

Building a sound legal department

General counsels can look to general contractors' models for controlling costs.



As talk of an economic slowdown and the word “recession” seems to be entering more and more conversations, there is nothing surprising in corporations looking at ways to tighten their belts. While companies will take a closer look at their expenses and the budgets for all of their teams, especially those deemed as “cost centers”, in-house legal departments will be under particular scrutiny.

Legal costs in transactions, litigation, IP work and other activities are simply too high to go unnoticed, and untrimmed. A first year associate in a New York City law firm can make upwards of \$165,000 a year and in Kansas City, Missouri, the total reaches \$125,000. Law firms have enjoyed a decade of annual increases in net profits that ran as high as 35 to 45 percent, and CEOs footing the bills want an explanation. According to The Wall Street Journal, many large law firms, due to the impact of the credit crunch, are asking first-year associates to delay their start dates by several months and are cutting the amount of time they use summer associates.

What can general counsels learn from general contractors?

The amount of work won't necessarily lessen, so general counsels do not have the option to simply cut back operations. Instead, they need to find more economical ways to do more with less. Luckily, they can learn something from another type of GC: the general contractor. On the surface, blue-collar construction would

The big spend.

Even with a reported drop in new cases, litigation remains a significant part of many corporate budgets. However, company size and industry both play a role in dispute costs.

- 44 percent of U.S. companies said their annual litigation spending is \$1 million or higher, compared with only 28 percent for U.K. firms.
- Only 4 percent of smaller companies (revenues of \$100 million or less) said their annual litigation expenditure reached \$1 million; for most, the total was under \$500,000.
- For billion-dollar enterprises, 75 percent said their yearly litigation tab was at least \$1 million, including 21 percent for whom spending exceeds \$10 million.
- Manufacturers felt the biggest bite — 43 percent said their annual litigation outlay was at least \$5 million; insurers were next at 31 percent reaching the \$5 million plateau, followed by energy firms at 21 percent.
- Only a tenth of technology companies are spending \$5 million, while none of the education or real estate companies reached the \$5 million threshold.

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seem to have nothing in common with the law. However, since both positions have to manage complex undertakings, success depends on their ability to understand how to organize work to get the best values for the lowest costs.

The general contractor's strategy is simple. At any job site, the contractor splits the work based on expertise and efficiencies of scale. You wouldn't see a carpenter digging drainage ditches. That task is for a laborer who earns significantly less. Why should the contractor waste money, and the carpenter's training and talents, on something that requires limited skills? Similarly, there are framing carpenters who erect a house's frame and finish carpenters who do the interior work. Sheet rockers will attach the plaster board to make the final surfaces of the walls. Could a carpenter do that? Absolutely. However, by specializing, the sheet rockers move far more quickly and cost-effectively. Everyone does a specific job that pays in accordance with its difficulty and the scarcity of help.

The traditional approach of in-house law departments, however, has been to outsource much of the major work to law firms. Clearly the firms have broad resources and enormous collective experience. But to use a big law firm for every major task could be like having a master carpenter sweeping the floors. By right-sizing the match between tasks and resources, general counsels could stretch their budget dollars and often get better quality work as a result.

Alternative billing.

Hourly billing can provide an incentive for the law firm to bill as much as possible, and in some complex cases, it may be the only way to undertake the work. But much legal work is well-understood and predictable. The first step

Exploring new approaches to law firm compensation.

- Most in-house counsel surveyed by Fulbright chose fixed fees as their preferred fee arrangement, followed by volume discounts.
- Only 16 percent saying they would stick with hourly rates for outside counsel, and a small minority asked for firms to consider success-based billing.
- Another 12 percent said they would ask for contingency fees, which is itself a form of performance-based compensation.
- As the biggest customers of legal services, billion-dollar companies chose volume discounts as their ideal alternative to conventional hourly billables.

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to becoming a general legal contractor is to recognize that not all work is of the same magnitude, and there is a good amount of commodity services that a company needs.

DuPont is a pioneer in this area. In 1992, the company capped its legal fees and secured volume discounts from its counsel.

Sometimes creating an in-house outsourcing group can be part of an answer. Wyeth Pharmaceuticals used to send its patent prosecution work to firms, but found that was expensive. Instead, it now has a combination of patent attorneys and agents who draft, file, and maintain the applications and patents. The department can choose the level of experience and training it needs and exert more control over who actually needs to do the patent work.

