COMMENT & DEBATE

In-house needs reality check on value

General counsel needs to take the lead on getting value from their external lawyers. Richard Stock and Ted Dwyer report.

In-house counsel could do much to amend the billing methods used by their law firms.

IN-HOUSE legal departments are under increased pressure to reduce their operating costs, even when the company is doing well financially.

The simplest response is to focus on the cost of external counsel in law firms, and the first reflex is to focus on hourly rates. This is being done across the board, for example Wal-Mart's associate general counsel, Miguel Rivera, froze all hourly rates for 2008 by issuing a decree to all his law firms in late 2007.

The 2008 ACLA/CLANZ survey of legal departments in Australia and New Zealand revealed that the number one way (62 per cent of responses) a law firm could improve its working relationship with the company is "to be more concerned with costs". The pressure is much greater since the beginning of this economic downturn.

It's interesting that general counsel often look to law firms, rather than themselves, to reduce legal spend. And it's true that law firms are responsible for escalating costs by 5 per cent - 10 per cent a year on a weighted rate basis.

One leading Australian firm, for example, is now charging more than $1,000 an hour for some of its partners' advice. But whose fault is that in a free market? The business priorities and business model of a law firm are not the same as those of its primary corporate and institutional clients.

While some companies have introduced innovative methods to move to a true partnership with fewer firms, arguably most have not. It is time for those leading legal departments to conduct a reality check on their efforts to mitigate the cost of legal services.

It's interesting that only 32 per cent of legal departments have conducted a formal procurement process to select their law firms. Fewer than half of these will undertake a similar process to renew agreements within five years.

On top of this, for the most part, legal departments do not know how many hours of legal work they have purchased by category or specialisation in the last three years. They do not forecast their demand using the number of hours by legal specialty and they do not rely on gradations in complexity of legal work for planning and management purposes.

It's worth considering, as well, that there are no recognised optimal staffing configurations for law firms to use for given categories of work and certainly none are discussed with their law firms. Everything is free form.

Only 60 per cent of legal departments negotiate discounts on fees, and 40 per cent pay full retail. Meanwhile, only 30 per cent use matter budgeting and require detailed fee estimates by matter from their law firms. And, finally, only 31 per cent have agreed-upon service levels 28 per cent use non-hourly billing some of the time, but fully 90 per cent of the legal work is still billed on a variation of the hourly rate.

Corporate counsel could do much to fill this void. Many general counsel don't realise how legal spend can be quickly reduced with the right combination of measures. There has been a lack of confidence among general counsel about where to start. But there's no use complaining and then doing nothing.

The key objective should be about reaching a long-term agreement with quality law firms that is fair to both sides, and perfectly possible. However, the lead must come from general counsel.

Richard Stock is a partner of Catalyst Consulting. He has led sessions on performance in legal departments for ACLA since 2005. Ted Dwyer is director of Dwyer Heath. He consults to law firms and legal departments on profitability, pricing and work management. Catalyst Consulting is collaborating with Dwyer Heath to better address the management requirements of legal departments.

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