



Insider Corporate Legal is Legal Technology Insider newsletter's regular supplement looking at the benefits of technology and business best practices within general counsel and corporate legal departments.

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The mid market - an overlooked client base?

by Silvia Hodges

They represent the backbone of the European economy, but research recently commissioned by LexisNexis Martindale-Hubbell suggests mid-size companies do not feel valued as clients of law firms, with their needs all too often overlooked by external legal service providers. My recent study *How mid-sized companies in Europe select and review their legal services providers* – for LexisNexis Martindale-Hubbell – is the first study shedding light on the buying behaviour of European mid-size companies.

United Kingdom

UK mid-size companies tend to partially handle high-risk matters inhouse, more often than any of the other countries researched. Regularly working with two or three law firms, UK corporates have made an effort to decrease the number of firms in the last 12 months. The focus is to work with firms dedicated to client service, or as the CEO of one UK company complained "One international firm gave me the impression that I should be happy and thankful that they took on my case and my money." Real estate, M&A, and finance advice is more often requested by UK companies than any of their European neighbours.

UK companies are likely to budget their legal spending, which explains why the head of finance is often involved in budgeting decisions. More often than companies in the other countries, UK clients expect an increase in their external legal expenditure, citing anticipated organic business growth. At the same time, UK companies are making great efforts to control or "cut" their legal costs.

Respondents stated a clear preference for value-based billing (whether fixed-price projects, caps or retainer arrangements). Like most clients, UK mid-sizers disapprove of surprises, especially bills significantly beyond budgetary expectation. "We stopped working with one firm after it continuously billed us much higher than what we initially had agreed. The final straw was when they billed us for taking time to explain the large bill," explained the chief executive of a UK company. *...continued on page 2* ➔

Survey shows law department spend up

The newly released *2006 Altman Weil Law Department Metrics Benchmarking Survey*, published in partnership with LexisNexis Martindale-Hubbell, reports total legal expenses per lawyer up 7.9% over the previous year.

"Despite all the talk about finding ways to reduce outside legal spending, some law departments still appear to have a difficult time walking the walk, since the largest part of the increase was attributable to external legal fees and expenses," said Altman Weil principal James Wilber.

"After holding the line on expenses for the past several years, we're now seeing a significant jump. General Counsel can only do so much in response to billing rate increases, and there will always be critically important work that is predominantly price insensitive."

Law Department Expenditures

- Total law department expenses in all companies surveyed averaged US\$914,229 per lawyer, up 7.9% in fiscal year 2005.
- The internal costs of operating an inhouse law department rose to an average of \$332,823 per lawyer, a 2.6% increase over the prior year. Lawyer compensation and benefits, the biggest internal expenditure, averaged \$258,205 per lawyer.
- Outside expenditures rose 5.5% to \$602,070 per lawyer on average for all law departments nationwide. The Computer/Electrical Manufacturing and Chemical Manufacturing industries had the highest average outside counsel expenses: \$1,017,948/lawyer and \$935,402/lawyer respectively. The Insurance industry had the lowest at \$292,134/lawyer.

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Mid-market survey results

➔ *continued from front page...* The majority of UK mid-size companies discuss discounts at least 'sometimes' with their external providers. As one director commented "Discounts are normal in business. I am not afraid of discussing them with lawyers either. Why should the rules of the game be different for them than for anybody else?"

Marketing – When targeting mid-size companies, law firms usually send letters, newsletters or cold-call to propose their services. However UK mid-size companies are not fond of them. Comments included "I receive more and more cold calls from law firms, offering their services. They are wasting their time and my time. They should take more care of their current clients so they don't have to prey on everyone else." Several mid-size companies heavily criticised firms: "The level of complacency of law firms continues to surprise me." Another CEO said that law firms "all talk about how important their clients are to them. In my experience this is either wishful thinking or paying lip service."

When looking for referrals, UK mid-size companies turn to their own employees, other inhouse lawyers, accountants and notaries as well as banks. In the UK, trust, value, transparency and location ranked more highly than in the other countries, and specialisation was below the average.

GERMANY

German mid-size companies generally do not employ inhouse lawyers but outsource to two or three law firms. Several anticipated an increase in the number of firms they work with. Like their Italian and French neighbours, both corporate & commercial and employment law top the list of most frequently outsourced practice areas.

