COMMON GROUND

A guide to better relationships between corporate legal departments and outside counsel

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Within the legal ecosystem, two diametrically opposed paradigms for success contend. On one side are corporate law firms, where rising billable hours and billing rates drive revenue. On the other side are corporate legal departments, which measure their success in large part by cost containment and reduction.

There's a lot of money at stake in this clash of titans. In 2015[1] alone, companies spent an estimated $437 billion on legal fees. It is common for clients to have varying degrees of doubt regarding the accuracy of an invoice just as an attorney may be skeptical regarding the client's willingness to fully pay for services performed. In a way, they are both right. Law firm realization rates continue to fall to all-time lows as a result of pre-emptive write-downs and a long-time culture of client discounts.

The juxtaposition of opposing principles has led to where the industry stands today. Cognizant of the fact that clients and attorneys need each other as they operate within a broken system, the industry is seeking ways to build a business model that better aligns expectations and rewards efficiency.

Alternative Fee Arrangements (AFAs) - later rebranded simply to "fee arrangements" — have shown promise as a solution. Once the golden child of aligned incentives, AFAs may have found their limitations. In 2012, 79.2% of legal departments utilized AFAs. In 2015, that number dropped to 68.4%[2]. While it's true that AFAs, as a percentage of spend, increased from 20.5% to 35.6% during the same period, it is likely because legal departments and law firms have begun to optimize AFAs on certain matter-types. High-volume, low-value matters, for example, work better than unique, high-value matters which account for the dramatic increases in AFAs on insurance[3] and intellectual property matters[4]. For those high-value matters, where complicated fact-patterns and strategies are likely to require more collaboration between attorney and client, however, AFAs are often not an option. So while AFAs were once seen as a way to foster collaboration, they are best applied to the types of matters where collaboration is least needed.

In past years, legal departments were viewed as a cost center — **the cost of doing business**. In turn, legal departments had large budgets to be spent on outside counsel, who were tasked with protecting the company. In that way, expectations were results-oriented. Today, however, legal departments serve an increasingly important purpose of managing risk and therefore seek a more business-friendly approach towards outside counsel: They seek "value."

In this whitepaper, we **explore the implications of a value-based approach** and how new innovations in technology are breaking down the barriers of communication in the legal ecosystem.

- **WHAT MUST A LEGAL DEPARTMENT CONSIDER WHEN THINKING ABOUT VALUE?**
- **HOW DO LAW FIRM REALITIES AFFECT THE LIKELIHOOD OF SUCCESS?**
- **WHAT ARE THE KEYS TO SUCCESS AND HOW CAN SUCCESS BE MEASURED?**

Ultimately, a value-based approach depends on legal departments having the ability and willingness to establish transparent lines of communication with outside counsel and for both sides to depart from the status quo.

1 http://legalexecutiveinstitute.com/the-size-of-the-us-legal-market-shrinking-piece-of-a-bigger-pie-an-lei-graphic/
2 http://www.law360.com/articles/787247/afas-now-dominate-a-third-of-firm-spending
3 http://businessoflawog.com/2016/04/afa-legal-matters/
4 http://www.law360.com/articles/656332/more-gcs-dabbling-in-afas-as-ip-work-pours-into-bigfirms

In its most basic form, "value" is a measure of worth — both objectively and subjectively. For example, it could be said that an attorney's time is valued at an average of $490 per hour. Rate of pay is an objective measurement that is calculable, comparable and sets the standard for hourly billing. However, it can also be said differently: the value of legal work is determined by the business's needs at any given time. This is subjective. It is not easily calculable. And this is the type of "value" legal departments are seeking — in lieu of the objective hourly value.

Value-based billing refers to the pricing of legal services based on the client's perceived worth. In theory, it creates an exchange where incentives are aligned—much like any other marketplace. But in order to get it right, three key pieces of information are continually needed:

- **THE CLIENT'S DEFINITION OF VALUE**
- **THE LAW FIRMS UNDERSTANDING OF, AND ABILITY TO DELIVER, SUCH VALUE**
- **RETURN ON INVESTMENT**

CLIENT'S DEFINITION OF VALUE

At Mitratech, we invest a significant amount of time diving into conversations with corporate legal departments to keep our pulse on trends within legal operations. When our clients define outside counsel value, their responses range from wanting more diverse staffing on their matters to wishing that outside counsel would work as an extension of their legal department. They also want a partnership where both sides can innovate.

No two people have identical priorities, and therefore no two people will have a common definition of value. A general counsel is apt to have a different concept of value than a chief of legal operations, who will both have different notions than outside counsel.

