

*Legal Business World eBook Series*

# PERFORMANCE FOR LAW DEPARTMENTS

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Part 3. External Counsel and Costs

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*This is the third of 3 books based on the series '[Performance for law departments](#)' by Richard G. Stock.*

## *About the Author*



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- [What you need to know before buying legal services](#)
- [My favorite approach to pricing](#)
- [How to secure sponsorship when buying legal services](#)
- [This is the most effective approach to buying legal services](#)

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# EXTERNAL COUNSEL AND COSTS

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## *1. Pricing and Negotiating Legal Services*

### **PRICING LEGAL SERVICES**

The Association of Corporate Counsel (ACC) released a comprehensive [report](#) benchmarking legal operations in March 2020. The law department maturity model (3 stages) surveys 15 functions, with one of the functions being *External Resources Management*. The findings were telling. Only 11 % of the 316 participants reported they were in an advanced stage for this function. Three of the 13 sub-functions are noteworthy when considering the proportion of companies that had no measures / protocols in place:

- 42.8 % of companies did not have outside counsel and vendor management as centralized functions within legal operations or involvement of legal ops in RFPs, engagements, pricing and performance reviews
- 65 % reported that Alternative Fee Arrangements (AFAs) were not considered and were not heavily used in all matters

- 69.2 % of law departments did not rely on systems to smoothly incorporate / support AFAs in billings and metrics.

It is worth remembering that the “best price” for a portfolio of legal work depends on a combination of factors, including:

- multi-year demand forecasting that reflect estimates, not guarantees, of work volumes
- the fewest possible number of firms (convergence)
- agreement on staffing / delegation distributions for each portfolio and category of work
- a commitment to rigorous matter budgeting by task / phase and by timekeeper

### **Pricing Specifications**

When it comes to pricing, managing the expectations of all stakeholders, including law firms, requires considerable preparation. This is essential when the objective is to prioritize non-hourly fee arrangements such as AFAs and make these the predominant rather than the occasional method of pricing legal work. For most companies, and for many law firms, AFAs still represent a significant shift away from variations of the hourly rate. Many law firms introduced the role of pricing specialist to respond to RFPs and ISPs some years ago, and in many cases to lead the firm’s pricing negotiations. Many firms have experience working systematically with dozens of clients on pricing. Their knowledge of law firm economics is sophisticated.

Pricing legal work requires much more than proficiency in AFAs. Companies should possess a practical understanding of law firm economics and the related profitability variables, of law firm cultures, and of law firm compensation systems for partners and associates for the firms that they use.

Unmanaged practice patterns in law firms add at least 10 % to the effective rate. The RFP or ISP should prescribe “optimal staffing distributions” for categories and portfolios of work. Firms should be asked to propose compact and stable teams of senior and junior professionals as well as paralegals to cover the reference period.

Law firm responses to the RFP / ISP should state the extent of their support and the related conditions for the application of these optimal staffing distributions in pricing legal work.

### **Choosing the Most Effective Alternative Fee Arrangements**

Some have said that AFAs should stand for “appropriate” rather than “alternative” fee arrangements. This leaves the door wide open to default to traditional variations of hourly rates. It is also at variance with making non-hourly fee arrangements the predominant albeit non-exclusive approach to pricing legal work. Over the years, corporate



law departments have selected pricing that they believed suitable for individual matters. Nevertheless, today more than 80% of legal work referred to external counsel is still priced on a variation of hourly rates. This is not surprising, since hourly rates require a minimum amount of change to operating practices in the company and in the law firm. This is not the same as cost-effective pricing.

There are three basic categories of fee arrangements and each has variations - hourly fees, fixed and flat fees, and contingency / percentage-based fees. There are hybrids and variations for each of them. For instance, a fixed fee can be combined with a performance fee tied to a result. Designing an alternative fee arrangement that is effective and appropriate for a category of matters - possibly for hundreds of matters with a broad range complexity levels covering a 3 - 5 year reference period - requires a credible demand forecast and a critical mass of work.

Getting companies and their law firms "off the clock" and focused on the company's priorities suggests that the choice of pricing should:

- stimulate *efficiency* in legal work, enough to reduce the hours needed to support a portfolio of matters by at least 10 % over time.
- reward the *effectiveness* of legal work, as measured by the results anticipated by the client

- promote *innovation* initiatives that pass the **S.M.A.R.T.** test and which improve efficiency and / or effectiveness.

**Fees for Performance and Innovation** Performance-based fees are a retrospective fee based on value. The performance indicators should be set out in the RFP / ISP and in the terms of engagement with each firm.

Performance indicators typically include results, service levels, efficiency and cost predictability.

A few companies have migrated to a more advanced and simpler form of performance fee with their primary firms because they have been satisfied with service levels, with results and cost management over the years. In such cases, performance tends to be more developmental in nature and can take the form of an Innovation Fee that supplements a fixed base fee. From 10%-15% of the overall legal budget can be reserved to fund innovation.

Specific projects are developed by the law firm and the company - effectively a list of research and development initiatives that benefit the company in the short term. A specific budget is proposed for each project. Under the guidance of the law department, each project is evaluated upon completion. The extent of success determines how much of the project budget is paid to the firm. Some law

departments have concluded that the only way that they will make innovation headway is when they pay law firms to help them do so. Nearly 10 years of innovation awards testify to the opportunities for innovation in all facets a company's legal activity.

**Costing a Preliminary Allocation to Law Firms** It has been nearly 30 years since some companies began to use the procurement process to reduce or "converge" the number of law firms relied upon. Some have completed their fourth or fifth procurement cycle. Convergence is a sourcing strategy that creates a larger share of work for the successful firms. This in turn provides the company with more leverage in price negotiations. In the context of multi-year agreements or multi-national coverage, the law firm has access to a critical mass of work and to a dependable but not guaranteed revenue stream.

Ben Heineman's *The Inside Counsel Revolution* (2016) traced the continuum of practices and relationships that law departments have had with external counsel over five phases. Phase Three refers to the era of "preferred providers" when preferences for key law firms and particular lawyers become explicit. The largest volumes and most interesting work continue to flow to traditional providers, and it appears that relationships and a good track record continue to trump price. In this phase, law departments do not have the analytical tools or they fail to

use them to their full potential. They cannot determine how much more they are paying than what they would pay to other panel firms.

Assuming a Phase Four relationship is in place with primary law firms, a company should then commit - but not guarantee - a volume of work for several years in exchange for a fixed price. The company secures budget predictability and the firm has regular cash flow. Provided annual volumes are sufficient, collar arrangements, ranging from 10 % to 15 % are usually sufficient for the firm to secure predictable cash flow and to stimulate efficiency in the law firm.

It follows that fixed fees for a portfolio of work can easily evolve into hybrid fees consisting of a fixed base amount plus a variable portion tied to key performance indicators. It is still only a minority of companies that systematically evaluate the performance of their primary law firms, with most others preferring a “no news is good news” approach. Heineman discusses the elements of company-law firm partnering arrangement in Phase Five.

Setting aside transitional arrangements with legacy firms which are not retained after a new procurement cycle, companies should prepare a preliminary work allocation of 100 % of the RFP / ISP Scope of Work to the smallest number of firms.

An example follows for a portfolio of 25,000 hours per year covering employment, labor, benefits advice, affirmative action, and strategic advice regarding Human Resources with requirements in 15 states.

Area of law	Firm A <i>Low Cost</i>	Firm B <i>Coverage</i>	Firm C <i>Coverage</i>	Firm D <i>Strategic Relationship and Specialized</i>
Affirmative Action (4,000 hours)	4,000 hours @ \$325 \$ 1,300,000			
Benefits Advice (4,000 hours)				4000 hours @ \$425 \$ 1,700,000
Employment Law (10,000 hours)		5,000 hours @ \$360 \$ 1,800,000	5,000 hours @ \$340 \$ 1,700,000	
Labor Law (3,000 hours)		1,500 hours @ \$380 \$ 570,000	1,500 hours @ \$360 \$ 540,000	
Strategic Advice (4,000 hours)				4,000 hours @ \$675 \$ 2,700,000
Totals	\$ 1,300,000 4,000 hours @ \$325.00/hr	\$ 2,370,000 6,500 hours @ \$364.62/hr	\$ 2,240,000 6,500 hours @ \$344.62/hr	\$ 4,400,000 8,000 hours @ \$550/hr

Preparing a first draft of the costing allows the law department to consider the best balance of cost, coverage, and competence (expertise). Additional drafts for different allocations will affect the applicable discounts and the overall cost. A preliminary costing should be prepared

before the second (or final) round of price negotiations with the successful law firms. In the example above, Firm D would be paid \$ 4,400,000 per year for 8.000 hours.

The 3-year price would be \$ 13,200,000 for 24,000 hours of Benefits and Strategic Advice. The fee would not vary if the worked hours (assuming a 10 % collar) ranged from 21,600 to 26,400 over the three (3) years.

### **Final Evaluation**

A final comparison of prices is carried out after a second round of price negotiations is completed with the successful firms and after the final/provisional allocation of work is made. Experience suggests that firms are eliminated:

- based on the results of the non-financial evaluation
- after a comparative evaluation of prices but before negotiations
- after a first round of fee negotiations
- after a last round of price negotiations and a final/provisional allocation of the portfolio of work

*Abridged with permission from the Buying Legal Council's [The Definitive Guide Buying Legal Services](#)*

### **NEGOTIATING LEGAL FEES**

There are many types of successful negotiations for professional services with law firms.

It can be useful for law departments and procurement professionals to have a road map to make the negotiations as effective and efficient as possible. In this case, negotiations are in respect of multi-year portfolios of legal work rather than for single legal matters. The focus is less about the art of negotiating with law firms and more about practical advice in preparing and conducting negotiations.

## **Building Blocks**

### **Pricing**

My article on *Pricing* advocated in favor of non-hourly fees as the predominant financial arrangement for most categories and complexities of work. It argued in favor of alternative fee arrangements that stimulate and reward effectiveness, efficiency and innovation in legal services provided there is a measurable contribution for each of these. Provisional allocations and comparative pricing of law firm proposals at different stages of the RFP / ISP and negotiation process are described later in this article.

### **What to Negotiate**

There are specific questions to be asked in the RFP / ISP. These can be expanded for both the financial and non-financial elements. The answers will assist in qualifying firms and accelerating the negotiation process. Consider the firms' written responses to be the early stage of negotiations.

Some of the non-financial elements to discuss with firms include:

- a commitment to detailed matter planning and budgeting to manage the number and distribution of hours before they are worked by the firm,
- coverage by the firm for each legal specialty, for various levels of partner / associate / paralegal experience, and by jurisdiction,
- the expertise and availability of the law firm's team members at all levels of experience,
- service level guarantees with key performance indicators, covering all offices of the firm as well as the allocation of work by primary firms to secondary firms,
- a relationship partner accountable for all aspects of the firm's professional and financial performance,
- acceptance of the transfer of administrative and management reporting from the company to primary and coordinating firms to minimize the company's investment in infrastructure.