Perhaps somewhat surprisingly, German companies claim to have no fixed/allocated budget for purchasing legal assistance. Managing directors/owners explain this by not expecting major changes in the expenses for employing outside counsel. German respondents expressed a clear preference for value-based billing and hourly billing. More important than the billing method however were realistic estimates and being kept informed of progress.

Marketing – According to the survey's findings, law firms generally do not target German mid-size companies "I believe law firms probably don't realise or care we exist. They want the Siemens of this world, not us," explained one German company executive. Some German companies have started using used RFPs (request for proposal) or tenders: "I asked two law firms to pitch for ➔

⇒ an important matter. One firm didn't ask any questions, one of their senior people came and gave his general presentation. The other firm asked me a number of questions I hadn't actually thought of myself but were worth reflecting. They brought the team that would work on my case and gave me a relatively detailed idea about what they would do for *my* case instead of just telling me how great they were. They demonstrated it instead of telling me. Guess who I hired?"

Word-of-mouth and referrals work in Germany, with entrepreneurs/other managers, notaries, accountants and trade organisations usually being asked for their opinion. German mid-size companies value responsiveness, specialisation and personal chemistry above the collective average, whilst importance of location scored lower.

FRANCE

Of all the Europeans, French mid-size companies were the most likely to employ inhouse lawyers. "We would rather do technically simple legal issues inhouse. We are organised better than the law firms we encounter and operate at far more competitive costs," said one. High risk legal matters do however still get outsourced – and to more law firms than mid-size companies in the other countries included in the study. Litigation and M&A advice is more often requested than in any of the neighbouring countries.

French mid-sizers also differ in their preference for budgeting: more than half stated to have an annual budget. The majority do not discuss discounts with their lawyers and prefer traditional billing methods, such as one based on a percentage of the value of the transaction.

Marketing – Law firms in France are not perceived as particularly aggressive in their marketing efforts, having only recently started to send promotional literature to mid-size companies. Most French participants in the study reported to have neither the time nor interest to read this material, with newsletters widely perceived as too general, lengthy and time consuming to trawl through. Said one participant in the study "Lawyers need to understand we don't want to become legal experts. We want to know what implications a new law has for our business and what we have to do."

According to the survey 'test runs' at lower rates are not a common marketing tool among lawyers to get their foot in the door with a new client. "We don't try out firms for a cut rate. When I turn to a law firm, it means that I have a serious problem. I can't risk anything then. So if it costs, it costs, but the result had better be good!" ⇒

⇒ French mid-sizers turn to entrepreneurs, other managers, inhouse lawyers at other companies and trade organisations for referrals. Another information instrument of choice are legal seminars by professional organisations. The French place less importance on trust and location than their neighbours, but rate efficiency and value/cost efficiency as important.

ITALY

Italian mid-size companies commonly do not have internal legal departments yet almost half claim to handle low risk matters inhouse and a third even handle part of their high risk matters inhouse.

Italian companies appear to be quite loyal clients with most of them stating that the number of law firms they regularly turn to for legal advice had remained unchanged over the past twelve months. "The longer we work with a law firm, the better they usually know us and our industry. That means that we waste less time explaining the issues to them."

Italian companies most frequently need employment law advice, followed by corporate & commercial law. More so than in any of their European neighbours, Italian companies turn to lawyers for tax and regulatory/compliance advice.

Financial budgeting of legal services does not appear to be a priority for Italian companies: The majority of respondents have no fixed/allocated budget for purchasing legal assistance, saying they follow a needs-based, ad hoc approach to funding their legal outsourcing. Typically, the managing directors/owner decide the budget alone. Respondents expressed a slight preference for value-based billing over hourly billing. In line with their European neighbours, the majority of Italian mid-size companies discuss discounts at least 'sometimes' with their external lawyers. "If we give a firm a lot of business, of course I expect them to be flexible when it comes to giving us discounts." ⇒

⇒ Several mid-size companies pointed out the importance of matching the task with experience. The CEO of an Italian retail/wholesale company explained “We don’t always want the most brilliant lawyer on the case. If it is a minor thing, a less brilliant and thus less costly lawyer might do just as well.”

Marketing – With the recent liberation of the country’s professionals (the so-called Bersani law introduced in September 2006), law firms have just started to feel free to more actively market their services. In general however they do not yet seem to target mid-size companies. Only a few firms send newsletters – which are not viewed as particularly useful. “Most newsletters are written in an archaic, overly technical style and don’t focus on the practical implications of the law,” said one manager. Similarly, seminars are often not seen as practical and pragmatic enough to merit attendance.

