

LAW DEPARTMENT SPENDING

Rees W. Morrison

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LAW DEPARTMENT SPENDING

Productivity | Outside counsel costs | Spending

These are three of the most important challenges for those who manage in-house lawyers, staff and outside counsel. The common thread is money.

The first report in this series covered productivity and the second report covered outside-counsel costs. Each of them reprinted five-to-seven recent articles by Rees Morrison, a lawyer who for the past 20 years has consulted to law departments on management issues. Accompanying several of the articles is a relevant post or two from Morrison's blog, Law Department Management lawdepartmentmanagement.typepad.com.

It became apparent from the responses to the first two collections that money was on the minds of many general counsel. So, this third report collects articles on *spending*, a broader topic than law-department costs.

For example, matter management systems help a department compile and analyze its spending figures. Some law firms

charge too much for the value they deliver, so a second article delves into firing law firms. Competitive bids enables law departments to obtain better pricing and terms, and one article explains how to carry them out effectively. Every method to control spending depends on the cooperation of individual lawyers, so there are ideas for how to enlist their support. Two articles take up the topic of outside counsel guidelines, including how they mesh – or don't mesh – with law firms that send engagement letters and how tough a position a law department might take.

We hope you find these reports useful and thought provoking. If you would like to see either of the previous two reports, or if you have any comments about this one, please call me at 732-560-8888 (ext. 289) or e-mail me at rwmorrison@hildebrandt.com.

A handwritten signature in blue ink that reads "Rees Morrison". The signature is written in a cursive, flowing style.

LAW DEPARTMENT SPENDING

For most law departments, what they spend outside – on law departments and service providers – is considerably more than what they spend on their inside budget. A typical ratio sees 60 percent or more of total legal spending going outside, most of which is paid to outside counsel.

The articles in this collection zero in on various aspects of law-department spending. The topic is a very broad one,

so these thoughts can only tackle some of the issues that present themselves to general counsel.

Some of the techniques discussed have been around for years – matter management systems, for example; some techniques are newcomers – e-billing software; all of them have applicability to most law departments under some circumstances.

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WHO REPRESENTS AMERICA'S BIGGEST COMPANIES

BY REES MORRISON

Getting to Know You

Seven tips for crafting more effective requests-for-proposals.

AS A CONSULTANT TO LAW DEPARTMENTS ON MORE THAN A DOZEN COMPETITIVE bids, I have found few that do efficient reviews of the responses that they get to their requests for proposals. Many different techniques and methodologies are used in these reviews, and not all of them are productive. Corporate law departments don't compare notes much, and law firms stay mum about competitive bid processes, so it is difficult for either side to make the best possible use of this potentially very helpful tool. To remedy that gap (at least partially), here are seven innovative tips for conducting competitive bids.

1. Send the request for proposal to the managing partner of the firm. Some law departments send their RFP to the relationship partner, if the department has used the firm before, or to the head of a practice group if the work to be done would fall to that group. The problem with either approach is that the recipient may not give the RFP a completely balanced (i.e., fully informed) view.

The managing partner of the firm, by contrast, is more likely to take a firmwide perspective, to involve everyone who should be involved in the response, and to give the RFP the importance it deserves. When the managing partner receives the RFP, it also eliminates the potential for unproductive squabbling over origination credits. For that matter, it makes sense to call the managing partner's office before you send the RFP in the first place.

2. Only ask questions that will help you make the decision about which firm to select. It is very easy to load up an RFP with all kinds of requests for information or topics for the law firm to discuss. But it's more useful to ask sharply focused questions: What offices have they closed in the last two years; do they make a distinction between equity partners and nonequity partners? Some law departments succumb to the urge to ask essay-type questions such as "What is your philosophy about advancement of associates?"

The test for whether a question is effective is simple: Are the answers to it likely to help you separate out the more desirable from the less desirable law firms? If, for example, almost all the firms will answer similarly, then you have merely put them through an exercise that

leads to no benefit on either side. One technique for testing the effectiveness of a potential question is to devise a scale that will allow you to score likely answers. If a scale proves difficult to devise, don't ask the question.

3. Invite incumbents (firms that have recently worked for the company), strong contenders, and some long shots to respond to your RFP. Some law departments make the mistake of sending their RFPs only to incumbents. By so doing, they miss opportunities to bring in new blood and competitive juices.

Incumbent law firms always have an advantage over a new firm in that they understand more about the client, its business, and its key executives, but it is also true that the law department knows the warts of the incumbent firm. In any

case, it is better to invite some law firms that are known to be strong, but have not recently (perhaps ever) represented the company.

A further step is to invite at least a few firms that may be long shots, but that also might bring creativity, attractive terms, or a new mix of ideas to the table. Think of the selection of law firms to receive the RFP the way high school seniors consider which colleges to apply to. Take some safety schools, some stretch schools, and some solid contenders. And you should disclose, in the RFP, the identities of every law firm you have invited. It gives the group a clear sense of how serious you are and the strength of the competition.

4. Describe hours of anticipated work, not fees. Most law departments, if they include in their RFP materials anything about the estimated volume of services they seek, state those services in terms of fees paid in the past, or likely to be paid in the future. For example, the RFP may say: "Over the past three years we have averaged \$1.3 million per year in fees

Notwithstanding a law department's most careful efforts to be unambiguous and complete in what it provides, law firms will want to ask questions so that they can submit better proposals.

The cost is relatively low for the law department to sponsor a bidders' teleconference call. On such a call, all of the law firms can dial in and ask questions anonymously. One or more lawyers from the law department will be available to field the questions. If the department has to get back to the firms with more information, that is certainly acceptable. And by holding such a conference call, a law department can also take a long stride toward making sure that every law firm has an equal opportunity to hear the same questions and the same answers.

6. bring to the surface assumptions in the proposals, and address them fully and specifically. No law firm can understand all the facts and circumstances on which it is basing its bids, so each law firm makes its own assumptions. Rarely do those law firms explicitly state the assumptions

them to the best of the law department's ability. Even better, the law department can circulate to the remaining law firms—assuming there is a second or third round of proposals—any assumptions that might improve the proposals of the remaining firms. For example, "Assume there is not more than one class action pending during the period of the services."

7. Collect two rounds of bids. Many competitive bids permit the law firms to submit only one proposal. It is their best and final submission, right out of the gate.

A much better practice is for the law department to ponder the first round of proposals and narrow down the number of law firms that make it to the second round. Before the second round, however, give the firms additional information and clarify assumptions.

More importantly, tell the firms remaining in the second round the range of proposal amounts in the first round—of the firms still standing in the second round—so they can calibrate their proposal against that range. When the competitive bid allows for a second round of proposals, it usually means that the second round average drops somewhat, and the proposals converge on the most probable market-based figure.

Fortunately, these seven steps are not difficult to put into practice. Hopefully, they will make everyone involved in the request-for-proposal selection process better informed and more effective.

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With law firms basing bids on different assumptions, they all propose terms

for deals according to different sets of facts.

paid for this kind of litigation." Naturally, the law firms that respond to the RFP will anchor their proposal amounts around that figure.

A sounder approach is to convert the historical data and the projected amount of services into hours of lawyer work. You can do that if you calculate the effective rates of several firms who represented you in the service area and determine from those figures a roughly representative hourly rate to divide into the total amount spent. If a law department couches the anticipated work in terms of hours, law firms that have lower hourly billing rates will come back with lower proposals.

5. Hold a bidders' teleconference before the first proposals are due. It is unwise to restrict the information available to the law firms involved to whatever the law department chooses to put in its RFP.

on which they bid, and rarely do law departments request a thorough detailing of those assumptions. Different firms make different assumptions, which means that in real life, they are not all proposing terms of an agreement according to the same facts. For example, one firm might assume no more than two class actions will be brought; another firm, in a different context, might assume that patent review committees meet quarterly and cover the entire company's output of proposed inventions. The disadvantage of unstated assumptions is that in almost every case the law firm has proposed a higher figure to make up for its ignorance about some set of facts.

If the law department requests from law firms a list of whatever operative assumptions the law firm bases its proposal on, the law department can then accept the assumptions as reasonable or correct

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Game Plan for Controlling Costs

Spending too much for outside counsel? Peer pressure can be a useful tool.