Some of the financial elements to cover with the RFP / ISP and in meetings with firms include:

- the company's preferred staffing distributions by category of work,
- the use of alternative fee arrangements,
- the prices and related conditions/discounts for the work proposed by the firm,



- the stability of prices over the RFP / ISP reference period,
- fees for performance and / or innovation as part of hybrid alternative fee arrangements,
- the admissibility of disbursements,
- the speed of payment and its relationship to price,
- the annual review and adjustment mechanisms based on work type and volumes.

### **The First Elimination Round**

The Project Manager should prepare two reports for the working group. These are useful guides to the other members as they read all the proposals. The reports are a *Qualitative Analysis of the Responses to the RFP/ ISP*, including a score for each firm and a *Financial Analysis of the Responses to the RFP (or ISP)*. The financial analysis is prepared prior to any discussions with law firms and before any provisional allocations of work to firms.

Experience suggests that working groups should eliminate proposals which score less than 75 % on the qualitative (non-financial) analysis. At this stage, the Project Manager should press the working group to reduce the number of proponents without regard to the financial analysis. It makes little sense to engage with law firms for three or more years when their competitors out-score them

significantly on multiple fronts. Law departments prefer a gradual approach to eliminating firms for non-financial reasons rather than on price before negotiations commence.

### **Provisional Allocations**

Law firm proposals should indicate the amount and type of available work that they wish to acquire for each jurisdiction. The law department representatives to the working group will have read the proposals and the reports prepared by the Project Manager. The working group should then be ready to provide the specifications for a *provisional* allocation of work before the first round of negotiations with the remaining firms. For example, they could indicate that the litigation portfolio for a given region be allocated 60 % to Firm A, and 10 % to each of four other firms. The Project Manager can then cost the allocation using each firm's initial pricing proposal.

None of this information is shared with the law firms. However, it represents the projected legal spend for each portfolio of work prior to the start of negotiations. And it illustrates any gap with the financial targets set out in the agreed sourcing program. Experience suggests that some law departments are reticent to develop provisional allocations. In such cases, the Project Manager can prepare an allocation based on historical usage patterns, the proposed pricing of the firms remaining after the first

elimination round, and the results of the financial and non-financial analyses. This allocation and costing should be shared with the members of the working group to serve as a baseline for the first round of negotiations.

Provisional allocations and costing should be prepared after the first elimination round as well as after each round of negotiations.

## **The First Round of Negotiations**

### **In Person**

Law firms invest considerable resources to prepare comprehensive proposals for legal services, especially for multi-year portfolios of legal work. It is recommended that the first round of negotiations take place face-to-face and that two hours be set aside for each meeting, especially if there is a list of non-financial items to cover and if there is to be a departure from the historical pricing model.

### **Who Should Be Invited?**

No more than five individuals should attend from the law firms. At a minimum, these should include the Relationship Partner, two or three other partners, responsible for primary categories of work such as litigation, and mergers and acquisitions, etc., and the firm's Chief Pricing Officer. The firm should identify its proposed attendees by name and role in the letter accepting the invitation to meet.

## **The Schedule and Agenda**

### **The Schedule**

An agenda should be sent to each law firm 3 to 4 weeks prior to the meeting to ensure the availability of each participant and of each member of the working group. Provided that logistics allow it, primary firms and legacy firms should be met early in the sequence. Three meetings per day are sufficient to allow pre-meeting briefings, tardiness by group members, breaks and lunch, and the end-of-day briefing of the group. Schedule a secondary firm if a fourth meeting is necessary on a given day.

The Project Manager should schedule a half-day preparatory meeting for the working group on the first day of law firm meetings to discuss:

- the two reports, namely The Qualitative Analysis of the Response to the RFP/ISP and The Financial Analysis of the Responses to the RFP/ISP,
- the costing of preliminary allocations,
- the roles and responsibilities of each member of the working group, with attention to the questions to be asked by each group member,
- the agenda and issues particular to each firm,
- the timeline for the conduct of each meeting,

- the 30-minute end-of-day debriefing session.

### **The First Meeting**

Firms should be discouraged from making a general presentation lasting more than 15 minutes. Any presentation should be customized to the company's RFP / ISP requirements and should address as many of the agenda items as possible. For the sake of efficiency and effectiveness, the first four agenda items and the presentation should be completed within the first 60 minutes.

The financial portion of the meeting should be led by the working group's pricing specialist. Specific changes to the firm's initial pricing proposal are typically requested, and may include:

- coverage by jurisdiction
- practice patterns and staffing ratios
- the configuration of alternative fee arrangements
- annual rate and/or price increases
- discounts and related conditions

Firms can rely on a mix of variables to offer more favorable prices for the RFP/ISP reference period. At this stage, the company can suggest a specific target and price together with the relevant conditions, such as volumes and

categories of work, that would have to be met by the company to achieve it.

Experience suggests that this level of specificity by the company always yields a better result than asking for a bigger discount. Many working groups elect to eliminate some firms after the first round of meetings.

There are several reasons:

- some firms were met for legacy business and relationship management purposes but with few chances of work in the future
- a new firm was invited to propose but did not “align” well with the law department members of the working group
- the firm’s responses to the non-financial and financial discussions offered little chance of significant work allocation in the future
- the projections for the cost of services will fall outside of the range acceptable to the company

The Project Manager should request a reduced list of eligible firms from the working group to limit the number of participants for the final negotiations.

Finally, the Project Manager should ask for a revised financial proposal – either as revised spreadsheets or

detailed in a cover letter – within 2 or 3 days. The firm should also answer any non-financial questions raised during the meeting. Expect the firm’s Chief Pricing Officer to request access to the working group’s pricing specialist while preparing the firm’s revised prices and terms.

## **The Final Negotiations**

### **Evaluating the Revised Proposals**

Once the revised proposals or letters are received, a summary should be prepared for the working group with a costing of the remaining firms based on the previous allocation, or if a new allocation is available a revised provisional allocation by jurisdiction and category. The summary may include recommendations from the Project Manager for a different allocation to achieve improved discount thresholds and company targets.

### **Negotiations**

Alternatively, the Project Manager and the working group members may prefer a final round of negotiations with one or more of the remaining firms. Experience suggests that this round is likely to be primarily financial. In-person discussions are not necessary for this. Instead, one representative of the law department, the Project Manager, and the company’s legal pricing specialist can arrange a video call with each firm.

At this point, the company should be prepared to suggest a provisional allocation of work to each firm in exchange for best and final pricing offers incorporating alternative fee arrangements, fees for performance and innovation, limits to annual increases, as well non-financial arrangements. provisional allocations should only be revised once the working group considers each of the law firm responses. Allocations will influence each firm's resource allocation, pricing, and workflow management all the while remaining provisional rather than guaranteed.

### **Allocations**

Once all the revised proposals and related correspondence are on hand, the working group should meet to review its planned allocations and costing. Adjustments can be finalized at this stage. The Project Manager can then develop Terms of Engagement / Master Service Agreements with each firm.

### **Administrative Arrangements**

Experience suggests that accelerated terms of payment in the context of non-hourly fee arrangements will leverage a lower overall price. There are examples where anticipated volumes of work are pre-paid and fees reconciled on a quarterly or annual basis.



MSAs and partnering arrangements that cover 3-5 years cannot accurately anticipate the volume and distribution of work for each year. Variations by complexity and jurisdiction are inevitable. Agreements should include annual review mechanisms which are both retrospective and prospective. Adjustment to price may be appropriate when work allocation falls outside an agreed range.

Not all legacy law firms are retained after the sourcing process. It may be necessary to leave certain matters and hours with these firms in the first year while allocating work to successful firms.

*Abridged with permission from the Buying Legal Council's [Definitive Guide Buying Legal Services](#)*

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## *2. Sourcing and Scoping Legal Services*

### **1. SECURING SPONSORSHIP FROM LEGAL**

Multi-nationals such as banks, insurance companies, pharma, the full spectrum of technology companies, as well as manufacturers with global supply chains and distribution networks have complex legal requirements. The stakeholders affected by strategic sourcing for legal services can be many and varied within the company. A successful sourcing program goes beyond managing a process efficiently to save on legal costs. To secure stakeholder sponsorship, it must actively engage primary and secondary stakeholders at key intervals.

#### **Who Are the Stakeholders?**

The primary stakeholder for a strategic sourcing initiative should be the Chief Legal or General Counsel. As a company executive, the Chief Legal Officer can mobilize the support of key Board members, the Chief Executive Officer, the Chief Financial Officer as well as other corporate executives. There are too many instances of very elegant, and potentially effective arrangements with law firms that are eviscerated by carve-outs and exceptions. This outcome can be avoided with strong stewardship of

the program by Procurement and Legal. The Chief Legal Officer's role is to identify the range of legal stakeholders across the company, secure their support, and communicate the developments and results of the sourcing process.

## **Two Steps**

Procurement faces one of two possible dynamics in its efforts to secure sponsorship. The first is a reluctant law department that is less than enthusiastic because the company's executive leadership has mandated more systematic and cost-effective sourcing of all goods and services across the company. The second is one where Legal is more engaged and has learned that many other companies have successfully completed legal sourcing programs - some of them over many years. Because this is a leading management practice, the CLO wants to "stay ahead of the curve" rather than react to a sourcing program that is imposed. In both scenarios, Procurement should take two steps to "secure sponsorship" from Legal.

It is no longer sufficient for Procurement to say that it can manage an efficient sourcing process and that it will negotiate better discounts on hourly rates through a competitive process with a limited number of legal service providers. That may have worked 15 years ago. It will not

work in the 2020's for the relationship-based business that is legal services. This is especially true for companies that have completed their fourth or fifth wave of sourcing legal services in the last two decades.

The second step to effectively secure sponsorship is a meeting where Procurement presents its formal program to Legal. There are four parts to the program,

- a description of the Qualitative and Financial Objectives to be achieved during the reference period – possibly over several years,
- the Mandate setting out Procurement's precise role in point form, a detailed Work Plan setting out the necessary research, documentation, demand forecast / scope of legal services, the invitations for strategic partnering / RFPs, the analysis of law firm proposals, the schedule of meetings and negotiations, how best to measure the results, and
- the Logistics and Schedule
- Procurement would be well-advised to liaise with one member of Legal when preparing the program and its presentation to legal leadership.

### **Roles and Responsibilities**

Many companies and their law departments are decentralized. Often, many individuals in business units and members of Legal have their preferences for specific

external legal counsel and how best to instruct them.