When looking for lawyers, Italians turn to their friends. Results, trust, responsiveness and efficiency lead the list of the most important criteria when evaluating firms. Absolute price (rather than value/cost-efficiency) seems to be more important in Italy than in the other jurisdictions. Italian companies also appear to place relatively less importance on responsiveness and efficiency – and seem less concerned about the need for personal chemistry.

- *Silvia Hodges is a legal marketing and communications consultant with particular focus on continental Europe.*

Quote, unquote

“I don’t understand why all law firms say how high quality their work is. For me, quality is a given... I don’t expect anything less. Law firms can only surprise me positively if they are attentive, good listeners, and are truly interested in the well-being of my company.” ...*the director of an Italian manufacturing and production company interviewed by Silvia Hodges in the course of her research.*

Five security questions to ask e-billing vendors

by Brad Blickstein

Legal invoices are protected under attorney/client privilege for a reason. They include detailed information about a company’s legal problems and, as such, can be damaging in the wrong hands. For this reason (not to mention compliance with regulations such as Sarbanes Oxley) it is paramount that invoice data – and the matter data to which it pertains – be protected and secure.

At the same time, many companies are starting to see the value of electronic billing. Legal invoices can be long and complex and expensive to process and approve. Estimates put the cost of processing a paper invoice at \$20-\$100 per invoice. Electronic billing, with a processing cost of as little as \$0.90 cents per page, can be the answer but only if the invoices are properly secured at all times: in transit, while being processed, while stored and when accessed. If you are considering receiving your invoices electronically – or even if you already are – here are some questions you should ask your e-billing vendor about security.

1. Where is my data? There are two distinct models for the transfer and storage of electronic billing information. Many providers use an ASP model, where invoice information is stored on a server owned and controlled by the e-billing vendor itself. With other providers, invoices are stored on the clients’ own servers, inside its firewalls and other security protections.

Both methods pose unique security risks. If your invoices and related matter data are not stored on your servers, they do not fall within the security protocols established by your corporate IT department and are under the complete control of the ASP vendor. Make sure that the vendor’s own protocols and systems are as good as your own. While data that is permanently stored at the vendor’s ASP is at the most risk, remember that both types of e-billing companies provide the pipeline on which the invoice data moves. Keeping the data behind your firewall may rightly make you more comfortable but the data has to get there first. Moreover, particularly in Europe where VAT controls are so important, being able to authenticate the issuer of the invoice is mandated by law in most jurisdictions.

2. What type of security protection is in place? Whether your IT or theirs, you want state-of-the-art protection, with periodic testing from an outside source. Current best practice include encrypting data in binary large objects (blobs) and using public key infrastructure (PKI). ⇒

⇒ Blobs and PKI make data effectively inaccessible without the 128-bit private key to unlock it. If your vendor uses the ASP model, make sure they encrypt stored data and do not rely only on a user name and password to access your data. There have been public allegations of client matter and invoice data being accessed by other clients, law firms and the vendor itself.

Some vendors will claim their storage facility is SAS-70 certified, but SAS-70 security does not guarantee a vendor has applied the appropriate level of security and authentication around your data. Again, ask about the procedures and controls in place by the vendor to maintain security and authenticity of your data. Better still, ask if there have been instances of data intrusion, publicly known or otherwise, that has put client data at risk and whether client data has ever been breached.

3. Where is the key? And the passwords? The most secure safe will not protect you if you leave the combination lying around. Make sure that your vendor has proper protocols for protecting keys, usernames and passwords. At the same time, make sure the URL, usernames and passwords are not easy to guess. Ask about how they protect them and, ideally, make sure their controls have been scrutinised by a third party qualified to do so. For example, suppose your data is hosted at www.yourcompany.ebillingvendor.com. Your username is your email address and the default password is 'password'. Care to guess what your competitor's URL, username and password are? Think a hacker could figure it out? I know it sounds simple but at least one e-billing company has recently been in the news for exactly this type of problem.

4. Is all my data where it is supposed to be? All the time? Ask anyone at any e-billing vendor and they will tell you they have been asked to help a client come up with some custom report or other special data-related tasks. And sometimes the best way to serve the client is to do that work for them, using the client's actual data. It's easier and quicker for the client and often easier for the vendor, too. This happens all the time.

