

10 Ways To Get Serious About Cutting Legal Costs

Even before the current economic crisis, general counsels were getting squeezed between their companies' mandates to trim legal budgets and hourly rate increases by outside counsel. The situation is now much more dire for many GCs, who not only face significant budget pressures but also personnel reductions. For many chief legal officers, it's time to get serious about cutting legal costs.

Much has been written about strategies for and experiences with reducing the cost of the corporate legal function. Typically, these have included approaches such as:

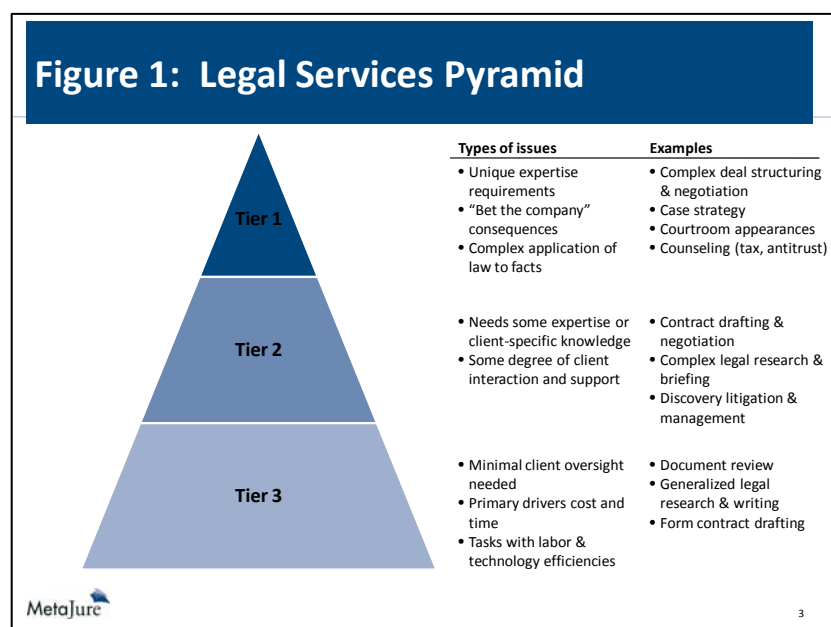
- Consolidating legal work sent to outside counsel into a reduced number of "preferred providers"
- Negotiating hourly rate discounts
- Capping common expenses and eliminating mark-ups for additional services such as document reproduction
- Requiring detailed billings from outside firms, which are then carefully reviewed for duplication or inefficiency

While most corporate legal departments have implemented these and other cost containment measures in the last few years, the current economic climate has general counsel taking another look at what else can be done. The following are 10 ideas to consider when deciding where next to turn for efficiencies and cost savings.

10. Categorize legal spending and distribute the work to the right provider

Legal departments that have undertaken comprehensive cost reduction analysis often find that the greatest gains come not from negotiating price reductions with their law firms, but rather from categorizing work and redirecting lower priority tasks or "commodity work" to lower cost firms and alternative service providers. Figure 1 shows a sample methodology of grouping legal services into tiers. The general counsel of a Fortune 100 public company that undertook such an exercise recalls, "I soon realized that about 80% of my legal budget was going to firms doing this third tier work, but I was paying rates that were in most cases equivalent to legal work in the middle tier; even in Tier 1 'bet the company' work, there can be commodity work costs that can be managed."

Unlike simple price reductions that cannot be repeated year after year, optimizing the distribution of legal work can yield recurring savings as more functions are distributed to alternative providers. While outside law firms may initially view this as losing work, experience shows that this approach ultimately allows firms to focus on their highest value-add. The most innovative firms



are those that understand this process and have either started their own low-cost commodity work operations or partner with third party providers to reduce their clients' costs. Examples include:

- A leading technology company re-engineered its patent prosecution work, outsourcing certain proofing and review functions to a specialized provider in India. After initial consternation, the company's patent firms found that this work, which had previously always been part of the prosecution process, was better performed by the specialist at lower total cost.

9. Increase the use of fixed and alternative fee arrangements (or "Kill the billable hour")

Like the weather, everyone complains about hourly billing by attorneys, but nobody does anything about it. Now would be a good time to change that. Fee arrangements for legal services perform at least four distinct and important functions: (1) cost predictability, (2) cost comparability, (3) price-value alignment, and (4) efficiency incentives. It is well understood that the billable hour is probably the least effective arrangement for each of these functions. Perhaps most overlooked by corporate clients in terms of importance is cost comparison—lower hourly rates do not necessarily result in lower total cost. Hourly billing persists largely because of the failure of large firms to proactively offer alternatives, and the difficulty perceived by corporate clients with negotiating other arrangements. To make progress against the billable hour, consider implementing the following:

- Calculate the percentage of your overall outside legal budget paid last year pursuant to fixed and alternative fee arrangements, and announce a goal for your firms to increase that percentage by 20% next year (or whatever target is aggressive but attainable).
- Reward firms for developing innovative fee arrangements. One client, a large private university with millions of dollars in outside legal costs, pays its firms in advance for fixed fee work, thereby enabling the firms to substantially discount its fees.
- Be careful to separate the goal of fixing the cost of a certain activity (e.g., initial draft of a contract, the summary judgment phase of litigation, etc.) from the risk that the volume of that activity will vary significantly from forecasts (e.g., the number of contracts, the number of cases, etc.). If fixed fees are structured such that law firms must bear the cost of unexpectedly high volume, their fees will need to be increased to take such risk into account, which is not always to the advantage of the client. For example, seeking a fixed fee for all procurement-related contract work will be problematic without defining and accounting for the volume of contracts.

8. Regularly bid out legal work

Both companies and law firms have gotten used to formal bidding processes for legal work, and this is much more common today than it was even a few years ago. But where companies may assume that firms dislike this process, many law firms in fact wish they had more opportunities to compete for new work. The traditional advice has been that companies should always seek to reduce the number of firms they use while increasing hourly discounts, but this runs counter to cultivating long-term relationships that benefit both parties. One way to resolve this conflict is for companies to do a better job of communicating to their preferred firms new matters in need of legal support, thereby allowing firms to compete on price and quality. Examples:

- Companies regularly underestimate the willingness of their firms to compete on price. One large company was convinced that the fixed fees it had painstakingly negotiated for patent prosecution work were as low as possible, and so conducting a formal bidding process was a waste of time. When it was tried, however, the average bid came in almost 33% below the previously negotiated price.

- In-house litigation counsel for one leading company was reluctant to engage in price negotiation for its “bet the company” litigation because he assumed he had little leverage with nationally known litigators. He found out, however, that even these sought-after individuals were receptive to fee reductions in exchange for their firms being considered for certain new work—something he was unaware of prior to discussing costs.
- One innovative law firm secured a large volume of legal work by offering a fixed fee per cell tower for regulatory work, which undercut the competition without taking undue risk that the volume of work would exceed forecasts.
- Formal bidding processes are often too cumbersome and time-consuming. Consider setting up in advance an agile or rapid RFP or bidding process whereby preferred firms are notified of new work opportunities, which they can quickly respond to with a summary proposal—all electronically via email or your company’s preferred provider network web site.

7. Pay special attention to discovery costs

Discovery work can be thought of as another example of the first idea presented above, namely getting the right work to the right provider. Given that such work can consume as much as one-third of some companies’ legal budgets, however, it may be better viewed as a special case that merits focused consideration. Companies that have had to deal with discovery issues in a significant way have generally developed sophisticated systems, often created in-house and/or in partnership with special service providers, for dealing with large requests and productions at reasonable cost. For everyone else, several rules of thumb apply to this broad category of work:

- It is surprising how many companies continue to use the most expensive and least efficient service providers—law firms—for discovery work. Regardless of whether your company currently has significant discovery issues, it will pay dividends for you to understand how a specialized discovery service provider can save you money in the future. If you don’t know what you’re paying for discovery in total costs and attorney’s fees per document or per gigabyte, your company is likely paying much more for such services than it should.
- Typically, by the time that companies realize that they have a significant discovery issue, it’s too late to affect one of their biggest cost drivers, namely the supply of records. While almost all companies now have records retention policies, these too often are mere policies without any implementing technology, much less incentives for compliance. Companies who have given this considerable thought are now implementing programs in advance to ensure records are only retained that should be kept for business or legal purposes.
- Records retention programs are often difficult to sell within the corporation because of the common misperception that storage costs, and particularly electronic storage costs, are small and declining. But this misses the point. The physical costs of data storage are between \$0.10 and \$0.20 per 1GB, but the legal costs of reviewing and processing that same 1GB of email in the context of a discovery request has been found to be in the range of \$20,000. The true costs of needlessly retained data should be brought to the attention of management.

6. Re-engineer the process before seeking legal cost reductions

One of the most common mistakes when it comes to cost reduction projects within legal departments is “jumping to solution.” If reviewing procurement contracts is too expensive, the obvious solution is to negotiate price reductions with outside counsel, or to move the work to cheaper contract counsel aided by improvements in information technology. In this simple illustration, however, what should happen first is an analysis and re-engineering of the underlying processes. How can the procurement process

itself be changed to streamline the contracting process? More to the point, do the underlying procurement transactions even merit the investment in legal support that an improved process would deliver? The operations group at one leading legal department expressed this point as an admonition in the form of an acronym: DABP: “Don’t Automate Broken Processes.”