Procurement should serve as the Project Manager for the legal sourcing program. Legal should be responsible to:

- supply data and other reports on legal spend and on the historical use of external counsel by legal specialty, by business unit and by jurisdiction,
- provide insight on arrangements and agreements which may currently be in place with legal service providers,
- ensure that the other members of Legal and other business units are consulted about the forecast / demand for legal services and about their preferences for certain firms to be invited to participate in the sourcing process,
- identify a limited number of members from Legal who will be required to read law firm proposals as well as the analysis and recommendations prepared by Procurement, and
- identify those members from Legal who will attend meetings with the law firms - a maximum of four representatives from Legal and two from Procurement should be sufficient.

Apart from coordinating all communications with law firms and with other legal service providers during the sourcing process, Procurement should manage all logistics for the meetings with law firms. Experience demonstrates that success and effectiveness in sourcing and negotiating legal

services depends on an intimate knowledge of law firm culture, law firm economics, and the variety of relationships that a company has with its law firms. These relationships can range from routine to specialized to highly strategic. Procurement must exhibit greater proficiency with non-hourly fee arrangements than Legal if it is to be entrusted with negotiating arrangements with a company's legal business partners in the 2020s.

## **Objectives**

Non-financial objectives are often as important as financial ones in the drive to source external legal counsel for formal multi-year agreements. These objectives include:

- reducing the number of law firms in order to reduce the amount of time the company's inside counsel and business units spend maintaining relationships and instructing law firms. The time saved can be re-allocated to other priorities within the company. Just changing the configuration of law firms and how they work together for greater geographic coverage. Some companies have chosen to retain a handful of firms that can coordinate local, regional and country counsel. In effect, these firms serve as general contractors of legal services,
- simplifying reporting requirements, including billing and payment protocols, in order to reduce the company's administrative load for analysis and processing payments.

Under the right conditions, law firms will take on this work at no cost to the company,

- leveraging technology to achieve measurable improvements in service delivery and, possibly, in legal outcomes. Efficiency and effectiveness are critical key performance indicators, but are often mis-aligned with non-hourly fee arrangements,
- changing the ratio of risk / reward between the company and its legal service providers primarily through the use of alternative fee arrangements,

Financial objectives in sourcing external counsel can be quite straightforward. A target should be set to reduce the projected legal spend for the ISP / RFP reference period. It is not inevitable that legal fees should increase every year simply because law firm standard rates increase. However, the pathway to achieving significant reductions in legal expenses rarely includes greater discounts or hourly-based fee arrangements. That approach offers marginal savings to companies that have had formal sourcing programs in place for more than 10 years.

### **Securing Sponsorship**

“Securing sponsorship” means obtaining a formal sign-off from Legal for a detailed sourcing program. The program proposal must pass the S.M.A.R.T. test in that it must be

Specific, Measurable, Achievable with the available resources, Results-oriented and Time-bound. Procurement and Legal must regard each other as equal partners in legal sourcing. The way ahead must be clear.

Accountability for specific steps must be unambiguous. Only in this way will “sponsorship” for a legal sourcing program be secured.

*(Abridged with permission from the Buying Legal Council's The Definitive Guide to Buying Legal Services)*

## **2. SCOPING LEGAL SERVICES**

Scoping is that portion of a Request for Proposals (RFP) or of an Invitation for Strategic Partnering (ISP) designed to inform law firms of the scope of work (SoW) in a way that can achieve a company's objectives. This is particularly important when covering portfolios of work or multiple jurisdictions over time.

### **Historical Data**

The past is not a predictor of the future when it comes to expressing the demand for legal services. However, historical data is the first place to start. A matter



management system is a superior source of data when compared to accounting data.

Still, companies that maintain a matter management system may find that some legal activity is not captured because it is a pass-through charged to customers, to insurers, to special projects or is cost-shared with other companies in the same industry.

Experience shows that asking each law firm that has been paid more than a certain threshold (e.g. \$10,000) in one of the last two years, to produce data in a uniform format will generate a more comprehensive picture of the company's historical demand for legal services. A basic spreadsheet supported by clear definitions of each legal category is sufficient to secure what is needed from firms. Ensure that the spreadsheet covers at least two complete calendar years plus as many months as possible in the current year. Data is required for each legal specialty and should be broken down according to jurisdiction or region, by legal specialty and matter complexity, and with the total hours per year for each. In turn, the annual hours should be available by experience level for lawyers and technical staff to map practice patterns and staffing ratios for each law firm and legal specialty.

## **Analysis of Law Firm Data**

Provided the data sourced internally and from law firms is comprehensive, then it is straightforward to determine the volume of activity (hours, number of matters), total fees and effective rate, as well as the staffing patterns for each legal specialty for each law firm by jurisdiction, and for the company and its subsidiaries for each year covered by the RFI.

As part of a supporting document, law firms should describe discount and favorable fee arrangements that were applied to the spreadsheet data. For companies that retain dozens, not to mention hundreds, of primary and secondary firms across multiple jurisdictions, asking the firms to provide pricing information is more efficient than sourcing fee arrangements internally. Apart from rates, internal data may not be current or well-documented.

The analysis of the RFI data and discount arrangements should be prepared by Procurement and discussed with the law department. Experience shows that companies are seldom aware of the extent and detail of their company's external legal activity, including:

- the precise number of primary and secondary firms used across the company each year
- fees, not including disbursements and taxes, paid to each firm by jurisdiction and legal specialty

- the number of matters and hours for each firm, again by specialty and jurisdiction
- variations in effective rates, discount arrangements, and alternative fee arrangements for similar work
- variations in practice patterns and staffing ratios by law firm for similar work

A comprehensive review and discussion with the law department should generate clearer objectives for the RFP / ISP including:

- the preferred number of primary and secondary firms for the future
- preferred practice patterns and staffing ratios by legal specialty
- opportunities for non-hourly fee arrangements and for more favorable financial terms
- how best to formalize and improve internal protocols and operating practices governing how legal work is assigned and how it is managed with law firms
- how the law department and law firms can introduce and manage detailed matter budgets for all files over a minimum threshold (e.g. 50 hours)

### **Forecasting the Demand**

Companies balk at divulging projected volumes / hours of work for each legal specialty and jurisdiction in their RFP /

ISP. There will always be concerns that doing so can be interpreted as a company guarantee or commitment that the work (hours) will be there. For this reason, it is a common practice for the procurement process to be limited to creating a panel of qualified firms with the best possible hourly discount. Regrettably, this approach fails to leverage the data to stimulate non-hourly pricing, innovation, and efficiency from the law firms selected. It also fails to support many of the non-financial objectives. In short, the company is not using its buying power to maximum advantage.

Determining the scope of work for purposes of the RFP / ISP should be a joint process between Procurement and the Law Department. Consider a SoW that covers at least three years. Express the demand for each specialty and jurisdiction as the total hours per year. Projections should be adjusted up or down from historical patterns, based on the law department's knowledge of work that is recurrent and work such as litigation, regulatory matters and transactions which can be irregular in its timing. Volumes can vary for each calendar year. The text of the RFP / ISP should explain the type and configuration of the legal work in the SoW.

Significant migration towards non-hourly pricing in favor of

alternative fee arrangements (AFAs) which stimulate efficiency in law firms should diminish the number of hours required by the firm to do some of the work. The introduction of rigorous matter budgeting for files exceeding the defined threshold will also reduce the number of hours used. Companies have been successful in reducing the SoW (hours) by up to 15 % with the combined use of AFAs and legal matter budgets.

#### **Four Considerations**

There are important strategic and practical considerations when preparing the SoW for the RFP / ISP. The first is strategic because it addresses a non-financial objective of possibly changing the number and configuration of primary firms. Creating a critical mass of work that is sustainable for firms over the RFP / ISP reference period means reducing the number of firms invited for proposals.

A smaller number of law firms should be kept in mind for maximum leverage. Consider that 10,000 hours per year represents a full workload for only 5.5 lawyers and paralegals.

A three-year projection in the SoW is always an estimate at best. There will be fluctuations in volume by jurisdiction and specialty from year to year. Favorable fee

arrangements, even hourly arrangements, will be influenced by the amount of work the law firm hopes to receive. The RFP / ISP should state that the terms of engagement with each primary law firm will contain an annual review and adjustment mechanism which is both retrospective and prospective. Such reviews will consider variations from the anticipated scope of work and the potential for adjustments to fee arrangements.

Many law firms have at least 10 years and some have 20 years of experience with formal sourcing of legal counsel. Many legacy firms will be successful in remaining on panels and will not be at risk of losing legal work on active matters. Leading practices suggest that legacy work should be included in the SoW for the RFP / ISP, even if the same firms continue the work. Legal matter budgeting and optimal staffing ratios will usually be accepted by legacy firms as part of a concerted cost management program.

The composition of law firm panels can change for many reasons. Lead partners leave the firm, or the law department changes its preferences, and because some legacy firms emerge from the sourcing process as comparatively too expensive. The SoW for the first year following a multi-year sourcing process should allow for a transitional period to the new panel configuration.

RFPs and ISPs should seek to reduce panel sizes, prescribe optimal staffing ratios by specialty, and target a reduction from current pricing. Once sourcing is complete, incorporate an annual review and adjustment mechanism. Allow for the work of legacy firms and provide for a transitional process when changing the configuration of firms or introducing new pricing arrangements.

*Abridged with permission from the Buying Legal Council's [Definitive Guide Buying Legal Services](#)*

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### ***3. Can Perpetual Power Corp Get Off the Clock?***

Just a few years ago, I was asked to present a request for proposals (RFP) simulation for legal services at a national conference of General Counsel. The scenario was designed to question assumptions held by both buyers and providers of legal services. For the simulation, imagine a company called Perpetual Power Corp. (PPC), that manufactures and sells wind turbines. The headquarters is in Norway and the law department has lawyers in Oslo, Turkey, the United States, Brazil and India. PPC retains 12 firms for 21,500 hours of legal support on five continents.

One of PPC's initiatives is to reduce its number of firms to no more than three. Its General Counsel has invited three incumbent firms to submit proposals for as much of the work that they believe they can competently manage. About 30 per cent of the work is commercial, 45 per cent is litigation, with the remainder for labour, IP and environmental matters distributed across the regions. Apart from reducing its administrative workload and securing predictable pricing for the future, PPC wants its firms to offer the right balance of coverage, competence, and costs.



The imaginary Fudd & Leghorn LLP has been doing most of PPC's US work – about 40 per cent of its global requirements. Fudd is offering to cover the Americas by collaborating with law firms in Brazil and Argentina. Fudd's proposal is not specific about coverage for Chile. And it is offering limited information about its capabilities for environmental work. Overall, Fudd & Leghorn is light on quality assurance protocols and the credentials of its South American firms, preferring instead to emphasize its own history of service delivery with PPC to secure more work. Still, the firm proposes to increase its discount to 20 per cent and is agreeable to a fixed price and 36 equal payments, with no hours to be reported to PPC. In summary, Fudd & Leghorn is relying on a calculated strategy to increase its market share to 50%.