BY REES W. MORRISON

Cost control efforts, like diets, are only effective if you stick to them. Ay, there's the rub: How does a general counsel get individual lawyers to care about how much is spent on outside counsel for their matters?

This article presents nine techniques that help each in-house lawyer promote effective budget management and trim outside counsel spending. To be sure, saving money cannot be the primary goal of a law department; winning and succeeding count more than fees. But in the effort to balance costs and outcomes, these techniques can make a difference.

Jawbone. Keep talking about costs and measures to get on top of them. A general counsel's exhortations to

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mind the pennies to groups of lawyers or in one-on-one discussions are important—all leadership consists of repeating key messages. But cheerleading alone

has limits. After a period of time, members of the law department will pay lip service to the reminders from the top but will have come to realize that there is nothing backing up the words.

Report efforts of other law departments. Another technique to make cost control more relevant to the lawyers responsible for spending on outside counsel—because not all in-house counsel manage outside firms and approve their bills—is to ask each of them to call one other law department every quarter and find out what efforts they have taken to moderate external spending.

A good practice is to have each lawyer write a short summary of what he or she has learned. The summaries create a knowledge base, they show who has done the exercise, and they add a fillip of peer pressure. To complement this research, the lawyers might be urged to cite specific examples of cost control that are drawn from articles, conferences, and online material (including my blog, LawDepartmentManagement.typepad.com). The

point is to stimulate in them an awareness that there are many tools to control law firm invoices and that collective knowledge of those tools will help the entire department.

Include cost control in evaluations. A general counsel can ratchet up the incentive by explaining that cost control efforts will be a major element of year-end performance evaluations. That's all well and good, but how will a general counsel keep track of individual activities and successes during the year? How will the general counsel weigh that set of contributions against all the other expectations of counsel? The next technique answers these questions; the point here is to create some level of awareness of incentives.

Collect periodic reports on efforts and results. A general counsel should ask lawyers in the department to submit a quarterly summary of what they have done in the preceding quarter to rein in outside counsel spending. The reports serve to keep cost control more in the line of sight of lawyers. They give some contemporaneous evidence for cost-saving efforts if those are important in evaluations, and when compiled, the various actions may provide good examples for others in the law department and stimulate additional efforts.

Unfortunately, as with matter status reports, lawyers will tend to prepare them at the last moment, repeat each quarter the same efforts, and, shall we say, exercise the full panoply of lawyer creativity. It is crucial that the general counsel insist on specificity: "Reviewed invoices carefully" won't do.

If the law department were to hold a cost control conference once a quarter, people could be asked to give presentations about their efforts. They could summarize what they have learned that other law departments are doing. It could be useful to bring in a consultant for additional insights or to ask partners from law firms to explain what they have tried to do or their reactions to cost control efforts.

Establish so-called SMART goals. Personal goals that are "specific," "measurable," "attainable," "realistic," and "timely" push lawyers who have signed up for them to

Or you can take a look at the ratio of disbursements—covering anything other than what falls under billable hours—to fees. A typical ratio for everything other than lawyers' and paralegals' fees (excluding expert witnesses) is about 10 percent of the total bill, or approximately \$9 of fees for every \$1 of disbursement expenses. This analysis might suggest how you could substitute your preferred vendors, such as trial consultants or photocopiers, instead of using the firm's vendors, and save money.

A different perspective looks at timeliness. How many days elapsed from the last time entry on a bill until you received the bill? A well-run law firm should get you the bill within 30 days of the period's close.

Another analysis involves creating a table. The table shows the name of each timekeeper on your set of bills down the left side while the columns show each month. Fill in the hours for the timekeepers during the months and you should start seeing patterns of consistency over time. It's a visual way to understand how the law firm has staffed your matter.

Now, Compare the Firms

After you apply these analytics to a single firm's invoices, turn to the invoices of several other primary firms and make the analysis comparative.

With the wider set of data, you can calculate each law firm's effective billing rate. Total the amount of all the bills and divide by the number of lawyer hours on them. That gives you the effective lawyer-billing rate, which includes the time of paralegals and the cost of disbursements. That number can be compared to the cost per internal-lawyer-hour.

Second, calculate the difference between your internal per-hour cost and your firms' rates. Generally, the gap between the in-house lawyer cost and the law firm rate is between 40 and 60 percent.

For a third insight, look at the invoices from your group of law firms to test whether the effective billing rate matches the complexity of the matter. It makes sense that more sophisticated matters take more partner time and thus show higher rates.

A fourth insight comes from correlating the size of the law firm—measured by the number of lawyers at the firm at the end of the most recent year—to the firm's effective rate. Research has shown that the larger the firm, the higher the effective billing rate. You may come to realize that you need to more closely match firms to types of matters.

Finally, introduce yet another element into the invoice review. Match the invoice data to the inside lawyer who is chiefly responsible for the performance of the outside firm whose bills you are studying. Whatever patterns you learn from the bills may be partially a result of the oversight by that inside lawyer. It may be that the in-house lawyer has done a poor job of directing the law firm. That lawyer may not know or care about such notions as delegation, staff focus, and timeliness of billing.

All of this benchmarking is only useful if you speak with your law firms and push them toward more cost-effective practices. Present the comparative data to each firm and point out where they have less delegation, more associates who come and go, a high expense ratio, slower billing, or other indicators of inefficiency. Assess your progress with a similar analysis done six months later. For each measure of law firm effectiveness, you can show by an arrow and its length how much the law firm improved its lagging behavior or maintained its superior behavior. If you couple the message to outside counsel with a corresponding instruction to inside counsel, you will pack a one-two punch.

A sophisticated matter-management system can help you capture and calculate some of these metrics, especially if you use electronic billing to gather detailed data from bills, such as the level of the timekeeper. Otherwise, it does not take much time to extract the relevant data from your set of bills.

Keep in mind that this article is not about the kinds of billing abuses that third-party bill auditors should ferret out—block billing, differences in amounts billed for the same event, days of more than 10 hours billed, and long, suspicious patterns of hours. Trained and motivated in-house lawyers can spot and stamp out these poor billing practices. Nor does this analysis rely on outside guidelines and their restrictions. It is simply about looking at the data available from each invoice in a new light.

Bill review should not be just a drudgery to be gotten through. In fact, bills can tell you much more about the performance of your law firms and your own staff than most law departments realize.

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Altruistic information sharing doesn't happen: intranets, CMS and KM
(March 5, 2005)

In-house lawyers are loathe to share information. Just think about why it has proved so hard to keep intranet sites current, or why resistance develops to populating case management systems, why KM remains a chimera with little popular support. The reason is that lawyers do not want to take the time to make what they know available to other

lawyers. Altruistic information sharing has too little payoff, it seems to most lawyers. Law departments struggle with these compilations of information because lawyers do not want to expose their ideas – lest they be criticized, perhaps; or they claim they do not have time, which really means that they do not see the payoff justifying their effort.

One way to circumvent this obstacle is to assign lawyers responsibility for developing content. Don't leave it voluntary. A second technique is to let software comb through documents and emails and weave it into gold.

Rees W. Morrison

SPENDING



Thursday, September 20, 2007

Law Department Management

DUELING DOCUMENTS

*Law-firm retention letters
versus law department
outside-counsel guidelines*

BY REES W. MORRISON

DUELING may be outlawed, but at the start of an engagement law departments and their law firms sometimes walk back 10 paces, turn and fire. In this country, law departments blast away with their outside-counsel guidelines; law firms return fire with their retention letters. Neither document will disappear, but the two sides can take a shot at improving the exchange. This article starts with a bit of history on both documents and then considers both sides of the shootout.

For many years, law firms

undertook matters for companies after routinely sending a letter of retention, which the in-house lawyer or client dutifully signed. Even now, the typical retention letter from a law firm explains how it will bill for its work on the matter, including expenses; limits the enforceability of its representations regarding budgets and outcomes; details how it figures its bills and its right to be paid and to hold attorneys' liens; narrows any interpretations of conflicts of interest; and covers assorted points in its favor that the law firm thought important to explain. Often, state ethics rules require a firm to include certain terms. A retention letter strongly favors its drafter, the law firm.



