



BY RICHARD STOCK

From Vendor to Strategic Partner

A new book plots the law firm's management of external counsel, in five stages, over nearly three decades

I RECENTLY READ Ben Heineman's *The Inside Counsel Revolution*. As the former GC for General Electric and a prolific writer, he covered a lot of ground. One section concerned The Global Legal Organization of the Future; its chapter on Law Firms and Alternatives is of particular interest because it provides the best description of the continuum of practices and relationships that law departments have had with external counsel that I have seen in 20 years.

Heineman traces the evolution of the corporate law department's relationship with law firms as five phases stretching over the past 25 years. These sometimes overlapping phases are worth examining in order to give law firms and GCs an idea of where they are in the continuum.

The first phase of corporate law department responses is, 'We hire lawyers, not law firms.'

As companies began to populate their law departments with specialists, these individuals in turn selected external counsel in an *ad hoc* fashion based on their networks. At the same time, inside counsel began to take on some of the complex work themselves, especially when the critical mass of work made it cost-effective to do so. For some law departments the 1980s was the beginning of the movement away from being a collection of commercial generalists acting as sole practitioners. Even today, too many law departments believe that this is the best business model to serve their corporations. Moreover, perhaps encouraged by law firm colleagues, they continue to believe that you hire the lawyer and not the firm.

The second phase of managing the relationship with external counsel, Heineman wrote, was to "make competition more systematic" with a clear objective of cost

reduction. Outside counsel guidelines were introduced but tended to focus on disbursements. The competitive aspects took the form of invitational requests to a small number of firms proposing fees on a matter-by-matter basis. Over time, informal requests evolved into formal RFPs, and in a few cases reverse auctions. Blended rates and discounts, both variations of hourly rates, were secured. Invoices became more detailed and task-based. Institutional consumers of legal services, such as banks, insurance and utility companies, did formalize processes, but did

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not systematically negotiate reduced fees or venture into alternative fee arrangements, with the exception of fixed fees for commodity work.

The third phase reflects the transition from relational to transactional retention of external counsel. Heineman refers to the era of "preferred providers," when implicit preferences for law firms and key lawyers became more explicit. The largest volumes and the most interesting work continue to flow to traditional legal providers, and it appears that relationships and a good track record continue to trump price. Law departments do not have the analytical tools or appetite to parse law firm prices, so it follows that they cannot determine how much more they are paying than they could pay to other panel firms. More than 80 per cent of Canadian law departments are operating at

phase-two and phase-three levels when retaining external counsel.

In phase four, the company commits a volume of work for several years in exchange for a flat annual fee. The company secures budget predictability and the firm has regular cash flow. Some Canadian companies have had such arrangements in place for 10 years, typically as a series of three- to four-year agreements. Adjustment clauses to recognize significant variations in volume and matter complexity are included to minimize the risks of paying too much or for unacceptable losses for the law firm. Collar arrangements of 15 per cent are usually sufficient for the firm to secure a predictable flow of work and to stimulate efficiency in the law firm. It followed naturally that fixed fees morphed into hybrid fees: a fixed-fee amount and a variable portion tied to key performance indicators. These arrangements are still rare today, however.

Heineman describes phase five as the effort by corporate legal departments to integrate more completely with law firms and make them strategic advisors. Goals and objectives are set for matters as well as for the portfolio of work. Joint law department and law firm teams select the optimal configuration of fees for the matter or perhaps for a book of business. This type of integration can incorporate LEAN initiatives, improving relationships with business units in the company, managing the network of local counsel, and facilitating detailed reports on legal services delivery.

GCs and law firms should agree on the cornerstones of strategic partnerships if they are to achieve their full potential. 

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