Prudential & Gibraltar LLP is a Swiss firm with offices in 20 European cities. The firm has a 25-year history with PPC, dating back to the creation of the company, with legal support mostly in Europe. Prudential's proposal is to take on all of PPC's European and African work, approximately 40 per cent of PPC's global requirements, by collaborating with firms in Cairo and Nigeria. Their proposal does not mention legal project management or budgeting. There is no apparent link of service delivery to available collaboration technologies.

The financial side of Prudential & Gibraltar's proposal consists of a blended hourly rate of €300, plus an annual rate increase of 2.5 per cent for Europe, and a blended hourly rate of €200 plus an annual rate increase of 2.5 per cent for work in Africa. A 15-per-cent rate discount is built in. Billing would continue on an hourly basis. Prudential is expanding its coverage slightly, albeit by collaborating with secondary firms. Overall, its proposal is designed for a conservative client looking for stable hourly pricing.

The third fictional firm, Mark & Whatney Inc., has supported PPC for five years with IP, environmental and specialized litigation work. It has expertise in Six Sigma and other process-improvement methodologies, with experts in India, Japan and the US. The firm is prepared to bring that expertise to PPC's headquarters in Oslo.

With a proven track record in process improvement and a solid network, Mark & Whatney proposes to do 70 per cent of PPCs work worldwide – virtually all of its litigation, IP and environmental legal requirements. Its strategy would not disrupt PPC's relationships with long-standing commercial and corporate firms.

The firm proposes a fixed fee, discounted by 10 per cent, and then discounted again by 15 per cent if PPC is

prepared to commit to ongoing efficiency projects. The firm believes that it can reduce PPC's requirements for legal services and is prepared to adjust its price up front to reflect this approach. An annual review and adjustment mechanism of the annual fee would examine significant variations from estimated and agreed work volumes and the complexity mix of matters.

The three-firm simulation illustrates a watershed opportunity for companies like PPC to move away from hourly billing in favour of a fee arrangement promoting efficiency, innovation and lower costs. The scenario has two firms offering simplified billing, reporting and payment – attractive to law departments that want to shed administrative activity. PPC could well accept to allocate all of its non-commercial work to a global provider that can balance competence, coverage and costs. Provided the data analytics are solid and the RFP is thorough, the winning combination of firms should be clear. Designing the right type of RFP makes the choice easier. Most law firms are ready for a change.

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## *4. Thoughts on Pricing Legal Services*

The Association of Corporate Counsel (ACC) released a comprehensive [report](#) benchmarking legal operations in March 2020. The law department maturity model uses three stages to survey 15 functions, with one of these being External Resources Management. The findings were telling. Only 11 % of the 316 participants reported they were in an advanced stage for this function.

Two of the 13 sub-functions for external resources management are noteworthy when considering the proportion of companies that have no measures / protocols in place:

- 65 % of the 316 companies reported that Alternative Fee Arrangements (AFAs) are not considered and are not heavily used in all matters  
69.2 % of law departments do not rely on systems to smoothly incorporate / support AFAs in billings and metrics.

Our last article on Critical Preparations maintained that “the pathway to achieving significant reductions in legal expenses rarely includes greater discounts on hourly-based fee arrangements because this offers marginal

savings to companies that have had formal sourcing programs in place for more than 10 years.” We recommended that companies set formal financial targets as part of a written pricing plan before drafting a Request for Proposals.

It is worth remembering that the “best price” for a portfolio of legal work depends on a combination of factors, including:

- multi-year demand forecasting that reflects estimates, not guarantees, of work volumes
- the fewest possible number of firms, otherwise called convergence
- agreement on staffing ratios and preferred delegation distributions for each portfolio and category of work
- a commitment to rigorous matter budgeting by task / phase and by timekeeper

### **Pricing Expertise**

When it comes to pricing, managing the expectations of all stakeholders, including law firms, requires considerable preparation. This is essential when the objective is to prioritize non-hourly fee arrangements and make AFAs the predominant rather than the occasional method of pricing legal work. It is true that most companies use apply non-hourly fee arrangements for part of the work referred to

external counsel. However, for most companies, and for many law firms, AFAs still represent a significant shift away from variations of the hourly rate for most of the work.

A growing number of law firms have introduced the role of pricing specialist to respond to RFPs, and in many cases to lead the firm's pricing negotiations. Some firms have 5 to 10 years of experience working systematically on pricing with dozens of clients. Their knowledge of law firm economics is sophisticated. It follows that companies should match that expertise.

Pricing legal work requires much more than proficiency in AFAs. Companies should possess a practical understanding of law firm economics and the related profitability variables, of law firm cultures, and of law firm compensation systems for partners and associates for the firms that they use. These responsibilities should rest with at least one senior person in the legal department and one in the procurement department.

### **Specific Questions**

Several quite specific pricing-related statements and questions should be asked of each law firm as part of the RFP. I have used text such as the following:

- “The firm is asked to bill a fixed fee or occasionally a variation of hourly rate or a hybrid fee arrangement. The preferred arrangement for the reference period is to be finalized during our discussions with you in the coming weeks.”
- “What is your firm’s pricing philosophy for the next 3 or 4 years?”
- “What would be your preferred partnering and pricing arrangements with us for the period covered by this RFP or ISP?”
- “The firm is encouraged to propose innovative methods to mitigate costs. This can include teams with more members based in less expensive markets where your firm has offices or where you have arrangements with correspondent firms. We will not compromise unique legal expertise. However, we are actively seeking less costly arrangements from you as a partnering firm.”

Unmanaged practice patterns in law firms add at least 10 % to the effective rate. The RFP should prescribe “optimal staffing distributions” for categories and portfolios of work. Firms should be asked to propose compact and stable teams of senior and junior professionals as well as paralegals to cover the reference period. Law firm responses to the RFP should state the extent of their support and the related conditions for the application of

these optimal staffing distributions in pricing a category of legal work.

### **Choosing Alternative Fee Arrangements**

Some have said that AFAs should stand for “appropriate” rather than “alternative” fee arrangements. This leaves the door wide open to default to traditional variations of hourly rates. It is also at variance with making non-hourly fee arrangements the predominant, albeit non-exclusive, approach to pricing legal work. Over the years, corporate law departments have selected pricing that they believed suitable for individual matters. Nevertheless, today more than 80% of legal work referred to external counsel is still priced on a variation of hourly rates. This is not surprising, since hourly rates require a minimum amount of change to operating practices in the company and in the law firm. However, this is not likely to be the most cost-effective pricing.

Getting companies and their law firms “off the clock” and focused on the company’s priorities suggests that the choice of pricing should:

- stimulate efficiency in legal work, enough to reduce the hours needed to support a portfolio of matters by at least 10 % over time.



- reward the effectiveness of legal work, as measured by the results anticipated by the client
- promote innovation initiatives that pass the S.M.A.R.T. test and which improve efficiency and / or effectiveness.

The leadership of legal departments should ensure that they are both strategic and proficient when pricing legal services. This function should be considered a specialized one within the company and likely concentrated with a trinity of one senior lawyer, legal operations and procurement.

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## *5. Critical Preparations*

My first article for Legal Business World was “Negotiating with Law Firms” in early 2018. For the most part, it reported the findings of Altman Weil’s Chief Legal Officer survey (2017). At the time, I concluded that “fair and informed negotiation of operating and financial arrangements with preferred law firms requires companies to enforce guidelines for matter staffing, matter budgeting, expenses and billing. Non-hourly fee arrangements for complex and routine work should be the order of the day, and in-house counsel should be proficient with every aspect of AFAs if they are to be accountable for the business side of the relationship with external counsel”.

Today, 30 months later, the evidence suggests that many company legal and procurement departments continue to underperform when sourcing external legal services. One of the primary reasons for this is insufficient preparation. This brief article is intended to make the eventual negotiations with law firms as effective and efficient as possible. One assumption in writing this piece is that such negotiations would be in respect of multi-year portfolios of

legal work rather than for single legal matters. I also favor non-hourly fee arrangements for almost all types and complexities of work.

### **Building Blocks**

There are three critical building blocks when sourcing external legal services. Each depends on the participation and collaboration of Procurement/Strategic Sourcing and of the legal department with its legal leadership - and with the legal operations professional when there is one.

### **Securing Sponsorship**

The first step is to forge a formal alliance. Procurement should develop a detailed sourcing program for legal services. It should describe the company's non-financial objectives for convergence, the optimal configuration of primary and secondary firms by jurisdiction and globally, simplified reporting and billing requirements, and the place of technology to improve effectiveness and efficiency.

The sourcing program should set out the company's objectives for non-hourly pricing, annual price increases, disbursements, law firm performance, annual review and adjustment mechanisms, and payment terms. The sourcing program sets a financial target for total legal spend and for

savings to be achieved with the Request for Proposals (RFP) or Invitation for Strategic Partnering (ISP).

The written sourcing program should also describe Procurement's division of labor with the law department for the preparation and conduct of negotiations. The company's law department should then sign off on the program before the work begins. Progressive companies typically share many, but not all, of their non-financial and financial objectives in the RFP / ISP and in the meetings with law firms.

### **Scoping Legal Services**

The second building block – scope of work – is typically core procurement competency. Providing extensive detail in the RFP / ISP about the scope of legal work which may be available to law firms over time is the basis of migrating the relationship with law firms from that of a traditional vendor where the company purchases one hour or one matter at a time, to that of a strategic business partner that is prepared to adopt non-hourly pricing, innovate with service delivery and operating practices, and invest in technologies that the law department that of a traditional vendor where the company purchases one hour or one matter at a time, to that of a strategic business partner that is prepared to adopt non-hourly pricing, innovate with

service delivery and operating practices, and invest in technologies that the law department can use. See Ben Heineman's *The Inside Counsel Revolution*, starting on page 401. Scoping legal services for sourcing purposes means describing each category of work, the types of matters and the complexity mix for each category, and the estimated volumes of work by category and by jurisdiction. The scope of work should set out the optimal practice patterns – staffing ratios – by legal category.

Not every company wishes to reveal this level of detail, perhaps reticent that by doing so it will raise expectations in law firms which cannot be fulfilled. However, all estimates are provisional, and none constitutes a guarantee of work to any firm. The advantages of sharing this information outweigh the perceived risk of doing so because firms will be more prepared to accept the company's non-financial and financial objectives when preparing proposals and negotiating favorable long-term arrangements.

## **Pricing**

The third building block calls for consensus on the most effective form of pricing legal work. When favoring non-hourly fees as the predominant financial arrangement for most categories and complexities of work, the fee

configuration should stimulate and reward effectiveness, efficiency and innovation in legal services provided there is a measurable contribution for each of these.