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Enter Guidelines

As for law departments, before they armed for the duel, most contented themselves with meek transmittal letters to law firms wherein they confirmed the engagement of the firm and sent along what documents were available. This complacent exchange began to come apart in the past 10 or 15 years as law departments took more active control over management of their outside counsel.

Law departments recognized that they need to set some of their own rules and expectations, so they began to create guidelines for outside counsel. These guidelines covered all matters sent to external counsel, unlike law-firm retention letters which govern a single matter. Occasionally a law department has a set of guidelines specifically for litigated matters. In general, guidelines swing to the opposite side from law-firm retention letters: The buyer asserts its dominance.

The guidelines specify how the law firm will bill—such as monthly and in detail with supporting documentation; what disbursements can be charged to the client and on what cost basis; limitations on changes of law firm personnel; and how the law department's responsible attorney is the key decision-maker. Guidelines for outside counsel are now commonplace; compilations of them have been published and many law departments have gone through several iterations.

Some retention letters run to three or four pages, even with attachments. Outside-counsel guidelines typically are more like five to six pages, but some that seek

even more specificity and control run to 20 pages or longer. They cover situations such as when journalists call, the necessity for electronic bills, the importance of timely billing, preferences for certain vendors of services, and much more.

No metrics have come to my attention about the frequency with which law firms send engagement letters; my estimate, having consulted to law departments for 20 years, is that more than three-quarters of all U.S. law departments with more than 10 attorneys have by now promulgated some form of outside-counsel guidelines.

Document Clash

What has developed in recent years has been a volley between the law firm's retention letter and the law department's outside-counsel guidelines. The two documents clash in almost every important respect because they seek opposite ends. The partner wants freedom of action, financial protection, and little accountability. The general counsel wants control, cost consciousness, and disciplined representation.

One response by law departments has been to negotiate or strike out the most egregious provisions of the law firm's letter. That effort takes time and can irritate both sides to the engagement, sides that have to work amicably together thereafter. It's as awkward as haggling through a prenuptial agreement.

Another response in the "battle of the forms" is that the law department signs the retention letter of the law firm but sends the department's own guidelines and states that where there are any conflicts, the guidelines take precedence.

A third choice is for law departments simply to refuse to sign law-firm engagement letters. The law department is the buyer, and it sets the terms of the engagement. If a law firm finds something objectionable in the client's guidelines, it is the firm's responsibility to ask for a modification.

Who signs what is not the only bump in the road. Consider also the proliferation of forms and the different degrees by which

law departments try to assure compliance with their guidelines.

What worsens the situation is the lack of consistency among outside-counsel guidelines—a consequence of how the guidelines sprang up. Unlike the uniform, task-based management system codes (UTBMS) and the LEDES 1998b billing format, both of which started out as standardized tools, outside-counsel guidelines never started out from a common set of wording or structure. Each law department that has adopted such guidelines takes the only respectable lawyerly route: "Let's write one from scratch using precedent documents." After years of this, many variants exist. As a result of the profusion of guidelines, large law firms face dozens of variations on what their clients want.

Practice and Enforcement

On top of the multitude of versions, the practices of law departments in regard to their guidelines differ substantially. Some law departments send each of the law firms they retain their guidelines and do nothing thereafter for each individual matter. They may never refer to them again. Other law departments insist on having the guidelines sent with each matter. Some law departments go so far as to insist that the responsible partner sign and return the guidelines, while others seek even more accountability and insist that the managing partner sign them and circulate them to everybody in the law firm.

Enforcement of the rules in guidelines, such as there is, usually occurs through the use of electronic billing software. That software encodes various staffing and disbursement rules and combs through invoices for any instances of non-compliance. Otherwise, much of the language in outside-counsel guidelines is precatory and may never be invoked. Even so, if a client is not happy with the work of a law firm, it does not need an outside-counsel guideline to give it grounds to terminate the relationship.

The efficacy of guidelines in terms of

controlling outside counsel costs, however, has yet to be measured, let alone proven. Guidelines serve the purpose of putting law firms on notice that costs and performance matter, but in the end I am dubious that all the time and energy expended on them have made much difference. The problems of warring documents, confusing variations everywhere, and dissimilar enforcement could be ameliorated.

What we need as an industry is something akin to the common application for college. We need a set of baseline guidelines for outside counsel that law departments can start from uniformly and incorporate by reference. Such a taxonomy of concepts and positions, in a commonly recognized order, would make it easier for law departments to think about what they want to emphasize, rather than to struggle with drafting. If a department feels obliged to modify portions or add other provisions, at least there would be a framework for consistency and law firms would be more appreciative.

The benefit for law firms from a common set of terms is that they too could spend less time on this aspect of representation, accept industry standards, and only discuss the few provisions that seem inappropriate.

The Truth Behind Those ‘Firings’

How many law departments really dump their firms so abruptly? Let's look at the numbers.

BY REES W. MORRISON

Remember all the publicity about law departments “firing” their law firms? It certainly made the headlines and caused a good deal of hand-wringing at anxious law firms. But the truth is not nearly so stark.

In fact, even though it's become conventional wisdom that law departments commonly and increasingly fire their firms, I think that conventional wisdom is off-base.

First, we need to look at what it really means to “fire” a law firm. Firing a law firm ought to mean that an in-house lawyer has taken dramatic action and suddenly severed a relationship. I don't

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think it applies to situations involving a competitive bid process in which a law firm, which has been regularly representing a company, is not selected to be preferred counsel. Nor do I think it applies to situations in which the work assigned to a firm gradually tapers off. These sorts of situations lack the abruptness and deep dissatisfaction implied by the term “to fire.” Let's admit it: Law firms and law departments sometimes grow apart. Sometimes the kind of work available from a client changes, sometimes key partners develop different practices, sometimes in-house lawyers take over the work, and sometimes lawyers relocate.

WHAT BLUNDERS?

Firing a firm is far more dramatic. What serious wrongs might justify a law firm being fired? Fulbright & Jaworski's second annual survey of litigation trends offers seven possibilities, described as the characteristics of “least successful outside counsel.” These were the blunders, listed by in-house counsel at 103 large companies, that can get a firm black-balled. The top three reasons were “high cost” (from 62 percent of law departments), poor communication (44 percent), and incompetence or lack of knowledge (40 percent). Other problems included firms being “non-responsive” (25 percent),



not knowing the company (21 percent), being slow or late (16 percent), and being “unreliable” (13 percent).

Only one of the transgressions rests on not knowing the law well enough; the other six turn on horrible bedside manner and client service. It's simple, really: If you are grossly expensive, silent, or stupid, you can get chopped.

Two more examples of firings come to mind. Accenture stopped using a firm that refused to complete the company's 2005 survey on diversity. And Christopher Littlefield, general counsel of Dial Corp., said he has fired a firm. He explained: “The times we have faced a problem are when we have someone too low a level working on our case. You feel like you're not getting enough bang for your buck, so to speak, and that things aren't moving along quickly enough.”

In other words, law departments should set a tough standard to justify firing a law firm.

Unfortunately, surveys have done a lousy job obtaining reliable numbers and percentages. One survey of 2004 data conducted by the Association of Corporate Counsel, Practical Law Co., and Altman Weil, asked 45 chief legal officers in Europe, "Have you fired or are you considering firing one of your law firms this year?" Twenty-three of them (54 percent) answered yes.

Although that seems to be a shockingly high percentage, it may not measure anything real. Think of it this way: In the course of a year, what hard-pressed chief legal officer has not had pass through his mind, in a fit of pique, the satisfaction of calling up a partner and bellowing, "You're fired!?" But do they act on that fantasy? If the question had been, "How many law firms did you fire last year?" the survey could have separated the "thought about" looseness from the hard fact of action. Even better, the survey should have defined what it meant to fire a firm.

It also makes a difference how much the fired firms had been paid. Could it be that small fry get fired more often? The Association of Corporate Counsel's 2006 chief legal officer survey, with data from 848 respondents, asked, "Have you fired any of your law firms this year?" The survey found that 32 percent had fired a firm. Those companies stated that they had maintained "a significant relationship" with only 20 percent of the fired firms. It therefore seems plausible that most of the fired firms were either smaller firms, larger firms whose billings were small, or firms that were brought in for a single transaction.