Regardless of the particular definition in a given situation, value is representative of a collaborative approach between legal departments and outside counsel. It is a willingness — by both sides — to help each other accomplish the business goals of the law firm and the client.

LAW FIRM'S UNDERSTANDING OF VALUE

Law firms are part of an institution built on the billable hour. Everything from staffing decisions to hiring to compensation is framed around the billable hour. Despite attempts to move away from it, the billable hour remains at the core of most law firms' business models. Most law firms are willing to adapt but market demand must drive the progress.

The disconnect between law firms and clients stems from the fact that many billing partners still believe successful results equates to value; whereas clients understand that successful results can be purchased from any number of law firms, and that

the delivery of legal services determines value. It is imperative for clients to communicate with outside counsel in order to define and align expectations around value. Doing so provides outside counsel the opportunity to meet such expectations.

RETURN ON INVESTMENT

Since clients prefer to work with healthy, profitable law firms, value-based billing must make financial sense for the law firm as well. For example, a blanket rule that junior associates cannot bill on a client's matter may appeal to legal departments as a way to improve a law firm's efficiency. Conversely, such a rule would increase a firm's costs and could damage their ability to recruit and grow in the future.

Measuring ROI on value is difficult for both legal departments and law firms. They either lack data or they lack the right data at the right time. Shadow billing (the act of providing the hourly values alongside an AFA bill) helps when illustrating value to another stake-holder. However, some law firms hesitate to do so in fear that efficiency would be viewed by the client as a windfall to the firm.

Legal departments and law firms also lack common value metrics. For example, law firms measure value based on revenue, realization and attorney utilization. Legal departments measure value based on historic spend, budget adherence and eBilling compliance. Each side derives metrics from disparate data sources, which precludes timely, informed collaboration.

Fortunately, technology has begun to bridge this gap. Our solution, Viewabill, promotes collaboration between corporate legal departments and their outside counsel by providing the ability to see matter-related time entries in near real time. Using a common language of value becomes a joint concept, fueled by a shared understanding of goals and business realities. We will further discuss the innovation that Viewabill represents throughout our study. Poor communication between legal departments and law firms exacerbates the potential for problems in a value-based relationship. Billing arrangements are becoming more complicated and, in the absence of effective communication, are prone to result in a winner and a loser, as opposed to a win-win situation. Effective communication begins with understanding the various roles within legal departments and law firms and how to leverage those roles to create a broad strategy that benefit both sides.

OWNING THE RELATIONSHIP

Legal departments and law firms are not monolithic entities; they are collections of people. In past years, those people were predominantly lawyers. Headed by the general counsel, legal departments were filled with former law firm attorneys who worked directly with current law firm attorneys. The lawyer-lawyer relationship was symbiotic. Legal departments fed a steady stream of work to outside counsel, who gained years' worth of institutional knowledge with which to protect the client.

Today's legal departments are far more complicated. The general counsel is now expected to be a strategic advisor for the company's management team.They must bridge the gap between legal and business matters stemming from the Sarbanes-Oxley Act of 2002. As it relates to outside counsel relationships, the biggest change has been the rise of the legal operations role, the legal operations role, which embeds business-oriented individuals into the legal department in order to apply non-legal process rigor to the department. Just ten years ago, the legal operations role was an anomaly. However, the Association of Corporate Counsel reports that 48% percent of companies now employ legal operations — double the percentage a year ago[5]. The injection of professionals with MBAs seeking to apply technology, innovation and metrics to the previously opaque legal space is disruptive to an industry that values the status quo. It is also a unique opportunity to view the industry from an objective lens.

A similar evolution is taking place in parallel with law firms. The shift to incorporate pricing models beyond hourly billing has necessitated the rise of the pricing director role. Leveraging data and project management experience from careers outside the legal industry, pricing directors (or equivalent) bridge the gap within the law firm between lawyers, management and clients to build a profitable business. Similar to legal operations, pricing directors are responsible for affecting change and must first contend with the old-world attorney mentality.

Yet, despite having the tools to apply sophisticated business processes, many legal departments continue to interact with law firms on a strictly lawyer-lawyer basis. Fees are often negotiated lawyer-lawyer; matters are managed lawyer-lawyer. Invoice analysis might involve non-lawyers, but approvals and final decisions are still left up to attorneys. In short, legal operations and pricing directors are often still viewed as non-core functions, capable of opining on strategy but not necessarily driving it.