## **What to Negotiate**

Quite specific questions should be asked of the law firms in the RFP / ISP. These can be expanded for both the financial and non-financial elements. The answers will assist in qualifying firms and accelerating the negotiation process. Consider the firms' written responses to be the early stage of negotiations.

Some of the non-financial elements to discuss with firms include:

- a commitment to detailed matter planning and budgeting to manage the number and distribution of hours before they are worked by the firm
- coverage by the firm for each legal specialty, for various levels of partner / associate / paralegal experience, and by jurisdiction
- the expertise and availability of the law firm's team members at all levels of experience
- service level guarantees with key performance indicators, covering all offices of the firm as well as the allocation of work by primary firms to secondary firms
- a relationship partner accountable to the company for all

- aspects of the firm's professional and financial performance
- acceptance of the transfer of administrative and management reporting from the company to primary and coordinating firms to minimize the company's investment in infrastructure.

Some of the financial elements to cover with the RFP / ISP and in meetings with firms include:

- the company's preferred staffing distributions by category of work
- the use of alternative fee arrangements
- the prices and related conditions/discounts for the work proposed by the firm
- the stability of prices over the RFP / ISP reference period
- fees for performance and / or innovation as part of hybrid fee arrangements
- the admissibility of disbursements
- the speed of payment and its relationship to price annual review and adjustment mechanisms based on work type and volumes

## **Roles and Responsibilities**

The working group charged with scoring the proposals and meeting the firms should consist of no more than five individuals: the Project Manager, likely from Procurement; a

second person from Procurement to record discussions and decisions as well as to run all financial projections; the CLO or deputy; and one or two senior members of the law department representing significant legal categories. Because the sourcing process can stretch out over time and the documentation can be extensive, a five-member working group is sufficient, assuming there is consultation with other stakeholders at select intervals. One of the group members should be proficient in the full range of AFAs and law firm economics.

Experience suggests that the law department should take the lead in “negotiating” the non-financial elements. It is preferable that these be addressed before the financial elements. Discussion of the financial elements should be led by the Project Manager and/or by the company’s AFA specialist – ideally an individual from Procurement, provided there is a very good understanding of law firm economics, the full spectrum of alternative fee arrangements, law firm cultures, and partner compensation systems.

## **Conclusion**

Successful negotiation of sustainable relationships with law firms depends on putting the three building blocks in place, developing a detailed scope of work for the RFP/ISP,



explicit statements of financial and non-financial objectives for legal services, and meaningful roles and responsibilities for the procurement and legal departments during the sourcing process.

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## ***6. The Critical Elements of Non-Hourly Pricing***

Companies have managed legal sourcing processes for more than 20 years. A great deal has been achieved. There is less improvisation about who gets the work. There is more predictability in pricing. And in many instances, convergence in the number of firms has come along nicely – to the point that some organizations have announced that their panels of law firms are stable and that they will no longer be issuing RFPs. Otherwise put, “the work is the firm’s to lose”.

Some companies are entering into Strategic Partnering arrangements with their preferred law firms. These are typically long-term arrangements where the legal teams, the work allocation, the service delivery requirements, technology and pricing are agreed. There are important differences between this approach and the more traditional panel of firms with heavily discounted hourly work or fixed fees for commodity work. Traditional panels can be cost-effective under the right conditions, but they cannot be characterized as strategic for three reasons.

### **Three Missing Links**

Firstly, the business and financial incentives for the company and the law firm are not aligned. The law firm's business model is to maximize the number of hours it works, bills and collects while the client wants to encourage productivity, appropriate delegation of tasks, and lower costs without compromising results. An hourly-based fee arrangement mitigates the company's objectives.

Second, the company is not committing to a volume of work over time, even on a provisional basis. Instead, the firm is retained on a matter by matter basis and selected from the approved panel. Perhaps the firm is also completing a detailed matter plan and budget as part of the terms. Many law departments are reluctant to commit to a volume of work over time because they do not know the number of transactions or the volume of litigation. Moreover, they worry about "putting too many eggs in one legal basket".

Third, the traditional system of panels retained with some variation of hourly fee makes it very

difficult to focus on and target innovation. A firm will improve its service delivery and reporting arrangements to

the extent it is doing so for other clients as well and to the extent it can spare unbillable time or use other internal resources. This differs from setting aside a significant portion of legal fees to pay for innovation in service delivery and performance with targets in mind.

### **The Critical Elements**

Non-hourly pricing should be designed to align law firm interests with the interests of the company. The right pricing arrangement can stimulate productivity and can focus and accelerate innovation. AFAs fundamentally change the law firm's relationship with the company if it is truly a Strategic Partner. Non-hourly pricing introduces significant predictability and stability of legal teams, reduces the administrative work for both the company and the firm, and can reduce legal costs well beyond the usual 20% discount. There are two obstacles - insufficient data and no proficiency in non-hourly pricing as applied to complex work and multi-year portfolios of legal work. There are 8 critical elements for successful non-hourly pricing.

The first is having solid historical data that goes beyond how much was spent on which firms for what type of work. It is essential to have a grasp of law firm staffing patterns for each experience level and each legal specialty. The

complexity mix of matters for the company should be detailed by specialty. The distribution of work by region and sub-region should be planned as well as the distribution of work by jurisdiction. The forecast can then be reduced by about 10% for purposes of the RFP as this affects the price. Finally, the company should know the past and planned year-over-year increases in the average rates for each firm and region. Some have reported 7% going into 2020.

The second element is easy to list, hard to achieve and essential. Getting the scope of the work estimated requires good historical data from which the demand for 3 to 5 years can be estimated. The forecast must include preferred staffing patterns, volumes/hours, the complexity mix of matters, legal specialties, and the distribution of the work by jurisdiction. It can then be reduced by about 10% for purposes of the RFP, since a proper AFA can generate real improvements in law firm productivity.

The third essential element is a clear strategy for the preferred way to retain counsel, regardless of whether the work is competitively bid or sole-sourced. Does the company want to move from a panel of preferred firms to strategic partnering with counsel? Does it want a small number of firms or even a single firm to coordinate and

deliver legal services with a combination of local counsel? Does the company want greater convergence with fewer than five firms overseeing 100% of the work? Is it possible to harmonize the record of instructions to be sent to firms and couple this with legal project plans and budgets for all matters beyond a given threshold? What is the most appropriate design for the AFA? Should firms be paid for performance and innovation?

The fourth element is the RFP. Is it to be a competitive process or sole-sourced and aligned with a planned allocation of work? The scope of work should be detailed as set out in the second element above. It should prescribe staffing distributions for each specialty. The evaluation and selection criteria should be specific and measurable and state whether they are weighted or not. Non-financial questions should be sufficient to evaluate expertise, coverage, technology, AFAs and the capacity for innovation.

The fifth element is pricing. The sequence begins with agreement on the staffing ratios that must be applied to each specialty across the portfolio of work across all complexities and jurisdictions. A blended rate is then calculated for each specialty - first for each year and then as a single blended rate for all years covered in the scope

of work. There is good precedent to determine a blend for all specialties and across entire regions such as Europe, the UK and the US. From those building blocks, the company can customize the fee arrangement. Will it be a fixed fee for the volume of work covering the reference period?

Or will part of the fee be set aside to stimulate innovation and recognize performance? This type of hybrid fee requires a minimum of 10% of the total fee to achieve the planned objectives for improvement to service delivery and to the effectiveness of results. There should be a significant investment by the company in the firm in exchange for an ongoing strategic contribution. All AFAs should be supported by an annual review and adjustment mechanism to share risk when the volumes, complexity mix or distribution by region varies significantly from plan.

The sixth element comes into play after the proposals have been evaluated. Qualified firms are interviewed to begin the first round of pricing negotiations. Details can include the choice of partners and the allocation of work to specific fee earners, the annual increase in rate structure, and the use of lawyers from less expensive offices of the firm. There should be a thorough discussion of the preferred AFA at this stage. The second round of pricing discussions is part of the seventh element when the proposed allocation of work is

shared with the firm. There is agreement on out-of-scope work if any, on the annual review and adjustment mechanism, and how all of this affects the proposed price of the work. Strategic Partner firms will assist in the design and hosting of a standardized record of instruction. Work intake and allocation protocols, LPM and budgeting, and billing and reporting requirements are finalized. This is especially important when the Strategic Partner is responsible to retain, oversee and pay designated local counsel.

The last critical element consists of documenting the master agreement with each firm. Strategic Partnering Agreements extend far beyond classic billing guidelines. They incorporate service delivery, pricing, review and adjustment mechanisms, operating protocols, innovation initiatives and funding, performance indicators and targets, and management reporting.

There is plenty of work for procurement, the law department and the strategic partner to manage a transition to an effective non-hourly fee arrangement. Data, preparation and trust are pre-requisites. The result must be innovative, measurable and renewable if it is to be effective.

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## *7. Budgeting Complex Legal Work*

Very few lawyers enjoy budgeting for complex legal matters. This is equally true for inside counsel and partners in law firms. I recently had the opportunity to review 50 budgets from 20 law firms. Some were for commercial agreements, but most were for complex litigation. At the low end, the smallest files had 100 hours, while at the high end, the largest matter exceeded 12,000 hours.

Timeframes for matter completion ranged from 5 months to 5 years. A few firms had well developed templates for budgeting complex matters in several specialties. Yet, 80 % of the firms had no templates or standards for planning and budgeting matters. Relationship partners tended to improvise with general statements and relied on long e-mails instead.

It has been nearly 20 years since detailed matter plans and budgets for complex work have been required by some companies and since they have been well done by a few progressive firms.

Today, much of the work referred to external counsel is for litigation since few law departments have the volume of matters and infrastructure to support complex files in

multiple jurisdictions. It is often the case that a file is referred by a commercial lawyer serving as inside counsel with no experience in managing litigation files. Few in-house counsel feel at ease analyzing and challenging the matter plans and estimates put forward by law firms.

Law firms may not eagerly offer detailed matter budgets to clients that do not ask for them. Instead, they may provide figures rounded to the nearest \$ 25,000 by phase of the matter, accompanied by an eloquent explanation of why each case is different and detailed estimates with probabilities are unreliable or impossible.

Detailed matter budgets set out the hours for individual fee earners by phase and task, initially at least for pre-trial phases, if not for the duration of the matter. The company and the firm agree on the planning assumptions for each task, as well as the percentage probability for each assumption. This should prompt an up-front discussion and agreement with the company's law department before too many resources are expended. An 80 % probability threshold is recommended for each task requiring no more than 100 hours. Activities with more than 100 hours should be broken down into smaller steps to avoid rounding up the estimates.

Companies and their business units should plan their legal costs on an annual basis and for each matter to the end of the matter cycle. This suggests that law departments and their law firms need to “up their game.” Both should master legal project planning and budgets. Primary law firms should be asked to describe their training programs, methodologies, and resources for project management. This description should reflect the firm’s formal position rather than the preferences of individual partners.