Here's another survey that probably added more confusion than clarity. In a survey that gathered responses from 38 of the Fortune 250 general counsel, *Corporate Counsel*, an ALM publication, reported that 37 percent of them "did not fire a firm in 2005." Companies in that elite bracket may have retained hundreds of firms during the year, so for that many of them to have kept the same herd demonstrates the loyalty of law departments, their lawyers' confidence that they choose and manage firms wisely, and the performance of the firms.

Although this answer also means that 63 percent of the respondents said they had fired a firm, it's more interesting to look more carefully at the reasons they did. First, 34 percent of the respondents (13 general counsel) said they had fired a firm during 2005 "for poor performance." Oddly, about the same percentage said they fired a firm for some other reason, such as technological inability (as one GC said) or diversity (one also). What might be some other reasons? Perhaps the sale of a business ended the flow of certain work, a disabling conflict surfaced, or there was poor chemistry between a new deputy GC and a relationship partner. Maybe a key partner went to another firm, or maybe law firms merged.

How Is It Defined?

The other point to remember is that law department managers may not be using the same definition of "firing" a firm. Some may feel that they're not firing a firm unless they've actually stopped using it in the middle of a matter. Others may say that not using a firm after the matter ends amounts to firing

it. The surveys jumble together all the possibilities yet pronounce alarmist conclusions. It's even possible that under a broad definition of firing, even more firms go up against the wall each year. If every time a law department replaces one firm with another, the former firm is deemed "fired," then the numbers will increase, but the usefulness of what is meant by firing will disappear.

Better for the surveys to ask, "How many firms did you suddenly stop using for reasons of poor performance or deep dissatisfaction?" Better still, they could calculate the number fired as a percentage of all firms paid during the year or the fees paid to the departed firm as a percentage of all fees paid.

Let's consider another survey. In the middle of last year, a survey by *InsideCounsel* magazine announced the responses of 407 law department lawyers who said their department "fired or planned to fire" one of their law firms in 2006. In big print, the magazine proclaimed, "34 percent!"

But there are reasons to be skeptical about those responses. It's odd, first of all, that many in-house counsel "plan to fire" a firm. If the firm's performance is so poor that execution is warranted, why wait? Are transition costs and risks so big that you endure subpar performance? But I have a more fundamental objection: Even if the percentage is true, it might mean just a small number of firms were fired.

Start with the fact that the average department in this survey had 31 lawyers, so at a common benchmark of five lawyers per billion dollars of revenue, assume the average department served a \$6 billion company. A rough rule of thumb based on my consulting experience is that companies of that size in 2006 paid 20 to 40 law firms per billion dollars of revenue, which means that the average department in this survey might have paid between 120 and 240 law firms. Let's pick the midpoint, 180 law firms.

Now, back to the trumpeted finding that one-third of the respondent departments fired or planned to fire a single firm. First, two out of three of these large departments, each likely represented by around 180 law firms, didn't even consider firing one of them. Of those who even contemplated execution—we do not know how many acted on that thought—some number might have fired only one firm.

The alarming headlines over methodologically suspect data become even more dubious if a survey purports to show a trend. In other words, if each survey is full of these kinds of interpretive issues and ambiguities, how can anyone comment on a pattern? One survey analysis did just that, however. Taking 165 responses to a survey conducted in 2006 by Altman Weil and LexisNexis Martindale-Hubbell, the firms made much of the drop in the "fired or considering firing" percentage that year compared with previous years. The latest survey reported that 30 percent of the respondents said they had fired or considered firing a firm and went on to discuss why that figure had dropped significantly from the approximately 50 percent figures of previous years. The analysis attributed the drop mostly to steps outside firms had taken to improve communication, reduce fees, work as partners with law departments, improve staff assignments, and provide free training.

This may all be true, but another set of forces could also explain the shift. Perhaps the convergence of law firms has gone

on so long that many law departments have culled out their underperforming firms. Perhaps with bigger firms serving some departments, there are more ways to resolve dissatisfaction than dismissing every lawyer of the entire firm. Perhaps law departments regard simply not using an unsatisfactory firm as different from “firing” the firm. Perhaps a quite different group of general counsel replied to this year’s survey.

I doubt that U.S. law firms, taken as a whole, have so dramatically improved.

As should be apparent, the surveys that have ventured into the fiery heat of this matter have been burned, badly, by poor questions and methodology. They don’t even define the key term. But even if you accept the general direction of their data, the situation is not as bleak as the headlines proclaim.

It’s no surprise that law departments decide, based on a single dramatic mistake or a series of avoidable missteps, to fire a firm. But despite the gaggle of surveys that have pronounced on this subject, the number of firms that a given law department fires each year is probably a small fraction of all of its law firm relationships. We need better surveys and clearer thinking for us to understand the actual incidence of abrupt terminations of law firms and the performance- or capability-related causes of those firings.

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BLOG CONTENT

From LawDepartmentManagement.typepad.com

SPENDING

Rees W. Morrison

Loyalty to law firms eroded by increased lateral mobility of partners

(March 11, 2007)

“Across the country, firms have continued the aggressive pursuit of individual partners, groups of partners, and whole practice groups, sometimes offering substantial bonuses and other incentives to entice partners to relocate from competitive firms.” The *Client Advisory*, March 2007 of Hildebrandt and Citigroup Private Bank at 4, points out this turbulence and adds: “According to American Lawyer Media’s *Lateral Report* [*Am. Lawyer*, Feb. 2007 at 106], there were 2,153 lateral partner moves among AmLaw 200 firms during the one-year period of October 2, 2005 through September 30, 2006.” Worsening matters, “associate attrition is currently at record levels in US firms, with an annual turnover of about 20% a year...” (at 9).

The notion of partnering between a firm and a law department pales if the partners and associates don’t stay put. Too, a revolving door of partners may account for some of the “firings” of law firms and there will be less accretion of institutional knowledge of a client at firms that see partners come and go.

“It’s more disruptive to replace a firm than to live with poor service”

(*InsideCounsel*) (July 21, 2006)

Rob Vosper, Executive Editor of *InsideCounsel*, writes in the July 2006 issue, at page 10, that in-house counsel pay law firms’ bills, but the “firms run the show.” As incredibly, he then asserts that “firms know that most in-house lawyers believe it’s more disruptive to replace a firm than to live with poor service.”

I disagree completely, for three reasons: law firm unease over client loyalty, law department’s axes, and overstated transitional costs.

Law firm partners worry about their hold on clients and do not take for granted that the manna will fall forever. With convergence, turnover of general counsel, cost control mandates, conflicts of interest, virulent marketing by competitors, in-house evaluation systems, and changes in clients’ businesses, uneasy lie the heads.

That law departments cut law firms off is undeniable, if only by not giving new matters to firms that fall behind. The institutional hold of firms is thin soil on a windy hill: always at risk of being blown away.

And, finally, familiarity does root incumbent firms but they can and are deracinated when their service drops to poor, since another firm will gladly implant itself and even absorb some ramp up costs. It seems to me, in fact, that in specialty areas of law the hold is least secure.

In Legal Matters, Everyone Cares

It's not just the law department that has a stake in the company's matter-management system.

BY REES W. MORRISON

Few law departments sufficiently appreciate how many other groups have a stake in the workings of the department's matter-management system. In particular, five groups care about the software that helps track cases, matters, and how much has been paid to outside counsel.

The influence of these groups is important because law departments should not proceed in isolation when they choose, use, or modify their matter-management system. Most law departments take a myopic view of their software, concerned only with whether it serves the department's needs. But a much wider set of interests are in play and need to be satisfied.

I would like to examine the concerns of five groups (four of them clients of the department) regarding the way legal details are tracked: internal audit, accounting, in-house clients, infor-

mation technology, and law firms. Each of them, plus the law department, depends on the matter-management system for different, interrelated reasons.

