt that prompt payment discounts are an effective tool, but some law departments have had success with them.

7. Electronic Bill Ratio. More and more, law departments keep track of what percentage of their outside counsel invoices they process through an electronic billing system. The more bills that pass through e-billing, the less data entry and trivial review time is required. E-billing also speeds up routing of bills and can enable a deeper level of reporting.

Related to this report is that a law department can track what percentage of its bills and amounts paid flow electronically through to Accounts Payable. This is an indicator of process streamlining; the goal ought to be 100 percent.

8. Statistical Characteristics of Bills. A statistically minded law department might look at various characteristics of the invoices, such as average size, number per matter, and dispersion. It can pick out timekeepers per bill and the amounts on the bill by level of timekeeper.

Armed with this knowledge, a department might urge law firms not to bill unless an invoice exceeds $1,000, simply to reduce the administrative inconvenience and cost. Or, a law department might insist on each bill covering only one matter. Alternatively, a law department might push for blended billing rates or a core team of approved timekeepers.

9. Rolling Averages. Another form of analysis calculates the rolling average of outside counsel spending over three- or four-month periods. That view gives a better sense of trends of spending than the annual snapshot does. Most of the reports described here disclose a different view of the department when a general counsel looks at rolling averages. Many outside counsel expenses spike up or down in a single month, so a multi-month figure evens out those perturbations and gives a better sense of a baseline rate that is representative of spending over a period of time.

10. Spending Per Matter. A tenth lens looks at spending by individual matters. Here the objective is to identify milestones so that different matters can be compared on common activity points. For example, what is the per month cost for different firms that handle discrimination claims to move for summary judgment? Or, the report can show monthly burn rates (how much the department spends each month) or the number of timekeepers. Ultimately the goal is to identify drivers of costs because those are where the leverage can be applied and savings obtained.

Each of these techniques for extracting more insights from outside counsel bills in the aggregate has usefulness. Clearly, these techniques depend on there being a matter management system that has captured the necessary information. Which ones appeal to a particular law department and its spending patterns depends on many factors. All of them have variations also, but in the end, a composite understanding of bills, from different analyses is greater than the sum of the parts.