For the most part, it is sufficient to include the description of the matter and the planning assumptions in a memorandum accompanying a matter budget as long as these are clearly correlated with phases and tasks of the matter. Firms should provide a breakdown of hours planned for partners, associates, and paralegals, identified by name for each phase and task. The company’s law department can then determine if the ratio of work delegated to associates and paralegals is appropriate for each task. Our studies reveal that partners and associates could delegate an additional 20 % of their hours to a less senior member of the team without compromising efficiency and results.

There is evidence of sophisticated budgeting for class actions, coroner’s inquests, trials, appeals, as well as all

manner of litigation, complex labour disputes and arbitrations. Excellent templates and code sets exist for mergers and acquisitions, commercial agreements, intellectual property and general advisory work. Inside counsel can ask their primary firms or colleagues in other company law departments for sample templates and leading practices in matter budgeting.

Clients should encourage their law firms to budget the most likely and not the worst-case scenarios. This means that retainer agreements should provide for milestones to review and revise matter plans and budgets.

At the very least, a new budget should be prepared if the original budget is to be exceeded by 10 % or more.

Companies, especially those with more than five lawyers and with important volumes of work referred to external counsel, should consider designating one or two members of the law department - one for transactions and another for litigation and disputes - to review and approve all complex matter budgets. Concentrating this responsibility with one or two individuals builds up expertise in the law department in the area of resource management and pays dividends for the company. External counsel will eventually appreciate the investment of time and effort.

## ***8. Why a Productivity Improvement Fee Arrangement?***

Law firms always respond positively when asked about their experience with and their appetite for Alternative Fee Arrangements (AFAs). Some are enthusiastic for broad application, while most firms prefer to apply AFAs to individual matters only. General Counsel must insist on AFAs because law firms will never volunteer.

One simulation based on a recent law firm proposal was designed to support AFA discussions within the law department. It began with this statement from the General Counsel to the company's preferred law firms.

*"Our company's experience is that working to find the best and fairest fee structure for each engagement aligns our goals and those of our panel firms, promoting greater efficiency in the delivery of legal services and making success a shared experience. We recognize that successful and sustainable AFAs require trust. We expect a sensible profit to be made by our panel firms under AFAs, but with the value being measured in ways other than the number of billable hours recorded. Our company is seeking a specific commitment from firms to work with us to replace, so far as*

*practical, traditional time-based billing with AFAs that provide greater cost-certainty and incentivize the firm's success in delivering high quality advice efficiently. Examples of the firm's previous experience in delivering successful value-added initiatives to clients will be well received. However, unless a compelling pricing proposal is retained, we will default to variations of hourly-based billings in combination with detailed matter budgeting."*

### **Planning Assumptions for an AFA**

The company identified 4 700 hours per year in its Invitation for Strategic Partnering (ISP). The hours were spread across eight categories of law and represented a total of 14 100 hours across three (3) years.

The company was able to assemble good historical data for 2018 and 2019 regarding fees and hours for each category of law and staffing patterns by experience level of lawyer. From there, it was easy enough to calculate representative hourly rates for most categories and use these as a baseline for AFAs and projected legal spend.

The ISP specified staffing ratios of partners, associates and paralegals for each category of law in order to compare blended rates across its panel firms for a 30-year reference period.

In this example one firm, not the lowest priced firm, was judged to have the competence and coverage to be provisionally allocated 10 500 hours across three years - 3 500 hours or the equivalent of two lawyers per year- in the following configuration:

- 1 000 hours per year of construction/major projects
- 1 000 hours per year of employment law
- 1 000 hours per year of litigation
- 500 hours (half of the annual volume) per year of M&A

### **Three Pricing Questions**

*1. What would the 10 500 hours cost if purchased in the traditional (pre-ISP) fashion over the next 3 years?*

- This calculation requires an escalation the 2019 baseline rate for each category by 4% per year. Thus,
- Construction at € 659 per hour in 2019 averages € 713.14 over the next 3 years and the 3 000 hours would cost € 2 139 415
- Employment at € 404.82 per hour in 2019 averages € 438.08 over the next 3 years and the 3 000 hours would cost € 1 314 227
- Litigation at € 489.06 per hour in 2019 averages € 529.23

over the next 3 years and the 3 000 hours would cost € 1 587 705

- M&A at € 637.97 per hour in 2019 averages € 690.38 over the next 3 years and the 1 500 hours would cost € 1 035 574
- The total cost of the “Traditional Option” is € 6 076 921 (€ 578.75 per hour)

*2. What would the same 10 500 hours cost using the ISP blended rate option?*

*Construction at € 460.00 for 3 000 hours = € 1 380 000*

*Employment at € 437.83 for 3 000 hours = € 1 313 490*

*Litigation at € 441.92 for 3 000 hours = € 1 325 760*

*M&A at € 467.35 for 1 500 hours = € 701 025*

*The total cost of the “Blended Rate Option” is € 4 720 275 (€ 449.55 per hour).*

*3. What could the same 10 500 hours cost with a fixed fee combined with 10 % collar for 3 years?*

One can call this the Productivity Improvement AFA. In this case, a fixed fee with a 10 % collar is designed as a shared risk / shared reward AFA which stimulates the firm to be more productive (fewer hours to reach the same objective on a legal matter) and to delegate certain tasks



appropriately. It is also administratively simpler for the company to manage 36 equal monthly payments supported by regular activity reports.

Such a fee arrangement is best agreed with a strategic partner law firm, hence the use of an ISP (Invitation for Strategic Partnering) and not an RFP, whereby both the company and the firm make investments in innovation for service delivery, work intake and allocation, legal project budgets, knowledge transfer programs, legal technology, and management reporting.

The devil is in the details when it comes to the mechanics of such a Productivity Improvement AFA. Instead of 10 500 hours purchased one hour at a time for the three (3) years, the baseline hours anchoring the agreement are set at 9 450 hours (90%) in the belief that a good law firm can be 10% more productive with the right incentives in place. The fixed fee is based on € 449.55 and costs € 4 248 247. Payment would be in 36 equal amounts.

All hours below 8 505 (90% of the baseline) or in excess of 10 500 (110% of the baseline) would be reimbursed to the company or paid by the company, respectively, at the agreed rate of € 449.55. Activity reviews would be semi-annual to discuss volume trends and complexity mix.

The total cost of the “Productivity Improvement AFA” for 10 500 hours is the same as the cost of the 9 450 hours at € 4 228 247 (€ 404.59 per hour).

### **Observations**

The blended rate option is €1 356 646 (22.4%) less expensive than the 2019 traditional price escalated annually over the next 3 years. The fixed fee “productivity improvement” option is €1 828 674 (30.1%) less expensive than the 2019 traditional option escalated annually.

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## *9. Managing the Legal Supply Chain*

It has been 27 years since the DuPont Legal Model was inaugurated. DuPont recently published its fifth version of an 85-page handbook explaining the model. The model is premised on four elements: strategic partnerships where the parties invest in each other's financial success; technology utilization to drive collaboration, improve efficiency, and eliminate duplication; alternative fee arrangements; and a commitment to diversity.

Today, the company has 40 firms across North America including Fasken, formerly Fasken Martineau DuMoulin, in Canada. I have had the opportunity over more than two decades to represent almost 100 companies and their law departments in designing and negotiating multi-year arrangements with their preferred law firms. There is a successful precedent for almost everything: multi-national firms covering 200 countries and which can serve as the general contractor and guarantor of quality for firms in regions where it has no offices, specialty firms doing the same on a national basis for asbestos litigation or automobile recalls, and full service firms managing complex transactions and regulatory files.

Everything from high volume “commodity” work, to niche practices like cybersecurity, to bet the company transactions.

So why has there not been a stampede by companies and their law departments to re-design, introduce, develop and improve their relationships with external counsel? More than 80 % of companies still retain counsel on a discounted hourly basis. For the last 25 years, in-house counsel have been saying that they “retain the lawyer, not the firm.” What a failure to leverage the innovation, the expertise, and the operating practices of law firms that are on Version 4.0 of legal services delivery. What are the obstacles and how can the law department catch up? I have observed five impediments to modernizing the corporate law department’s relationship with law firms and other service providers in the legal universe.

**The first** is a lack of a clear statement - some call it a manifesto - over the signature of the Chief Legal Officer that sets out what the nature of the relationship with primary and preferred law firms should be. Are they merely vendors and suppliers of professional services to be priced by procurement and managed by the law department? Or are they closer to what Ben Heineman (see *The Inside Counsel Revolution*, 2016) calls Phase Five when “law

departments are seeking to integrate more completely with law firms and make them strategic advisers"? Few Chief Legal Officers provide unambiguous clarity to their legal and business teams, much less to their law firms, on this question.

**The second** pre-requisite to effective partnering with external counsel depends on some competence in influencing the causes and sources of legal work that comes into the law department. It also depends on proficiency in categorizing and quantifying the workflow by area of law, level of complexity and number of hours. Companies equipped with world-class matter management systems ensure that their law firms interface for billing and payment purposes. But they fail to leverage the analytical and management reporting functions of the systems they have in hand. It is one thing to carry out a retrospective statistical and financial analysis. But it is quite another to understand the data and the company well enough to predict and manage the demand for legal services for the ensuing three years. There are great examples of companies which do all this well, but the majority have no written and detailed statement of the demand for legal services.

**The third** obstacle to forging a viable partnering

arrangement with law firms amounts to a deficiency in the organization, resources and operating practices of the law department. Here are some of the symptoms. The Chief Legal Officer / General Counsel or deputy does not spend enough time managing the resources of the law department and relationships with external counsel. The department tends to operate as a group of solo practitioners or perhaps as a captive law firm. A department of 10 or more lawyers should have a professional head of legal operations, but many do not. The lawyers in the department have no professional training in legal project management and budgeting as a way to manage their own time and that of external counsel on matters. Finally, the department under-leverages the collaboration technologies available from its most progressive law firms.

A number of law firms now own consulting firms that are designed specifically to help law departments operate "smarter, better, faster."

The fourth barrier is a lack of proficiency with alternative fee arrangements, especially when applied to complex legal matters and to multi-year portfolios of legal work cutting across categories of law and legal jurisdictions. Being able to apply hybrid fees and fixed fees to more than

one matter at a time depends on two factors. The first is the ability of the law department to provide, but not guarantee, a scope and flow of work to its law firms as a way to secure stable legal teams and predictable pricing. The second is finding a way to stimulate the law firm to use fewer hours and to improve its delegation of tasks to get the same work done. Law firms have their Chief Pricing Officers and they are accomplished professionals. Law departments must master alternative fee arrangements to stimulate the right balance of results, innovation and cost with law firms.