INTERNAL AUDIT

The internal audit department wants the law department's matter-management system to keep a close watch on money spent and the processes by which the company spends its legal dollars. For example, at a food company I have been advising, internal auditors want to be assured that the proper financial controls are in place. Does the software keep a trail of who made initial entries of data and who later modified it? How far back does that trail go, and with what detail?

Auditors want to make sure the software helps enforce a system in which those at the right level of authority are the ones approving bills. And because of rules instituted under Sarbanes-Oxley, auditors want assurance that the person who approves payment of a bill is not the person who enters the invoice information into the system.

Auditors also want to be able to compare invoices that go to accounting against the data on those invoices that have been entered into the system; in essence, they want to feel comfortable that electronic bills accurately reflect hard-copy versions. In other words, internal audit serves a control purpose and has a

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clear interest in whether the law department's matter-management system promotes proper controls.

ACCOUNTING

The chief financial officer cares about the law department's tracking software because that software serves as the front end for all spending data that go into the corporate accounting system. So the CFO's group cares about financial accuracy, comprehensiveness, integrity, and reporting. The accounting department and others who report to the CFO want to be able to reconcile what the company's general ledger system shows with what the matter-management system shows. For example, according to both systems, did Firm A get paid \$350,000 last year? The general ledger system is the financial reporting system of record, while the law department's software plays the role of a front-end, data-entry system.

Accounting also needs to keep track of amounts to accrue for legal services provided the company but not yet billed, and can use the system to help it determine those figures. Accounting wants to properly reserve for contingent liabilities—those potential expenditures that depend on a court or regulatory decision to become real and quantifiable—and once again, the law department's system provides that data and support. (To that extent, the company's outside accountants also watch the matter-management system, because they must vouch for the reasonableness of reserves set aside by the company to cover future expenses, such as environmental cleanup costs.)

To the extent the law department transmits information electronically to the accounts payable system (often called the general ledger system) or prepares check-request vouchers, accounting has an interest in the accuracy of the matter-management system's accounts. If the bills from law firm Rees & Associates on the Morrison matter need to be charged to the Widget Group, both internal systems—that of the law department and that of the accounting system—must share the same information.

Accounting also cares about how much a system costs as well as what portion of that cost is capitalized and what portion is expensed. Accounting, much like internal audit, also wants the procedures by which financial information is entered and reported on in the system to comply with financial accounting standards and to be reliable.

Whatever the use, one point stands out: The matter-management system should serve as the most detailed and timely source of information about legal spending. The company's general accounting system does not need to duplicate that level of specific information.

As its most essential contribution to the internal clients of the law department, a matter-management system reports on legal costs and events and forecasts future legal costs. Client groups care about past expenditures and forecasted expenses, of course. But there are other ways that matter-management systems affect internal clients.

Here's one example: A good practice for a law department is to charge back to client groups those outside counsel costs incurred on behalf of the group. If the law department has to retain a firm to press for collection of the Widget Group invoice,

the Widget Group should be charged that firm's costs. Where chargebacks occur, clients learn to care about the accuracy and alacrity of the legal matter-management system.

Clients may also need to know how much legal costs increase when they take certain actions, such as setting up a subsidiary or applying for a patent. If comprehensive data aren't entered into the matter-management system, a company could be ignorant of the legal costs associated with an activity.

For various reasons client groups may want the right to drill down for detail on the costs of individual matters, and they may want to let their own financial personnel have access to the database. This can create a few complications. If clients have this kind of access, they will have to think in turn about its security capabilities. You do not want nonlawyers seeing legally privileged information, and you do not want people who are not trained to enter data correctly into the matter-management system running amok in it. Most law departments allow clients outside of the department access to the matter-management system only sparingly, and only give them the ability to read the data in the system, not to change it.

The matter-management system also makes a difference to clients in terms of its ability to produce analytical reports. Ultimately, the system becomes a tool to help clients with productivity, prognostication, and problematic costs.

INFORMATION TECHNOLOGY SERVICES

Obviously, case-management software, as it is sometimes called, matters to corporatewide systems and technology groups (also called IT). This kind of software can run either on an internal server or an external platform. If the software runs in house, IT cares hugely about it. But if the law department chooses a package that runs on the vendor's server, some technical issues still remain for IT. Either way, IT has to provide resources for the matter-management system, such as hardware, training, and software support.

The IT department also cares whether the technical performance of the system meets the users' requirements. For geographically dispersed law departments, IT needs to pay attention to bandwidth and access. There has to be appropriate security for access to the sensitive legal information in the matter-management system. IT will want to know whether users have support and training that enable them to make appropriate use of the tool.

Also, the IT department may be asked to customize anything that relates to this software, such as an interface with the accounting system, customized reports, security permissions, or a single log-on system. IT may be called upon to integrate two systems, such as an electronic bill-review system and a matter-management system. The department may also develop a portal to do so or to connect the data in the matter-management system to other data. For IT, the important elements in a matter-management system are security and technical performance, including the backup procedures.

For the law firms whose work and invoices are reflected in a matter-management system, the issues are clear. At the mundane level, firms want to be paid correctly and promptly, so the software has to enable that bookkeeping. Beyond that, the

information stored in the matter-management system helps the law department evaluate the firm's performance. For that important reason, the software intrudes on its business. The cost data in the system may determine the fate of a firm, either helping the firm get more work or causing it to fall off in the volume of work.

Whether the matter-management software has an electronic-billing capability or the system obtains electronic bills through a third-party vendor, law firms must comply with the requirements for submission of electronic bills. The rules for invoice review in either variation quite definitely affect the law firm. Does the software bounce time records that log more than 10 hours in a day? Can unauthorized timekeepers slip through?

Law firms also care if the introduction of a software package forces them to enter uniform task-based management-system codes in their time entries. I can envision that someday, law

firms will submit a bill-summary sheet that can be read electronically by the law department, much like the way SATs are scored electronically.

Choosing matter-management software is not an isolated effort by a company's lawyers. Each of these five groups—audit, accounting, IT, clients, and law firms—feels the effect of a matter-management system and expects it to serve its group's needs. The sometimes-complicated interplay and demands of these five groups means that selection and use of the software cannot be undertaken unilaterally by the law department. A capable matter-management system sits at the center of a web of needs and concerns.

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Number of new matters sent to outside counsel is a dubious benchmark

(June 10, 2007)

An article in CCCA Mag., Vol. 1, March 2007 at 62, advocates a set of financial and non-financial metrics for demonstrating the efficacy of a legal department. Most are typical, but of the seven financial metrics, one I do not support.

The authors recommend "new matters sent to outside counsel." Their rationale for the metric is that it will "provide a clearer understanding of which areas of law are most frequently outsourced to external lawyers, and why."

For several reasons I reject this metric as a benchmark. One is that there are no reliable metrics from comparable law departments. Every department defines matters differently, some do not even have a matter management system or a way to count matters. Even what constitutes a matter is hardly set in stone (See my post of April 17, 2006 on definitions of "matter:"). Even if many law departments could clear those hurdles and share their data, it is obvious that not all matters are created equal.

To count the number of matters sent outside tells nothing about why the department chose to involve external counsel. Also, does this metric suggest that virtually all the work on matters is done by outside counsel – what about the percentage contribution by inside counsel?

Most tellingly, what is the law department's goal if it tracks this figure? One department that outsources all its collection matters might have a very high number of matters sent out, whereas another department might handle them in-house. On those facts alone you cannot determine which department is the more effectively managed. This metric, as a comparative benchmark, is a very leaky boat.

A barebones, outside-counsel cost database in Excel

(July 21, 2006)

A down-and-dirty tracking system for outside counsel costs would enable a general counsel in a small department to track and report on fundamental information using nothing more than Excel. The data to be tracked would be law firm, matter type, internal client, invoice amount, and date of service.

Five or six fields of information, that's all it would take. In a spreadsheet that tracks law firms down the left-most column and the other fields across the top, you would have at very low cost a basic picture of what is spent on outside counsel. Some law departments might want to elaborate and track corporate cost centers and responsible in-house attorney.

Pivot tables and sorting can handle as much reporting as is needed, and graphics capabilities are plentiful. A home-grown database can't compare with the fine matter management systems out there, but for some limited purposes, this simple spreadsheet will do.