However, law firms and legal departments benefit from expanding the avenues of communication and democratizing ownership of the relationship. Legal operations can find counterparts in pricing

5 http://www.acc.com/aboutacc/newsroom/pressreleases/acc2016closurveypressrelease.cfm

directors in a similar fashion as in-house attorneys have counterparts in outside counsel. No individual owns the relationship with outside counsel which, admittedly, equates to some loss of control for attorneys. However, by encouraging collaboration on various levels, legal departments can identify areas of innovation and build coalitions of stakeholders to actually implement change. Perhaps more importantly, it fosters an environment where experimentation and even occasional failure is embraced without risk of damaging the attorney-attorney collaboration, already in place around legal work.

CREATE AN ENVIRONMENT FOR CHANGE

Creating an environment for change requires legal departments and law firms to make the business case for value-focused initiatives. In today's current climate, that means working together across the so-called divide.

For example, rather than assuming the billing partner is communicating the client's values to the law firm's stakeholders, legal operations may be best positioned to have the value discussion directly with the law firm's pricing director. The more understanding a pricing director has regarding a legal department's long-term goals and strategies, the better the law firm will be able to provide a value-based pricing scheme. Of course, such direct communication also empowers the pricing director to help enforce the client's policies.

Creating an environment for change goes beyond a one-time conversation between legal operations and the pricing director. It requires real-time communication and collaboration to monitor and adjust expectations based on actual progress. Sharing data and analytics on an ongoing basis is the best way to accomplish this.

In many situations, a client and law firm will agree to high-level matter budgets, but will fail to perform any meaningful analysis on such budgets. Legal departments will leverage eBilling guidelines to "reject" certain work before allocating and categorizing billed activity in various buckets. However, due to a lack of a meaningful feedback loop between legal department and law firm, the law firm often lacks any insight into how the work is being allocated and, ultimately, whether or not the services fall within the client's expectations. Alternatively, the law firm might hold invoices for 60-90 days before submitting to a client, at which point the legal department is left trying to allocate work into budgets without any actual understanding of what has been taking place. It amounts to guesswork on both sides.

The key, of course, is data. Neither law firms nor legal departments can impelement a value-oriented scheme without data.

The key, of course, is data. Neither law firm nor legal departments can implement a value-oriented scheme without data. Historically, law firms have been hesitant to share any data beyond financial invoices with their clients because billing partners need an opportunity to "scrub" invoices prior to submission. This practice is widespread within the legal industry and is a major obstacle preventing the gathering of meaningful data. It is also damaging to both the law firm and the legal department. If the pricing director

lacks real-time insight into billable activity, there is no way to ensure the firm is operating efficiently and profitably. Likewise, the legal department is blind to the true billing cycle and lacks an opportunity to perform analysis and provide feedback to the law firm.

Mitratech's product management ream likens this market problem to watching legal departments and law firms communicate through two cans and a string while the rest of the world uses an iPhone. Mitratech continuously seeks ways to improve inside and outside counsel collaboration efficiently and through multiple avenues. Historically focused on robust spend management solutions to address this chasm, Viewabill represents a new avenue — breaking down barriers that prevent collaboration between legal departments and law firms. Our clients can understand billable activity as it happens, the law firms understand how the client allocates such billable activity, and both sides can continually work toward joint solutions that prevent problems from occurring ahead of time.

Law firms need their clients to drive change. By demanding meaningful insight — contemporaneously — a client also provides the law firm the needed impetus to implement procedures for better data tracking. Pricing directors can then merge client expectations with actual data to ensure attorneys are delivering value. In previous years, this could be seen as collusion; today, it should be viewed merely as collaboration with a strong partner.

Value can be an amorphous concept, but it always involves a shared vision. In order to work towards the same goal, legal departments and law firms should collaborate on a set of metrics that can be measured and tracked jointly.

COMMON DATA SOURCES

There are two primary data sources where most legal metrics are derived:

- **THE LAW FIRM'S TIME AND BILLING SYSTEM, INCLUDING INVOICE DATA**
- **THE LEGAL DEPARTMENT'S MATTER MANAGEMENT SYSTEM, INCLUDING E-BILLING.**

The data sources frame the Key Performance Indicators for an organization. Law firm metrics, for example, tend to be activity-based and include timekeeper activity, utilization, realization, and unbilled inventory. Legal department metrics are spend-based and focus on spend by firm, spend by matter type, spend by activity type, and time to pay.

