



Michael C. Ross

Time to Bring Legal Work Inside?

By Michael C. Ross

For general counsel, little needs to be said about the constantly increasing cost of outside counsel, and there is little hope that the economic downturn will do anything more than temporarily slow the increases. Moreover, the slow economy will step up the pressure on companies to reduce their legal costs.

Alternate billing arrangements have become more common but still account for only a small percentage of outside counsel billings, and those arrangements do not guarantee lower long-term costs. Moving work to smaller firms or firms in geographic locations with lower rates can help, but only so much. There are transition costs and risks, and only some sorts of matters may be movable.

It is, therefore, no surprise that many companies are considering moving more legal work in-house. Here is a brief summary of some of the considerations and issues.

Outside Billings

The process must start with a careful and thorough analysis of outside billings. Billings over five years or more should be used to identify steady volumes of work and to avoid statistical anomalies. Decisions should not rely only upon averages, which can be misleading, but should also take into account the distribution of costs over the years reviewed. Consideration of the matters behind the numbers is important when it comes to determining if costs were affected by nonrecurring factors. Targeted work may well not be the work that is billed at the highest rates but, more likely, the work that comprises high volume in outside legal billings. On the other hand, "commodity" work (performed outside at highly competitive low rates and costs) will be difficult to do in-house at lower cost.

The selection of which practice areas to move in-house is critical. The results will vary

by industry and geographic location. Generally, the prime candidates include: regulatory, employment, labor, employee benefits, IP, commercial, environmental and tax. Some corporate and securities work may also be manageable by in-house counsel. In many situations, some continuing consultation with outside counsel will be necessary.

Consideration must also be given to the capacity of in-house attorneys to manage matters effectively and efficiently. Often this means that in-house counsel will handle routine, recurring and relatively low-risk matters, but this need not be so.

Qualified in-house counsel can deliver results at levels comparable to or better than outside counsel if they have the resources to keep current and react quickly to changing circumstances and laws. There should be a sufficient number of in-house attorneys to ensure coverage for expected and unexpected absences. They should also have adequate paralegal and other administrative support. In-house counsel also will need to keep abreast of what similarly situated companies are doing, something that outside attorneys can do because they and their colleagues are working for many clients.

Inside Costs

The next step is to calculate the expected cost of adding in-house counsel. This begins with the salary and benefit packages (which, according to recent surveys, account for approximately 80 percent of total in-house cost) necessary to attract high-quality attorneys from law firms and other legal departments. Total compensation at many law firms and legal departments has been rising in recent years, so hiring away lawyers can be expensive. But there may be opportunities to hire attorneys from firms and departments where

compensation is lagging. The initial cost will depend on the targeted practice areas and geographic location of the attorneys and the hiring company. Cost estimates should include dedicated support staff and other applicable general and administrative costs.

In-house departments should not need to compete dollar-for-dollar with the attorney's current employer. Ancillary benefits may be very attractive and offset compensation shortfalls. In-house legal work generally allows for a more accommodating lifestyle than what is available at many law firms. In-house attorneys become part of a team and can develop closer ties to their clients. In-house attorneys are not responsible for producing business. And often there are opportunities for in-house attorneys to move into business careers within the company.

Just as outside counsel costs are expected to increase, so are in-house costs, driven primarily by attorney compensation and benefits. Attorneys will expect and receive salary increases, and in many public companies, stock options that may appreciate in value and result in additional expense when the options are exercised.

In some practice areas, special attention to accounting and tax treatment of outside counsel costs is important. In some matters, including real estate projects, outside counsel costs may be capitalized while employee costs are treated as ordinary expense.

Special Issues for Litigators

The expected venues for cases may affect the effectiveness and efficiency of in-house litigators. Law and local court rules differ from jurisdiction to jurisdiction, so association of local counsel, at least on a limited basis, may be necessary. Local counsel may also be advisable to avoid becoming a victim of "hometown justice."

In-house attorneys may not have the resources to manage class actions and other document-intensive cases. Some highly qualified attorneys may not be satisfied working on routine, relatively low-exposure cases.

Maintaining attorney-client privilege for communications with in-house counsel may be a challenge. In order to maintain the privilege in its patent litigation, Affymetrix segregated the litigation group in separate offices and provided the group with a separate computer system. If in-house counsel values involvement in the business, this sort of arrangement may be frustrating because the in-house attorneys are being treated as if they were outside counsel.

Managing Expectations and Results

Some business people use a rule of thumb, based upon experience in other areas, that the cost of doing something inside the company should be approximately one-third the cost of obtaining the services outside the company. It will, therefore, be important for GCs to manage expectations about the savings from bringing additional work inside.

One of the biggest risks in moving work is that doing so will adversely affect results. Obviously, the savings from bringing work in-house may be more than offset by the costs of lower-quality legal work, from regulatory compliance to dispute management. It is critical, therefore, that the company hire qualified, highly competent attorneys for the targeted work, that they are fully supported and that they never sacrifice results for reduced costs.

The analysis of the advantages and disadvantages of bringing legal work in-house is complex. Costs and benefits will vary by industry, practice area, geographic location of the company and company culture. Although much of the focus will be

on future outside costs to be replaced and future in-house costs to be incurred, additional in-house counsel may create benefits that are difficult to quantify. Although they may be working for numerous business people, they will be serving one client and may be more highly motivated than outside counsel to achieve the highest-quality results at the lowest possible cost. They will not have the inherent conflict of interest created by the billable hour. In-house attorneys should gain a better understanding of their company's business than outside counsel, whose attentions are often split among numerous clients.

As a result, in-house counsel may be more effective and efficient than outside counsel in managing many matters. When their workload permits, in-house counsel may be more available and effective than outside counsel for prophylactic advice and training. So, look for more companies to be adding attorneys to their legal departments. ♦

Michael C. Ross is the former Senior Vice President and General Counsel of Safeway Inc. He has an associate relationship with Altman Weil, Inc. and can be reached at info@altmanweil.com.

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