Rees W. Morrison

SPENDING

BLOG CONTENT

From LawDepartmentManagement.typepad.com

You Should Go By the Numbers

When the CEO asks about costs, it's good to know what other law departments are doing. Compare total spending, cost per lawyer hour, or even head count.

BY REES W. MORRISON

Benchmark metrics help a general counsel know how well his or her law department is managed compared to other law departments. "Is my spending in line?" "Do I have a typical number of paralegals?"

These measures help the top lawyer respond confidently when the CEO asks, "Have you sufficiently narrowed down

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the number of law firms you use?" General counsel use benchmark data to argue for more hires or bigger budgets, defend the

resources they have, and look for clues to improve their department's operations.

Amid the profusion of benchmarks foisted on general counsel, three are pre-eminent. The most important metric—total legal spending as a percentage of revenue—overlaps somewhat with the other two: people (total legal staff per billion dollars of revenue) and costs (fully-loaded cost per lawyer hour). Appreciate that each metric is normalized, so it is stated in terms of units of revenue or lawyer hours. One figure is divided by another figure, which allows large companies to compare themselves similarly to small companies.

All general counsel need these sorts of benchmarks. All managers in legal departments, in fact, need to appreciate the nuances of these three particular benchmarks and to pursue improvement in them.

TOTAL LEGAL SPENDING

Among the three essential metrics, this one takes pride of place. Calculated properly, total legal spending expressed as a percentage of the company's revenue should total everything spent by the law department—both its internal costs such as compensation and facilities as well as its external costs such as outside counsel and other service providers.

Usually, little uncertainty arises from the revenue portion of the calculation. On the spending side, however, law departments include a variety of expenditures. For example, some law departments are not charged the equivalent of rent, but all law departments should at least add in an imputed number. To be comprehensive about TLS and thus on the same footing as other law departments, a general counsel who does not control all outside counsel spending or manage all practicing lawyers in a company should add in the missing expenses.

The total should not include settlements and judgments nor fees and costs of directors but it should include all incentive compensation charges as well as intellectual property fees and expenses. The goal is to include all the costs that the law department incurs, whether or not they are officially on the budget of the department.

Once a law department collects its own figure of TLS as a percentage of revenue it ought to obtain comparable figures from similarly situated law departments. Comparative data from one's industry serves as the best yardstick of performance. The size of a law department is not nearly as relevant as its industry. Not that benchmarking against other companies is essential; some law departments might simply set themselves the goal to maintain or lower their current-year figure.

As with all benchmarks, several proprietary surveys have collected data from law departments and are available for purchase. Other options include collecting data from peer companies informally or retaining a consultant to collect and present the information. A general counsel might reach out to peers and swap data informally, or a general counsel might obtain a wider set of data through the efforts of a consultant who can assure all of the participants that their data will be kept confidential.

This all-encompassing figure—TLS as a percentage of revenue—best represents how a law department stacks up against its peers. Most law departments in U.S. companies of \$500 million of revenue or more run between 0.25 percent and 0.75 percent of revenue. It subsumes costs and staff, which in turn lets a general counsel make changes to

any aspect of the department yet present a single number to be judged against. Since all legal spending is reflected in the figure, whatever changes—whether it's more lawyers hired, better technology installed, improved guidelines for law firms—will be covered.

Barring the exclusion of expenses that ought to be included in the total, a law department's managers cannot manipulate this calculation. The one drawback is that in a particular year, the ups and downs of spending on a major matter may distort the metric for that year. A large acquisition, for example, could bulge the number for spending (and note that even capitalized legal expenses should be included in the total). For this reason, take a two-year average and compare it to your benchmark figures. This technique will smooth out anomalous expenditures. As long as TLS as a percentage of revenue trends at or below revenue growth for your company, your law department can pat itself on the back.

STAFF PER BILLION OF REVENUE

The second most important metric for those who want to assess the performance of a law department focuses on the department's total head count. Many people favor lawyers per billion of revenue, but that ratio is not as trustworthy. One reason is that a law department, which has many paralegals and other nonlawyers—in other words, less expensive personnel—looks improperly good on the purely lawyer-based metrics. Better to include all employees of the law department so there is no incentive to distort the mix of personnel. It is quite typical for U.S. law departments to have one lawyer for every nonlawyer (paralegals, legal assistants, administrative assistants, and others). Typical U.S. companies have about 7 to 13 legal staff per billion dollars of revenue.

Even when all employees are counted, this metric permits some manipulation, as a law department can use consultants, contractors, and temporary employees to keep its official head count artificially low. My recommendation is to include in the employee head count those outside service providers who effectively are doing the job of an employee. Further, when a law department calculates its head count, it should translate part-time or new employees into full-time equivalents. Thus, if a lawyer worked half a year, count that lawyer as one-half of the full-time equivalent.

The costs of people account for about three-quarters of a law department's internal budget, so there is considerable overlap between this metric and total legal spending as a percentage of revenue. The difference is that this second metric has to do with the productivity of people. For a given staff size, how does the law department compare to its peers in presumably comparable output?

COST PER LAWYER HOUR

This third key metric allows a comparison between internal costs and external costs. Law firms, too, should grasp these two cost figures.

Here's how you can calculate your department's number. Multiply the number of your in-house lawyers by 1,850 chargeable hours per year. That number is reasonably well accepted as

the number of hours in-house lawyers work in a year that they would bill if they were at a law firm. Divide the result into the inside budget of the law department. The fully loaded cost—which should capture the total cost to the company of employing its lawyers—is what the lawyers would have to charge their clients to cover the department's internal costs.

Law firms have to cover all of their costs and profits through their billing rates; law departments calculate a similar number by this method. The effective rate of outside counsel usually runs at about \$280 to \$320 per hour. By "effective rate" I mean the total of a representative group of bills, as paid by the law department, divided by all the lawyer hours on those bills. Typically, U.S. law departments' lawyers run at about \$180 to \$220 per hour when all costs are fully accounted for.

Thus, each outside hour is about 50 percent more expensive than each inside hour. Not surprisingly, a typical law department spends 40 percent of its total legal budget inside and 60 percent outside. What that typical ratio says is that roughly the same number of hours are worked by lawyers inside the company as by lawyers outside the company.

What's tricky about fully loaded costs is how full the figure is. From my consulting experience, no law department comprehensively accounts for the cost to its company of maintaining the department. Law departments should include every cost they incur or share in because otherwise the company cannot accurately decide on the relative value of in-house lawyers and outside counsel. Overlooked costs include the cost of litigation over discrimination suits, executive-search fees, security provided for the law department, building and grounds maintenance, and other costs that are not be fully accounted for. Even so, these omissions probably do not add more than \$10 per hour.

To make use of this metric, it is not sufficient to keep the gap at no more than 50 percent. The department could retain more expensive law firms and increase its own costs, so the gap would remain constant, but total costs would soar. No, the trick is to keep both costs in line with each other and their total below the benchmark aggregate number. For instance, if your law department costs \$200 per lawyer hour and your law firms' effective rate is \$300 per hour, the aggregate is \$500 per hour. If the median figure for comparable law departments in your industry is greater than \$500 per hour in the aggregate, you are doing well.

Armed with this triumvirate of metrics, motivated to track and compare them every year, and possessed of a sophisticated understanding of their strengths and weaknesses, a general counsel is much better positioned to make the necessary management changes and to demonstrate the relative value provided by the legal department to senior executives.

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Hard line or soft pedal?

Three key elements of outside counsel guidelines.

Many law departments send their law firms a set of guidelines. Those guidelines typically cover general points about the relationship between the law department and the law firm in such areas as billing, expenses, staffing, publicity and others. Three particular choices regarding guidelines are the topic for this month's column.

1. Hard-wired positions or situational contingency.

One choice a general counsel makes about outside counsel guidelines is whether to bake into them specific requirements and terms, or whether to leave many decisions to the lead inside lawyer who is responsible for the matter.

For example, a guideline might mandate that all law firms will provide a 5% discount off their standard hourly rates. Or it might say that no more than three people may be assigned to a matter without prior approval of the lead lawyer. Both of those provisions set out hard and fast rules applicable in all situations.