Every good plan perishes on the battlefield. Overcoming the first four barriers to managing the legal supply chain for maximum value to the company will fall short unless the plan is well executed. The essence of an effective strategy - especially one that seeks to manage the legal supply chain through strategic partnering - is in its execution. The strategy and the tactics must allow for adjustments along the way. Unforeseen issues, challenges and opportunities should be incorporated along the way. The Chief Legal Officer needs to make the execution of the strategy a top priority, ensure its visibility every step of the way, and compensate members of the in-house and law firm teams for success

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## *10. Beyond the Basics*

Most legal software companies and specialty consulting firms populating the legal services universe will release white papers from time to time to raise their profiles and to announce new products and services. Quovant (formerly Legal Bill) is a Nashville-based company offering software solutions, data analytics and advisory services to both law firms and corporate law departments.

Their most recent white paper, entitled “Legal Spend and Matter Management” is worth downloading from their website. Authors Christopher Seezen, Alicia Hunter, and Emily Rhode sum up the paper as “four practical tips to avoid confusion and expensive surprises when managing outside counsel legal spend.” Like the authors, I consider the four “ideas” to be part of the basics. Some help reduce spend, while others provide greater visibility and data. There are a number of additional measures that move beyond the basics which a company and every law department should master.



The first idea consists of timekeeper authorizations to build greater accountability into the company's relationships with its law firms.

However, some surveys reveal that clients have no appetite or time to develop relationships with their law firm timekeepers. It is simply too time-consuming and impractical in a fast-paced business world. That is not to say that law firm relationship partners should not be professional and business-like in their dealings with clients. But imagine the number of relationships needed for 1 000 legal matters in six legal specializations supported by 15 law firms in 9 countries.

Quovant's approach to timekeeper authorizations seems tilted toward hiring individual lawyers and, with some exceptions, trying to control their individual hourly rates and hours - "rates should be set individually or by position." I find the authors' third question to be the most thought provoking: "how much control will you have over staffing?" Advice to keep the process of timekeeper approvals simple does not help to manage or reduce external legal spend. Most progressive and effective law firms now have professional staff on board that are certified in legal project planning and budgeting. Clients should require legal project budgets with planning assumptions

and probability estimate by phase and task for all matters likely to consume more than 50 hours. Some set the threshold for budget plans as low as 25 hours. Such plans should be specific about the staffing distributions for the matter. It is a choice between proper planning with clear up-front communications or conducting autopsies on invoices. I have seen too many companies commit to formal protocols for legal project planning and budgeting, and then default within a few months to more informal e-mail exchanges and phone calls. Inhouse counsel should themselves be trained in matter budgeting and legal economics if they are expected to meet targets for reducing or managing external legal spend.

Quovant's second idea concerns the use of billing guidelines. Most companies have had guidelines in place for 40 years. Basic reference is made to communication standards, billing formats, and the non-admissibility of administrative tasks for billing. Moving beyond the basics of billing guidelines to more comprehensive terms of engagement requires that companies and firms agree on a system of Records of Instruction (ROIs) whereby uniform technology-enabled requests for legal services become the norm regardless of the scope of the matter. Terms of engagement should also require detailed matter plans and budgets together with provisions for change orders.

Together, ROIs and matter plans introduce predictability and shared accountability for legal spend.

I found Quovant's third "idea" - the one dealing with alternative fee arrangements - to be the one with the greatest potential for controlling external legal spend. The advantages of AFAs over hourly rates are well laid out in the white paper. Yet Quovant's response to the question "when should you use AFAs?" is tentative in that the conditions proposed for use are quite limited. My position is quite different because I believe that some variation of non-hourly fees can and should always be used provided ROIs and a legal project plan and budget are in place. Popular hybrid AFAs combine capped or fixed fees by phase with a component for performance, success or innovation. Law firms are far less risk-averse to AFAs than are their clients. Companies need to up their game.

Quovant's last idea is for objective and subjective reviews of invoices. Few clients want to spend time on forensic work. Moreover, they find that asking for adjustments to billings to be distasteful and a waste of time. Better instead to use the ROIs and legal project management and budgets as preventive measures. Let the law firms ask for change orders and exceptions before the work is done, shifting the administrative burden to the firm.

Working with firms that have the tools, the professionals and the experience to use them is essential for companies that want to move beyond the basics of managing external legal spend.

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## *11. Seven Critical Steps for a New Deal*

As the incoming CEO of an established company, what would you do with a division or department which had very little data, aside from total fees, number of items purchased for the last two years, their variety and complexity, and the relative effectiveness of each item or service purchased? What would you do with a business unit which was unable to forecast its requirements for external professional services for the next three years? And what would you do if the company failed to leverage its purchasing power by not relying on advanced strategic sourcing practices?

These are not big concerns when looking at sectors such as banking, insurance, telecom, big pharma and global manufacturing companies because they continue to refine their practices for retaining external counsel. Still, the aftertaste of cost reduction programs regarding legal fees for law departments is not pleasant. Legal procurement professionals often encounter passive resistance even when invited to team up with their legal department to introduce a new business model for retaining legal counsel. With the possible exception of the US, the economies of most countries are unstable. Even the Chinese economy is slowing its rate of growth. Some

would observe that annual rate and price increases averaging 5 % or 6 % are not sustainable for legal services in many markets. One financial institution reported increases averaging 14 % per year over the last 5 years – a rate that is 3 to 4 times higher than increases for other goods and services or of wages in the organization.

While law firms will not be enthusiastic about changes to the status quo of business arrangements with their primary clients, most will be receptive to initiatives that deepen relationships and increase market share. The most progressive firms seek out clients that are prepared to invest the time and money to innovate and to carve out new ways to package, source, deliver and price legal services.

For legal department leadership charged with reducing legal spend, the answer cannot be found in asking for bigger discounts or mounting a procurement process that targets a race to the bottom of the barrel for better hourly rates. A new business model for relationships with external counsel requires a complete re-think of traditional arrangements. Companies and their legal leadership are at a net disadvantage unless they get quite a few things right.

First, two years worth of detailed data about the number

and complexity of matters should be obtained from each law firm. The data should include the number of hours for each experience level in the firm. Few companies have this information available from their matter management systems or accounting data bases even though improving law firm practice patterns represents 50 % or the savings available once discounts are exhausted.

Second, the company should forecast its requirements for legal services twinned with measures to improve productivity in legal services delivery and administration. The forecast should be quantified and converted into a scope of work that forms part of a request for proposals for legal services.

Third, the company should consider the next generation of “convergence” in the number of primary, specialist and regional law firms it retains. There are arrangements where firms are retained for legal work and to manage workflows, quality and pricing of a network of secondary firms for entire regions on behalf of the company. Increasing market share and making longer-term commitments for work to still fewer firms allows primary firms to migrate to new pricing models and to innovate with service delivery.

Fourth, the company must acquire expertise so that it can

evaluate the cost-effectiveness of alternative fee arrangements (AFAs). This is particularly important when applying alternative fee arrangements to non-recurrent and complex legal work as well as to large portfolios of work. A solid understanding of law firm economics is a prerequisite to negotiating fair, alternative pricing with law firms. Both legal and procurement professionals should be at the top of their game in this respect and avoid variations of hourly-based fees.

Fifth, getting the non-hourly price and conditions right for individual matters is a companion piece to a new business model with external counsel. Inside counsel must understand optimal staffing patterns as well as the related planning assumptions and their probabilities when budgeting individual matters in the context of a multi-year AFA program.

Sixth, the company should evaluate the performance of its primary counsel every six months. Criteria and process should be set out in the terms of engagement, even if the firm is sole-sourced, and even if fees are not tied to performance. The usual key performance indicators include results, service, innovation, and cost-management. Finally, there should be a formal commitment by the General Counsel to a detailed, written project plan to



implement each of the six elements above. Preparation and an execution strategy that is properly resourced will improve the prospect of success every time. Seven critical steps for a new deal - no margin for error.

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## *12. Fixed Fees and Performance*

In writing about fixed fee arrangements with law firms, Ben Heineman (Inside Counsel Revolution) suggests that there are trade-offs. Fixed fees “may drive firms to leaner, more productive staffing. The bad news is that, even though they need to produce a good result, firms may cut resources too far and impair quality in order to get a bonus for coming in under the fixed fee.” I can understand the concern that the General Counsel may have: that she may be getting the “B-team” or that the firm may be cutting corners on resource allocation.

It is common enough for companies to request budgets and caps for individual matters, or for phases of matters. This should be done as a matter of course for all files that are likely to require at least 50 hours of legal work. The budget estimate should detail the number of hours for each fee earner for each phase and for each task within a phase of a legal matter. Planning assumptions should support the estimates with an 85 % probability that each assumption is correct. All of this makes the firm and the client accountable to each other to define the scope of work, the risks, and the anticipated results.

A longer-term commitment to more work from fewer firms, using non-hourly fees, is more complex. Putting more eggs in fewer legal baskets has been a procurement / sourcing practice for 30 years. However, starting to do this in a way that integrates the company and the law firm in a strategic fashion goes several steps beyond managing a panel of firms and running a request for proposals every three or four years, especially if the fees are non-hourly.

I have seen of multi-year non-hourly fee arrangements succeed and I have seen them fail for a number of reasons. The performance of preferred law firms, including those to which a long-term commitment for workflow and work volumes is being made, should be assessed twice a year, as well as when certain milestones are reached for complex matters. There is something to be said for tying performance to part of the fees.

Key performance indicators (KPIs) are essential and must be set out clearly with targets that matter. No company wants to waste time evaluating primary firms on overall performance every six months if it means that part of the hold-back on the fixed fee is invariably released. This type of administrative overhead is resented by corporate counsel who have no

time to spare. KPIs will be effective if they are designed to improve results, productivity, innovation in service delivery, and / or costs. Behaviours and resource allocation must be influenced by the choice of performance activities to be carried out by the law firm and by the corporate client.

It can be tempting for a client that has agreed to a multi-year fixed fee for a volume of regular and complex work with a leading law firm to monitor and to manage the relationship informally or on an exception basis. Heineman maintains that corporate counsel must be held responsible for the quality and the cost of the legal work of external counsel. For this to happen, then inside counsel must assemble and manage an intelligent performance program for external counsel. The reasons are the same as those which support the evaluation of their own performance within the company.

There are three components for a basic performance program applied to external counsel. The first is a fee arrangement that combines a base fee with a fee for performance. The configuration must go beyond a hold-back on a

base fee to an arrangement which stimulates productivity, results and innovation in service delivery beyond what firms typically provide as part of their non-billable tie investment for their best clients.

The second component of a basic performance program applied to law firms is the right infrastructure and sufficient time from the law department to actually collect input from across the company and the law department, and then to organize well enough to debrief external counsel in a timely fashion every six months.

The third component suggests that you get what you measure and you get what you pay for. It makes sense for the company to spend money beyond the base fee for performance against targets set out in the KPIs. Too many companies prefer to trade on professional relationships only, rather than set stretch goals and performance targets for preferred external counsel.