The problem here is that each side is blind to important data in the other's possession. E-Billing has become an important spend management tool for legal departments, automatically screening invoice details for violations of billing guidelines. Law firms — specifically, the attorneys working on the matters — lack true visibility into a client's eBilling guidelines and spend weeks after each invoice cycle attempting to scrub the billable activity in hopes of complying. On the other hand, since eBilling data is derived from invoices rather than the law firm's time and billing system, legal departments cannot discern what actually took place from what the invoice said took place.

No one is able to see the full picture, and the blindness further feeds into the industry's "race to the bottom." Legal departments undertake broad cost-cutting initiatives because spend is measurable. Law firms prioritize revenue at the expense of efficiency because revenue is, again, measureable.

With disparate data sources, there is no common ground for legal departments and law firms to create common metrics—metrics that track the same data points for consumption on both sides. Even where metrics are tracked by legal departments and law firms, the separate data sources can lead to greater confusion.

Budgets are a common area of collaboration, and therefore budget metrics are tracked by both law firms and legal departments. However, while a law firm may know how much is billed to a budget, they rarely know how billed activity was actually applied to such budget. A firm can stray off budget without even knowing it. As always, there is another side to the story. Legal departments typically endure lengthy delays of 60-90 days before receiving an invoice, so their budget analysis is consistently 60-90 days behind reality.

While firms and legal departments may use budgets as a way of structuring legal work, neither side tracks budget-related data in a way that is action-able right away, and often wait until it is too late.

As important as deciding on common metrics to track value, legal departments should understand how data feeds the metrics:

- **WHAT IS THE SOURCE?**
- **WHAT IS THE PROCESS?**
- **WHAT IS THE TIMING?**

TIMELINESS OF INFORMATION

Imagine a GPS system that provided a starting point and an ending point, but nothing in between. Guidance was given at the beginning of your trip relative to your destination at the time, but was never updated during the journey. How would you ever know if you have made a wrong turn or taken an inadvertent detour? A map is of little value if you do not know where you are. Having access to the right data at the right time is important when determining metrics. Viewabill provides real-time insight into work-in-progress (WIP) activity, thus providing the data the legal department needs during their journey to continuously track and re-align expectations. It enables people to quickly modify behavior based on actual progress. It also mitigates potential confusion later, once everyone has long forgotten what actually took place.

While there can be steep cost-savings with the use of real-time WIP data due to closer tracking, there are less obvious benefits to real time data, as well. For example, real time visibility often results in a more collaborative general approach by outside counsel. Their time hygiene also improves dramatically—with time entries being drafted, on average, within seven days of activity when real time visibility is used versus 27 days when it is not. Contemporaneous time entries mean better data, which means more opportunities for legal departments and law firms to work together.

INNOVATION IS A VIRTUE

Lawyers are, by their nature, risk-averse. Beginning in law school, they are trained to "issue spot" — that is, they are programmed to identify every potential problem that could arise from a given set of circumstances. In the United States, where all law firms are owned by practicing attorneys, the safety-first mentality runs rampant. Law firms tend to be poor early adopters. Everybody is safe in the middle majority.

But when a law firm is willing to show innovation, legal departments should take notice. Whether it's technology, or metrics, or even unique training opportunities, experimenting is the best way to find a solution. And a law firm willing to participate in such initiatives is a law firm that understands the evolving needs of the client.

Similarly, legal departments should lead the charge toward innovation by adopting solutions that bring value to both sides of the relationship. While the process of on boarding a new solution can be challenging in the early phases of adoption, Viewabill provides a differentiating level of transparency to work-in-progress that enhances collaboration. This mutual insight fosters strong, long-lasting relationships between corporate legal departments and their law firms, which ultimately drives better, more efficient results to all parties involved.

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CONCLUSION

There's no single way to improve the attorney-client relationship. It is a mindset more than a particular action plan. However, by working together to identify opportunities to view the relationship through a value lens, attorneys and their clients can organically strengthen a relationship that was designed to be bulletproof. Each side must show some vulnerability in order to stem the race to the bottom.

Industry experts have, for years, questioned if technology will spell the end for attorneys. Baker & Hostetler recently announced that they are employing IBM's Artificial Intelligence to handle bankruptcy matters. A new chatbot, DoNotPay, has helped overturn $4M of parking fines for 2014. But technology's biggest impact on society is how it enables people to communicate with each other. The legal industry is ripe to leverage technology's benefits. Whether it's real time collaboration through Viewabill, better application of eBilling guidelines or online matter planning, technology won't replace lawyers. But it can make the attorney-client relationship better.