The opposite position sets out general principles that the lead lawyer can apply as appropriate. To return to our examples, the guideline might say that “we expect discounts from our law firms, but recognize that the level of discount varies from matter to matter and firm to firm under the circumstances.” As to staffing requirements, the guidelines might merely say that the law firm and the lead lawyer will decide on the appropriate staffing for the matter.

In general, I favour the stronger and more specific positions, because otherwise, the law department might not achieve its objectives, given that each inside lawyer

who manages outside counsel might strike a different balance.

2. Enforced guidelines or laissez-faire guidelines.

Some general counsel take a hard line and insist that the managing partner of the law firm sign the guidelines, to indicate that the firm will comply with them. Others insist that the guidelines be circulated among the partners in the law firm who work on matters for that company. Another form of enforcement is to build into the guidelines punishments for non-compliance — for instance, if the law firm does not submit its bills in a timely fashion and in the required format, the law department will take a percent or two off of the bill.

A contrary view is held by those who see the guidelines as precatory. They are meant generally to shape the relationship, stimulate discussion if necessary, and push in the direction of a progressive and well-managed relationship. It is outside-counsel management with a light touch.

As to these positions, I favour the more heavy-handed approach. If a law department does not insist on compliance and accountability, why bother to draft and disseminate outside counsel guidelines? Change at law firms will not happen quickly enough without discipline and enforcement.

3. Detailed rules or broad understandings.

The third axis for thinking about outside counsel might be characterized as the “constitutional” school of thought compared to the “regulatory interpretation” school of thought. By this I mean that the guidelines might set out a few general principles for how the law department wants to work



with its outside firms, but leaves the implementation details to be fashioned by the lead lawyer. It doesn't dive into the details and spell out every alternative; rather, it states the basic operating premises.

Other law departments have created detailed compendia, as many as 25 pages, in which they specify in detail the treatment of every kind of disbursement. Or they lay out all sorts of rules and guidelines for when and how a law firm can address media inquiries. Some of these detailed guidelines, which remind me of lengthy, interpretive regulations, explain step-by-step how and when and with what content law firms should submit revised budgets.

This final spectrum of decisions is a hard one to come down on either side inclusively. In general, my personal preference is for guidelines to be constitutional, but there are sound arguments in favour of spelling out what is meant by the guidelines, giving examples, and guiding law firms with specificity as to how they should perform. ■



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GC New York Law Journal

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Law Department Management

Practical Tips on E-Billing

Implementation involves intricate steps and hurdles.



Rees W. Morrison, co-head of law department management consulting for Hildebrandt International, hosts the blog www.LawDepartmentManagement.typepad.com. He can be reached at rumorrison@hildebrandt.com. A list of e-billing vendors is on the blog.

BY REES W. MORRISON

MUCH HAS been written about the benefits of electronic billing by law firms to law departments; little is available about the practical steps that a department must take to achieve those benefits.

This article will explain some of the implementation travails.

The term e-billing covers the receipt and review of invoices for the work performed by law firms. The benefits of receiving invoices from law firms electronically is that a law department will save time, increase the accuracy of the data it saves, reduce administrative review, and better control its outside counsel costs. The implementation steps, however, to enable those benefits, include a fair amount of preparation, set-up, testing, and decisions, followed by ongoing maintenance. E-billing will require some time and effort on both sides to ensure the process runs smoothly.

To set the stage, this article assumes that the law department has licensed and installed a matter management system. The electronic billing function may be a module within the matter management system, used to maintain records and processes, or it may be a separate application that feeds data into the matter management system. In either case, the law firm sends its invoices directly to the e-billing system.

Each matter management system or third-party application has variations. This article presents a generic model of the steps that a law department must follow.

Components of the System

The law department needs to decide how many law firms, and which ones, will submit their invoices electronically. Most law departments choose the five or 10 law firms that they use most consistently. A few law departments try to have nearly all their domestic firms on the e-bill system. The e-billing system may charge for each law firm that takes part, so the decision comes down to balancing that cost plus the time and effort of starting up the process against the benefits of the e-billing. The cost of the e-billing function varies widely, with different arrangements available from vendors.

A challenge for all these systems is to accommodate any billing arrangement other than hourly billing. Fixed-fee work, phased billing, incentive payments, holdbacks—each of these presents a challenge.

The law department must decide on the rules of the e-billing system, which means what kinds of characteristics of the bill the system will check and when it will alert the bill reviewer to unusual items.

The law department needs to make a number of decisions regarding which rules it will invoke and the parameters of those rules. For example, one rule might be that the software will “flag”—bring to the attention of the bill reviewer—any instances where a timekeeper (lawyer, paralegal or other person who charges their time to a client) has charged more than 10 hours to the matter in a day. That choice of 10 hours is a parameter; the rule is to look for billed hours greater than a certain parameter. At this point, consideration of what rules to invoke and their parameters might

lead you to revise your outside counsel guidelines to correspond.

Meanwhile, the law department needs to set up an e-mail address and directory to receive and store the electronic invoices. Periodically, someone in the law department must open those invoice files and process them against the rules of the electronic billing system.

Then the law department person responsible for the e-billing initiative must write to the law firm, in effect to the billing coordinator of the firm, and explain that the law department expects the firm to submit its bills through the e-billing process. It is also relevant how much the firm will be billing and how often it will submit bills. It is a good practice to prepare a detailed explanation of what the law firm needs to do and how the process will work as it applies to it. Send this to the person at the law firm responsible for e-billing. It is worthwhile to note that most large law firms are complying with the e-billing requirements of multiple clients. They are probably more experienced than you are.

Usually there is an exchange of information, such as the format specifications, and the law firm sends a test invoice.

The law department must tell the law firms the matter numbers that it wants to have appear on the invoices. Those numbers, a unique one for each matter, come from the matter management system used by the department. The department may also request that the law firm identify the billing rates of those timekeepers who will appear on invoices. The e-billing software can then check whether the proper rate has been charged for each timekeeper.

Sometimes, a law department may not care to receive its bills with Uniform Task-Based Management System (UTBMS) codes on the time entries. Many law departments do not make use of the UTBMS information, and to add

it is a nuisance for law firms. If so, the department may have to tweak the invoice format used by the law firms and advise them of it.

Once the tests have been run successfully, the bills arrive electronically from the selected law firms. There then follows a period of working the kinks out as the invoice coordinator at the law department learns how to process the invoices and correct for errors. The blips are usually small, like an incorrect taxpayer number or two timekeepers with the same initials. One choice for the law department is to send an incorrect invoice back to the law firm to be resubmitted. Alternatively the law department can make the correction at its end. For instance, an invoice might have an incorrect matter number.

With the e-billing flow smoothly underway, there are always additional maintenance steps. One regular maintenance update is the addition of new matters, while another one is the addition of new timekeepers and approved rates.

Other Key Steps

Having surmounted all of these implementation hurdles, it remains for the law department to nail down the process of bill review. Most of the systems route the reviewed invoice—where the software has expunged errors—to the lawyer who must approve the bill. Those lawyers must learn how to understand the electronic format of the bill and how to give their approval. They must learn how to move around on the screens and how to indicate their approval, but the training for this is minimal.

A final step is not commonly thought of as part of e-billing. The term e-billing covers the receipt and review of invoices for law firms. But part of e-billing should be to transmit electronically the approved bill

information to the accounts payable system of the company. If the law department can integrate that function, it negates the irritation of preparing check requests, it saves time and effort both at the law department sender and the accounts payable receiver, it speeds processing time, and it cuts down on errors. The tail on the dog is that the accounts payable system ought to notify the matter management system of the date of payment, the amount paid, and even perhaps a check number. The electronic flow of information between law department financial systems (e-billing or matter management) is not common, yet, but the trend is toward full integration.

Despite the streamlined electronics of e-billing, the law department might still have to retain hard copies of the bills it receives. Thus, the law firms might have to prepare bills in precisely the same way as they did before. This requirement to keep a hard copy may be a result of Sarbanes-Oxley and similar requirements for audit controls.