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Outsourcing to contract legal help.

Such areas as document review and e-discovery lend themselves to outsourcing. Ironically, most AM Law 100 firms actually outsource their own document review work to contract attorneys who are paid a fraction of what even new associates would make. They also make use of computer support to help sort through the material and, where possible, cut down the review that must be done by hand.

Some firms use services that even outsource review to trained offshore lawyers. When off-shoring, one can choose a comprehensive approach or, for those that are less adventurous, a hybrid approach. A typical hybrid engagement will entail sending a portion of the work overseas — typically the coding or the responsive/non-responsive production — while those making the determination for privilege or conducting a second pass review will stay with U.S.-trained lawyers. A significant cost savings for sure, but what about the potential time saved when you are running an almost around-the-clock operation? The coding and/or first pass could be done overnight at an offshore facility and then passed to the U.S. attorneys for privilege review or the like. This scenario would generate substantial cost savings by keeping overtime in check and allowing for a quicker turnaround. Further, there's the added benefit of keeping the U.S. attorneys at something less than 16 hours a day making them less prone to errors and missing those all important "smoking guns."

What about those that aren't ready to send that sensitive data overseas or even trust the information to non U.S.-trained attorneys? What about those that feel culture, language, and time are a few additional obstacles that they are not ready to navigate just yet? How about on-shoring? Smart counsels are able to exploit the market differentials in salary for contractors in so-called "second cities" — those that are major metropolitan areas for their region, but lack the scale of New York, Washington, D.C. and West coast powers, such as Austin, Charlotte and Pittsburgh. More often than not, these cities offer a significant discount over the major centers — many times over 40 percent — which puts them in the same ballpark as off-shoring in terms of price, but without the added frustration.

Paying the price.

Some companies have already been stung by not having a strong handle on their e-discovery methods.

- 17 percent reported that they had lost their right of document privilege due to inadvertent production of electronically stored information (ESI); among U.K. companies, the quotient was an attention-grabbing 40 percent.
- U.S. financial and retail firms both admitted a near-40 percent rate of lost privilege owing to errant ESI practices, suggesting there is much room for improvement in the way many businesses execute retrieval of archival electronic records.

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Take a more uniform approach.

Approaching the idea of rightsizing legal work in bits and pieces will only get you halfway there. Instead, general counsels must first analyze the types of work the department must undertake — look at the financial value to the company and the level of expertise necessary to completing this work.

Sort the work into three buckets: that which could be done by non-lawyers; the activities that require a lawyer, but that are still routine; and the more complex needs that demand sophisticated legal help. For the first two categories, look for alternative ways of getting the tasks done. Start pilot projects for the potential alternatives, and do a thorough analysis at the end to ensure that you aren't sacrificing necessary quality for the dollars. Devote some managerial resources to coordinating the efforts and tasks, so that lower-level work is ready when needed for more complex jobs. For the more routine work that still requires attorney's eyes, think about an onshore approach that farms the work out to a more sophisticated staffing or e-discovery company. These organizations are able to set up project centers in short time and assist in training the attorneys on your specific practices. Some firms provide the added benefit of utilizing your team when you can't and give them additional work from other clients. This enables you to keep a "team" together that knows your business, your expectations, and your needs without paying them full time, all the time. Think of it as an intellectual time share, only you have the option to use it whenever the need arises.

- 2006 commercial EDD revenues were about \$2 billion, up 51 percent from 2005.
- The top 30 providers collected about \$1.08 billion.
- An additional 550+ vendors accounted for another \$592 million.
- "Do-it-yourself" firms (law firms and companies doing EDD work they otherwise would have sent to a provider) represented \$130 million.

2007 Socha-Gelbmann Electronic Discovery Survey

The "general contractor" approach — more efficient and cost-effective.

By looking at legal work like a large-scale project, with different owners and subject matter experts for each piece, rather than using a one-solution-fits-all approach, general counsels will realize a host of benefits beyond just keeping costs in check. Constructing your team similar to how a general contractor approaches their work is not only more cost effective, but allows for reduction in the total amount of management oversight, better quality control as well as overall increased efficiency. Implementing this strategy will not only improve the way you work but will also keep you and your budget in good standing the next time you hear from your CFO.