ABOUT MITRATECH

Mitratech is the leading provider of fully integrated enterprise legal management solutions for global legal departments of all sizes, including almost 40% of the Fortune 500. Mitratech's offerings include the proven TeamConnect, eCounsel, Lawtrac, LawManager, Secretariat, and GettingContractsDone product platforms, which offer integrated matter management, eBilling, legal hold, contract management, entity management and GRC solutions. Mitratech clients are able to prove demonstrable value creation for their organization by automating legal workflows, improving business outcomes through actionable data and insight, increasing collaboration with external partners and reducing overall legal spend. For nearly 30 years, Mitratech has been focused on a singular mission: to make the legal department the best-run function in the corporation.

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DEFINE VALUE

1. Determine a Goal for Your Department

Cost savings is different than smarter resource allocation. Predictability is different than a strong relationship. Your department's goals should drive how you work with outside counsel.

2. Segment Matters Ripe or Value Initiatives

AFAs may work well with IP matters, but real-time insight may not. Focus on the handful of law firms that account for 80% of your department's annual spend and categorize the matters by:

- **Cost of Business Matters** — Matters that are likely to be appropriate for AFAs due to the volume and level of sophistication, such as IP finance and low-level insurance matters
- **On-Going Business Maintenance Matters**—Matters that can be optimized with better data and communication, such as corporate, governance and complianc matters
- **Unique Matters** — Matters that might not be suitable for value billing right away, either due to the stakes, level of complexity or likelihood of repeat circumstances.

3. Create a Communication Plan

A communication plan is an internal document that lays the groundwork for exploring value initiatives with outside counsel and should include:

- **Primary Attorney Contacts**— The relationship partner at each firm and the billing partner on each matter, as well as the primary point of contact for each firm and matter within the legal department
- **Primary Non-Attorney Contacts** — Project managers, pricing directors and any other strategic contacts at each law firm
- **Communication Templates** — Templated emails/letters to be sent to primary attorney and non-attorney contacts regarding value initiatives
- **Proposed Timing of Rollout** — When will the communication begin, and what is the desired implementation timing;
- **Priority Level** — On a scale of 1-5, how important is it to get buy-in from the law firm
- **Objection Handling** — If a law firm objects or pushes back on a value initiative, how will your department respond? What are the consequences if a firm does not comply?

COMMUNICATE VALUE

Build a coalition in order to prove the value business case.

1. Socialize Plan Internally

Value starts with your legal department. Getting buy-in from the general counsel and legal operations does not mean you need all the answers. It does, however, mean that there is alignment on the approach.

2. Establish Relationship with Primary Non-Attorney Contacts

Including non-attorney contacts early in the process will empower your coalition.

3. Socialize Plan to Primary Attorney Contacts

Your department's relationship and desired outcome with a particular firm should determine who initially reaches out to that firm. It is imperative that your department communicate in a positive manner, and in a way that alleviates fears by attorney contacts that something is "wrong". Value is benefit to everyone, and is not punitive. The sooner outside counsel appreciates this, the easier it will be to have discussions about value. Always explain the "why" behind the push towards value.

- **Goals** — What is value?
- **Methods and avenues for continual communication and feedback loop** — How will information be disseminated?
- **Success metrics** — Which joint metrics will be used to determine success?
- **Consequences of Success** — Why should outside counsel strive to succeed?
- **Consequences of Failure**— What will happen if they fail?

MEASURE VALUE

Collaboratively determine metrics to be used for measuring value. The samples provided below are joint metrics that should be continuously tracked by both the legal department and outside counsel. Technology such as Viewabill can provide a common data source to align on measurement securely without exposing legal details within the matter.

- **Actuals vs. Budget:** Actual billed activity vs. budget.
- **Actual Forecast:** Actual billed + WIP vs. budgets.
- **Activity Velocity** — The speed in which outside counsel is piling activity can be calculated in many ways, but one way is to compare daily average over 7 days to the average over 30 days.
- **Leverage** — Ratio of work performed by partners to associates.
- **Entry Delay** — Measure time hygiene by subtracting the number of days between when a time entry was initially drafted and when it the work occurred.
- **WIP Age** — Speed invoice cycle by calculating the average age of WIP activity and keeping average age fewer than 30 days.
- **Write Downs** — Amount of work performed by outside counsel, but not billed.
- **Write Offs** — Amount of work that was billed, but unpaid.
- **Timekeeper Scorecard** — Timekeeper rating, as applied by client.
- **Client Loyalty** — Not a specific metric, but measurement(s) used by law firms to justify by client initiatives, by demonstrating im provement of client loyalty.