Thus ends our saga of the reality of electronic billing. The decision to implement e-billing and the choice of software to do so are but the first parts of a long process. The many steps described in this article have to be followed and done effectively for a law department to claim victory. Over time, however, with improvements in software and increasingly widespread acceptance of the techniques, more and more invoices of law firms will flow electronically. Even small law departments will in the coming years take on e-billing.

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Law Department Management

Most-Favored Nation: Least-Favored Arrangement

Requesting the best rates has its problems.

BY REES W. MORRISON

IN their efforts to reduce what they spend on outside counsel, many law departments have asked the firms they rely on significantly to give them a special privilege—the best hourly rates that the firm has agreed to for any other client. Like agreements between nations to lower tariffs to the lowest rates applied to the best trading partner, these so-called “Most-Favored Nation” requests may seem innocuous, but they are not.

Not that MFN requests are every-day occurrences. Mostly, only large and prestigious companies’ law departments feel they deserve the best treatment. Even then they press for that advantage mostly with law firms where they spend a lot and over whom they have some leverage. But an MFN demand seems like an easy cost-saver and it is simple to explain, so we are likely to see more such requests by law departments in the coming years.

I am not in favor of MFN arrangements. I dislike this request, despite having consulted to law departments for 20 years on how to manage costs. My objections, discussed in this article, fall into three areas: philosophical, economic and practical.

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Philosophical

Philosophically, it seems to me unfair to piggyback on the negotiation efforts, longevity or volume of other law departments. Perhaps some buyers who want to drive down legal costs could care less about fairness, but long-term business relations depend on some shared trust and evenhandedness.

Second, it seems clear to me that no attorney-client relationship is exactly like any other such relationship and therefore no economic terms between lawyer and client can be on the same footing. Even the simplest criterion, amounts paid to a law firm, is not the same client to client.

A law firm can distinguish any client from any other client, and honestly (though disingenuously) swear that “your company gets the best rates of all our clients like you.” One client might have a law firm representing it in a massive class action lawsuit; the second might use the law firm for two or three acquisitions. The technologies, resources, client knowledge, intensity and other factors differ hugely. Since no client is identical to another, a basic philosophical premise fails.

It is blazingly obvious that not all clients are created equal, and not all competitive arrangements deserve the same treatment. Can law departments insist on symmetrical terms? MFN arrangements make both sides hypocrites. Law departments think they are better than they are in the eyes of the firm, and law firms sign on for what they know is unenforceable. MFNs breed loose morality.

Thus, from a philosophical standpoint, MFN

agreements lack fairness, ride roughshod on logic, and breed poor morality.

Practical

Consider the practical issues arising from MFN arrangements. One is that large law firms find it difficult to monitor the constantly changing swirl of billing arrangements its partners agree to. A comprehensive, diligent and intrusive effort that clamps down firm-wide on variant billing arrangements might ferret out some near-equivalents, thus preserving MFN commitments, but the hours and heartburn would not be worth it. For example, firms will find it hard to manage individual write-offs on bills or other accommodations, such as prompt payment discounts. My suspicion is that firms don’t even track and analyze all their idiosyncratic engagement terms.

During a recent webinar, a law firm partner rued the difficulty of assuring clients “our best rates,” especially when discounting is rampant. Within a large law firm, it is nearly impossible to know the different permutations of write-offs on bills before they go to a client—and then under an MFN commitment how does a firm handle amounts written off after objections by clients?

In the real world, how can a law department find out what another company is being billed by a firm? If you can’t verify a law firm’s compliance with your terms, how practical can it be? Second, there are too many dimensions

to any given matter. Matters differ so much in staffing, complexity, prior familiarity, write-offs, billing policies, availability of law firm resources, urgency, partner personality, firm compensation systems, and a host of other dimensions. And many of these change over time. It's impractical to think there can be equivalence.

Even more fundamentally, since the quality of lawyers working on matters of various clients differs, as does the consistency of the team, what does it assure a client if billing rates are as low as any comparable client is offered? MFN rests on hourly billing rates, which is enough to hold it in contempt. By that I mean that hourly billing encourages firms to bill more hours. Billing by the hour is tantamount to cost-plus agreements, and the pressures to bill more time to a matter are constant.

Looked at pragmatically, therefore, most-favored nation agreements can't be patrolled by law firms or enforced by law departments. Further, they are based on hourly billing rates, which is a suspect economic arrangement.

Economic

From an economic perspective, MFN agreements thwart competition and improvement. If pressed to accede to MFN status, law firms, quite naturally, will eventually say that they cannot agree to give any law department automatically equivalent arrangements because of the cascading problem. If they agree to lower rates for one client, that theoretically should set in motion equivalent reductions for other MFN clients.

Even so, a law firm's refusal of an MFN guarantee, rate discounts, or other alternative fee arrangements because "if we do it for you, we'll have to do it for everyone" is flimsy.

In an ideal world, billing rates should not be monolithic for any lawyer—fixed for the year no matter what the lawyer is doing or for what client under what circumstances. Even less should rates be fixed by year out of law school or on some other broad band of lawyer, such as third-year partners.

More creative law departments, those that negotiate better economic arrangements, are penalized if another law department can free ride and gain from their structuring or negotiating prowess. I am completely in favor of each law department striving to obtain the best terms from those law firms that represent it; I oppose concepts



It is blazingly obvious that not all clients are created equal, and not all competitive arrangements deserve the same treatment. Can law departments insist on symmetrical terms?



that get in the way of innovative and free-flowing deals between firms and departments.

Another economic point argues against these agreements. To my understanding, MFN agreements primarily govern the billing rates of

individual lawyers. The firm says: "The hourly rates we charge you will be as low as the rates we charge our client who gets the most advantageous billing rates." An MFN assurance could also apply to flat-fee arrangements. "If our best client pays \$16,000 for a routine patent application, we'll charge you the same."

What MFN does not apply to are discounts off a bill. Hours are hours, but each matter is unique. Write-downs on an individual matter can't adhere to MFN commitments. If this reasoning is true, and write-offs don't fall under the MFN guarantees, the economic barn door hangs wide open.

Nor are all dollars to a law firm the same. For many law firms, cutting-edge litigation for a prestigious client is worth more than the same fee income from a passel of commodity cases for an obscure client.

The third ground for tossing out MFN agreements, economics, emphasizes the race to the bottom that it triggers, the blow against competition, and the non-monetary aspects of some representations.

Conclusion

MFN agreements should be one of the least-favored techniques for law departments to pursue. As any lawyer knows, you can distinguish the facts of Situation A from the facts of Situation B, so no representation is like any other representation. Inherent contradictions exist when a law department seeks similar treatment to what can always be viewed as dissimilar circumstances. Worse, the dance around MFN causes administrative friction, not to mention evasion or hypocrisy on both sides.

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Prior to joining Hildebrandt, Morrison was a partner at Altman Weil and at Arthur Andersen, after serving as the Consulting Assistant to the General Counsel of Merck. Before that, Morrison was a Director in the Law Department Services Group of Price Waterhouse, marketing vice president of Analytic Legal Programs and ComplInfo, and an associate at Weil, Gotshal & Manges and two other New York law firms.



Graduating from Harvard College in 1974, Morrison earned his law degree from Columbia Law School (1978) and an LLM from New York University (1984). He taught at Cardozo Law School and moderated the Lexis Counsel Connect Law Department Management discussion section. He is a Certified Management Consultant, a fellow of the College of Law Practice Management, has been on the Board of Advisors of Corporate Counselor, Law Department Management, and Metropolitan Corporate Counsel, is a Life Fellow of the American Bar Foundation, and participates in the ABA's Law Practice Management Section and ACC's Law Department Management Committee. He founded the monthly newsletter, *Managing Litigation Costs*. He has addressed more than 100 groups in his career, co-chaired 11 law department management conferences, and has published six books and more than 100 articles. Morrison wrote *Law Department Benchmarks: Myths, Metrics, and Management* (Glasser LegalWorks 2nd edition, 2001); *Client Satisfaction for Law Departments* (Corp. Legal Times 2003); and *Law Department Administrators: Lessons from Leaders* (Hildebrandt Institute 2004). He founded and chaired the Association of Consultants to Law Departments. He hosts the blog, LawDepartmentManagement.typepad.com, which currently has nearly 2,900 posts.



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