

## How do experienced lawyers prepare a complex costs estimate?

“Badly”, is the answer many of our clients would give-and they are not joking. Few things anger General Counsel (or clients generally) more than legal budget overruns arising from poor initial estimates. They don’t remember the tight deadlines you met by missing out on family time or staying up past two am. They do remember being embarrassed before their colleagues when the cost expectation we created was not met.

Managing costs *is* our job, not an annoying distraction from our “real work”. Estimates will have to be improved to retain clients, but this cannot be done in a few minutes based on the cursory measure of an experienced (or not so experienced) thumb.

Is there a magic solution to this problem? Unfortunately not; but the lessons learned from other businesses can be useful.

### Why do we get this wrong?

We are always hopelessly optimistic at the start of a project. Oddly, people are much better at estimating the likely cost and progress of someone else’s work than our own.<sup>1</sup> Nobel laureate Daniel Kahneman identifies a complex web of psychological and organizational factors that blunt our ability to bring experience and intellect to bear on time and costs estimations:

- **Anchoring:** the tendency to base our subsequent assessment of a problem on the initial frame of reference in draft plans and estimates;
- **Cognitive bias:** we have a surprising inability to truly rely on experience. We tend to place a much greater weight on recent events rather than a statistical average even though there is no logical reason to do so;
- **Over estimating control:** we like to think we are the masters of our own destiny. We tend to significantly over-estimate our ability to alter outcomes;
- **Under estimating our opponent:** even transactional law can be a combat sport. A litigation or project plan rarely survives the first few contacts with the enemy;
- **Organizational pressure:** we all know that the firm down the road is likely to bid low and bill high, so we have commercial pressure to do the same; and
- **Lack of resourcing:** No matter how many seminars we go to on this subject, lawyers rarely see estimating costs as a really critical part of the work.

(The article from the *Harvard Business Review* cited below is succinct (11 pages) and well worth reading)

### What can we do about it?

- **First and foremost**, take costs estimates a lot more seriously. This stage of the service may be – from the client’s perspective - as important as drafting pleadings. Junior staff should be briefed to prepare a framework for further assessment, not a client-ready document.

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<sup>1</sup> D Lovallo and D Kahneman, ‘Delusions of Success’ (2003) 81(7) Harvard Business Review 56.

- **Review old bills and keep them as a reference base.** Work out what factors increased or decreased the cost of old projects and keep that actual data available to use in future. This information is valuable data for the firm. Keep it and use it accurately.
- **Don't have enough information at the outset?** – make that clear. The initial costs agreement must provide a rough estimate, but make sure the client understands that the only accurate element of the initial estimate is likely to be the work necessary to do preliminary investigations.
- **The revision is just as important as the initial estimate** – probably more so as it is based on much better data. Once the preliminary information is available, schedule a client meeting to confirm their objectives and an agreed plan of attack, then prepare the revised estimate in detail. This should be done as early as is feasible, and we must not fall into the trap of doing a series of estimates for the “next step”. Clients need – and are entitled to – a genuine estimate of the entire cost as early as possible.
- **Develop some understanding of the methodology** appropriate to each stage. For example, the rough initial estimate is likely to be an “Analogous” estimate based upon a historical understanding of what similar work cost in the past. More detailed estimates should be based upon a “Parametric” or “Bottom up” methods.
- **Scope each stage of the work** and break it down as much as possible. We are much better estimating the likely cost of a single element of a task than the whole thing. A good spreadsheet tailored to your usual areas of work is a bare minimum.
- **Get it checked outside the team.** Research shows we are not objective assessing our work either retro or prospectively.
- **Ensure that you understand your client's objectives and expectations,** and how these factors relate to the time, cost and quality of work that they expect to be performed. These considerations will shape the scoping of the work and define your engagement with the client.

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