This traditional “modus operandi” is too easy,

too comfortable and much less than a company expects of its own lawyers.

Fixed fees for large portfolios of regular and complex work are cost-effective provided they are combined with a robust performance management program tied to legal fees.

*Adapted from an article published by Lexpert Magazine in March 2017.*

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## *13. Failure to Delegate*

A detailed analysis of law firm staffing patterns over the years reveals very idiosyncratic behaviour - variations in the ratios of partner, associate and paralegal time that cannot be explained except by a partner's preference on how to staff different matters for different clients. Partners in the same firm doing the same kind of work will use different proportions of associate and paralegal time.

This should be of significant interest to both law firm leadership and to corporate and institutional consumers of legal services. Law firm leadership should understand the extent to which partners leverage the time of associates at all levels of experience, of paralegals, and even of less senior partners. Leverage is central to law firm profitability. Gone are the days when a law firm would consider that first, second and third year associates were "loss leaders" - a very expensive training program with a serious attrition rate. More often than not, everyone in the legal "food chain" can readily delegate 20 % of their work to the next band of experience.

In most instances, this means delegating certain tasks rather than entire files. This requires planning and teamwork. Associates must do more than meet formal and informal billing targets. Firms should be more explicit in setting leverage objectives for individual partners.

Delegation should be optimal. Practice group leaders should consider this one of their core functions, not only because the law firm's bottom line is directly affected, but because knowledge transfer, training and development, and client service come into play.

General Counsel should take an avid interest in the staffing patterns of the law firms they retain both for an individual matter and for portfolios of legal work over time. Some of the reasons for doing so are the same as the ones that preoccupy law firm managing partners: turnaround time, knowledge transfer, and stable legal teams. However, the financial imperatives differ for the client.

The cost of a matter can be as much as 15 % less, depending on the extent of delegation. In recent years, law departments have been asking for detailed matter budgets for complex work beginning with files requiring at least 50 hours. The distribution of work by phase and task and by fee earner is now an established process in most firms.



Too few clients are rigorous in requesting and diligently reviewing matter plans and budgets.

Negotiating a blended hourly rate for all fee earners on the file helps the law firm to focus its resources on the tasks at hand, thus properly overseeing the distribution of who does what by when. The firm and the client should ensure that the matter plan and blended rate reflect the relative complexity of the file. However, a discounted blended rate will not control for the number of hours that are worked on a file. Better to agree on a capped number of hours, or on an annual fee that generates a productivity dividend - fewer hours - from the firm. It is easier to do this when the file is large enough or with a collection of matters over time. More eggs in fewer legal baskets. Failure to delegate tasks is a much more widespread challenge in law departments. The law firm leverage model is simply not available. Counsel will work collegially enough, but individually still then to do more than 90 % of the work on a file, no matter how complex or simple the tasks may be. To the extent that there is any delegation by inside counsel, it will be by co-counselling with a law firm to use their associates or because the law department has paralegals available.

I recently spent time looking at file allocation patterns and

service delivery in a 38-lawyer law department. About 85 % of the lawyers were litigators, supported by a legal assistant for each three (3) lawyers. Amazingly, there were no paralegals. Workloads were measured by file count without regard to any complexity levels or the mix of file types to each lawyer. There appeared to be no distinction made in file allocation to entry level and senior lawyers. No targets were set for file cycle times. All in all, this was a collection of hardworking solo practitioners.

Leverage in law departments need not take the form of senior and junior lawyers. Unlike law firms, law departments are not attrition-based models.

Demographics suggest that most in-side counsel have at least 10 years of practice experience.

What is the solution when there are no juniors or paralegals on board? Twinning a lawyer with another lawyer and encouraging them to divide the work - that is to say the tasks of a given file - between them will drive productivity with two provisos. The first is that work intake and allocation must be centralized with group leaders in the law department such that workflow and deadlines are more explicit and capped.

The second is that law department leadership has a system to monitor file count, file complexity, and cycle times against objectives. General Counsel and law firm leadership have much to gain but addressing the failure to delegate

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## *14. Four Questions in Legal Sourcing*

The trade organization for legal procurement, Buying Legal Council (see [www.buyinglegal.com](http://www.buyinglegal.com)), recently released the results of its 2018 survey. The themes covered by the study were:

- the impact of and the value realized by procurement professionals;
- partnering with law departments to deliver results;
- evidence of metrics, commitments to improvement, and of continuing education increasingly defining the market for legal services.

153 legal procurement specialists completed the survey earlier year. Many of those involved on a full-time basis with sourcing legal services come from financial institutions, the insurance industry, pharmaceutical companies and global manufacturing. There are others still who specialize in the procurement of professional services such as IT, human resources or management consulting and who support the legal function. As a management consultant involved with RFPs for legal services on behalf of 75 companies since 1998, usually at the request of the

Chief Legal Officer, I have seen the contribution that procurement professionals bring to the table. One chapter of the survey report addresses key benchmarks, particularly those which concern savings. The question posed was “How much, as a percent of total spending with legal service providers, do you believe your efforts have helped save the organization in the last year?” The responses averaged 14.6 %. When asked about target savings for 2018, the answer was 16.9 %. This is encouraging.

Yet, at least four questions remain for both procurement professionals and their law department clients.

The first is “How does one measure savings”? There is good legal spend (transactions) and necessary legal spend (litigation). Are savings determined by the size of the discount, the number of hours worked, total legal expenses or some combination of each? Do we expect a company’s total legal spend in 2018 to be 16.9 % lower than its total legal spend in 2017 – effectively a comparison of absolute expenditures? The next survey should set out a single methodology for participants to use when calculating savings.

The second question relates to the use of alternative fee arrangements (AFAs) and pre-matter scoping, also known

as legal project management and budgeting. The Buying Legal Council survey found that the three most effective techniques to deliver value in legal services procurement were “pre-matter scoping” of work, the negotiation of AFAs, and the creation of panels or lists of preferred firms.

I would agree in every respect. However, it is not really possible to use AFAs, except on the most routine matters, without also relying on detailed matter budgeting by the law department and their law firms as a prerequisite.

Procurement and legal professionals should be scoping entire portfolios of legal work with variables that include legal specialization, the number and types of matters together with their complexity levels, and the overall hours anticipated per year for each jurisdiction of interest to the company.

This scope of work should then make its way into RFPs, whether these be invitational or competitive. It then becomes possible to align the financial incentives for the law firm with those of the law department and to do so at a predictable price for all types of work. Failure to do so relegates AFAs and matter scoping to routine work. Serious savings invariably stall for a company after 10 years of RFPs when anchored in some variation of hourly based fees. The next survey should ask about the extent to which the entire

portfolio of legal work is scoped and then sourced on a non-hourly basis.

Our third question arises from the report finding that the top three goals for procurement professionals in 2018 were ranked as:

- better capture and analysis of spending data
- reduced legal spending
- improved management of legal work

These are worthy goals. It makes perfect sense that better data capture and analytics be ranked first. Many companies that have had commercial systems in place for years to receive, analyse and process legal invoices are still missing half of the data. For the most part, they rely on matter management systems that are very precise at spotting unauthorized tasks, hours, rates or fee-earners on bills. They are not used to sort matters by complexity within a specialization. And they are not used to examine and compare law firm staffing profiles and practice patterns with each other and with a standard. Yet, they could be adapted to do so. The next survey should inquire about these capabilities and the extent to which this type of analysis takes place as a way to determine appropriate (non-hourly) fee arrangements.

The survey report is eloquent about the evolution of collaboration between legal procurement and legal operations. This makes sense from the point of view of data capture, data analysis and the management of legal sourcing processes. In my experience, the selection of firms for critical and sensitive transactions, significant litigation and regulatory work tends to be relationship and professionally based. It is rarely the object of a procurement process. Either these firms are always on the preferred list or they are selected regardless of the roster.

The next survey would do well to inquire about the extent to which this type of work is incorporated into the formal sourcing process and whether it is priced on other than an hourly basis. Many hard-won savings in legal procurement are eclipsed by exceptional, expensive “bet-the-company” work

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## *15. Negotiating with Law Firms*

The 2018 Chief Legal Officer Survey will not be released until November 2018. In the meantime, the 2017 edition is rich with data and analysis. Some 231 companies participated. Particularly interesting are the findings regarding the relationships with and costs of external counsel. Authors Morrison and Wilbur inquired “which outside counsel management techniques produced a significant improvement in performance?” The top four tactics were enforcement of guidelines for billing, expenses, matter staffing and matter management (75.4%), fixed, capped or alternative fee arrangements (74.7%) , provision of guidelines for billing, expenses, matter staffing and matter management (62.4%), and mandatory budgets for major matters (59.6%).

Noteworthy is the gap between the provision and enforcement of guidelines. This is troubling when only 37.5% of the law departments report that they routinely perform data analysis of their external legal spend.

This is the first in a series of articles about how corporate and government law departments can improve their


performance and add measurable value to the organizations I have had the opportunity to negotiate legal fee arrangements for more than 80 law departments over the last two decades. Companies typically receive 10% discounts with some receiving up to 20% depending on volume, duration and exclusivity of the work given to a law firm. Surprisingly, up to 30% of companies with which I have worked over the last 5 years are still paying undiscounted hourly rates. Altman Weil found that 55% of Chief Legal Officers believe that they do not have enough buying power to negotiate more effectively. Some 51% also say that law firms are resisting discounting. Interestingly, 30% of the CLOs do not want to damage good relationships with external counsel by asking for greater discounts.

There is a significant cost to a company that relies on “relationship-based” procurement and pricing of legal services. Our experience suggests that the effect is more than leaving an additional 5% discount on the table with preferred firms. When billing guidelines, matter staffing, and matter budgets are not enforced and when data analytics are not systematically carried out then the number of hours worked may be more than 10% beyond what is needed to get the job done.

In-house counsel are not trained or prepared to manage matter staffing by specialty and complexity. They are even less adapted at detailed project budgeting for complex work. In the same way that law firms have brought legal pricing and project management professionals into their ranks in recent years, law departments should formalize and centralize the role of pricing and tracking legal work for complex transactions, litigation and regulatory work in the company. This is all the more necessary when moving to non-hourly fee arrangements for individual matters and portfolios of legal work. Law departments that invest in such resources can reduce their legal spend with preferred law firms by 15% beyond the best discounts.

Fair and informed negotiation of operating and financial arrangements with preferred law firms in 2018 require companies to enforce guidelines for expenses, billing, matter staffing and matter budgeting. Non-hourly fee arrangements for complex and routine work should be the order of the day. And in-house counsel should be proficient in every aspect if they are to be accountable for the business side of the relationship with external counsel.

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*Richard's continuing series on 'Performance for Law Departments' gives valuable insights and analyses on how corporate and government law departments can improve their performance and add measurable value to their organization.*