5. Exchange training for services

Especially when it comes to Tier 3 work (*see*, Figure 1), it may be possible to obtain reduced costs or even free legal services in exchange for on-site training and experience with the corporate client:

- The concept of *secondment*—an English term meaning the detachment of a person from their regular organization for temporary assignment elsewhere—is increasingly familiar to many US companies and their law firms. Typically this is done on a reduced hourly or fixed fee basis.
- Companies may use this approach as a way to gain experience with persons to whom they intend to offer employment assuming all goes well.
- Several years ago, one well known bank in the UK experimented with a program whereby junior lawyers from a law firm spent time in-house to gain experience with the corporate client. When funding was cut for the legal department, the general counsel at the bank called the firm to explain that the program would be terminated because it could no longer pay for the time of the loaned associates. The firm, however, offered to send the junior lawyers anyway at no cost. More surprisingly, the GC received a call from one of their other firms inquiring about the program, and asking why their firm was not similarly allowed to send associates for training. Ever since, the bank has had a steady stream of several associates working without charge.

4. Collaborate to reduce transaction costs

Process re-engineering typically takes place within the confines of the corporation, but this need not exclusively be the case, and there are many examples where meaningful cost reductions can be achieved by engaging outside parties. Examples include:

- High technology companies that regularly deal with each other often negotiate master agreements to cover issues such as non-disclosure, intellectual property ownership, and the like. Such agreements often prove challenging to negotiate in the first instance, but pay large dividends in terms of savings in time and expense by obviating the need for re-inventing the wheel each time in the future.
- Any time there are repeated transactions with the same party or parties should be viewed as an opportunity to execute a master agreement to which work orders, schedules, or addenda of some type may be attached.

3. Measure everything

Reasonable minds differ on the value of strict application of manufacturing defect reduction methodologies such as Six Sigma to the work of lawyers. But if any of the teachings of such methods is beyond dispute, it is this: You can’t improve what you can’t measure. Even knowing this, it is still challenging to apply to legal work because much of what lawyers do, such as risk avoidance, is inherently difficult to quantify, much less measure with any precision. Still, imperfect measures are better than none at all, and there is always “client satisfaction” as a catch-all. Especially when it comes to outside legal costs, measurement is key to improving efficiency and cutting costs. For example, it has produced no less than a revolution in reducing the cost of e-discovery services that document review and production costs are now measured per megabyte or document (rather than per hour spent reviewing documents).

2. Demand innovation from your outside firms and legal service providers

Too often, cost cutting is viewed as a zero-sum exercise where corporate clients only gain when outside counsel lose. This is generally the most contentious, least effective, and most unsustainable approach. Instead, outside law firms and legal service providers should be turned to first when seeking innovation in how to provide services faster, better, and cheaper. For firms content with the traditional way of doing things, this will sound like code for “cost-cutting.” For forward-thinking firms and providers, however, this will be an opportunity to develop next-generation tools and services that can be used to better serve other clients and get new clients. For example, if the traditional model of using law firm associates to do document review and other Tier 3 work is too expensive, why not challenge the firm to provide an alternative that uses paralegals or non-attorneys with a goal of cutting costs by 30%? The firm is unlikely to misunderstand that it can either succeed with a service that it can market to other clients or lose the work entirely. Firms have been thought to lack financial incentives to become more efficient, but is this because of the billable hour model or the lack of incentives from corporate clients?

1. Stop doing low value, low risk work

For some chief legal officers, it may be the case that there are simply not enough cost-cutting measures to allow the level of legal support heretofore provided. In this case, it is imperative to have a thoughtful methodology for measuring and prioritizing work. Even for general counsel who do not face such difficult budgetary constraints, the question of “what should we stop doing?” should be regularly addressed, ideally as part of each planning cycle. Of course, there are no set answers to this question, but companies that go through a thorough evaluation in advance of a crisis always note later that they are glad they did. A few other observations based on work by leading legal departments:

- Whereas the general counsel should always feel completely aligned with his or her management as to Tier 1 work (see, Figure 1), this may not always be the case with respect to work that takes place in Tiers 2 and 3. With respect to that lower tier work, it is important to have adequate feedback from in-house clients in order to assure alignment on the topic of value. Legal departments that regularly survey their clients as to what work is valued highest, especially in Tiers 2 and 3, will be best positioned to make service reductions should the need arise.
- At risk of stating the obvious, outside law firms are usually least well positioned to help corporate clients cut out low value work. Indeed, they may actually contribute to the problem by feeling the need to apply the “gold standard” to all of their work either for reputational reasons or out of concern about malpractice risk. Although applicable ethical rules generally do not allow clients to waive future negligence claims, there are reasonable ways for law firms and their corporate clients to come to agreement about the desired standard of work for any particular set of projects.

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