Think for a minute about the process. In order to create the report, the vendor must access your data. How do they do it? Are they logging in as one of your employees? Where is the data during this process? If the data is downloaded onto one of the vendor's employee's own laptops, how secure is that machine? What is the protocol for destroying that data? And what happens if the laptop is stolen in an airport in the meantime? While it is important that your vendor provide you with good client service at all times – and offering to create reports is exactly that – you must ⇒

⇒ be careful about this process. At a minimum: Only grant the vendor permission to use your data for a specific purpose. Do not grant blanket permission. Make sure all machines that have live data are properly secured. Ensure proper policies and procedures are in place to destroy/return the data. Make sure that your provider cannot access your data on their own, only allow them to see data you've sent them.

5. What precautions do they take when transferring my data? Again, even if the invoices ultimately reside inside your firewall, they must remain secure while getting there. Almost certainly the law firms send the electronic invoice to a server where it temporarily resides until someone from your company logs in to pick it up. Since this server is likely to hold your data as well as that of other clients, make sure it is properly encrypted. Make sure there is a time limit for how long the data will remain on this server before being destroyed. (30 days is a good rule-of-thumb.) Ensure the data is then really irretrievable – by overwriting the server space – and not backed up onto some system that hackers can access.

Think for a minute about the valuable information on your legal invoices. If you are planning to buy a distributor in Spain, it is there. If you are having trouble managing sexual harassment lawsuits, it is there. If you are trying to set up a tax shelter, it is there. It is easy to imagine the types of people who would be interested, from competitors to plaintiffs' firms to disgruntled current and former employees. Any of these could cause a whole lot of trouble. Moreover, with today's Sarbanes era accountability standards (not to mention the Act itself in the US) deficient controls can easily lead to trouble from regulators as well.

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Spending survey

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Outside Counsel Relationships

Despite rising costs, only 25.2% of law departments formally evaluate their outside counsel. Those that do evaluations indicated that *Results* was the top evaluation criteria, followed by *Knowledge/Expertise* second, with *Cost* and *Responsiveness* tied for third.

"Performance metrics are a critical component of managing outside counsel costs," said Barry Solomon, VP and General Manager of LexisNexis Martindale-Hubbell. "Client reviews also give inhouse counsel the opportunity for a dialogue with their outside advisors on what's working and what's not. Adding transparency and candid communications about strengths and weaknesses can only improve the relationship."

Asked about serious relationship mistakes made by their outside counsel, law departments pointed to lack of responsiveness, over-billing and over-lawyering as the top three problems.

When selecting outside counsel, law departments consider firm specialisation first by a big margin, followed by responsiveness, cost and prior history with the company. Nationally, all law departments employ an average of 54 law firms, and large law departments of 26 or more lawyers use an average 136 firms each year. "Despite convergence efforts, law departments are still employing a wide variety of outside law firms," notes Solomon. "And they're still being guided by the bedrock standard of firm expertise in making those selection decisions."

Law Department Staffing

Lawyer staffing in corporate law departments was up in 2005, with the key measure *lawyers per billion of revenue* rising to 3.49 lawyers/billion compared with 2.93 lawyers/billion in 2004.

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E-discovery trends and developments

by John Janes & Michael Conner

There are a number of drivers moving corporate legal departments to revisit their approach to the discovery process, document retention and records management. Some of these drivers are regulatory, some are legislative and some are just good business practices.

The major factors affecting electronic discovery for corporate legal departments are the recent changes to the US Federal Rules of Civil Procedure and the Sarbanes Oxley legislation. Those two items, coupled with the stepped up environment of government investigations both at the state and federal level, have created an atmosphere of uncertainty as to what electronically stored information (ESI) a company has to retain, and how much responsibility the company has for maintaining ready access to those electronic records or ESI. The result of the rule changes and recent legislation is that corporations, from the board of directors to IT managers, are trying to figure out a strategy for complying with these rules and laws so as not to pay more in fines and sanctions than it would cost to implement archival, retention and compliance systems.

The issue that has been getting the most press lately is the changes to the Federal Rules of Civil Procedure (FRCP). The changes to the rules have been the inspiration for numerous articles, seminars and books. Recent changes to the rules dictate companies must have discussions or meetings prior to going to trial to map out or discuss electronic files. It is now assumed that companies have these electronic files and that they are able to hand over responsive electronic records. And it is now recognised that electronic records are not restricted to documents and email. For example, ESI can include video or audio files such as voicemail.

Seventy percent of 440 financial officers responding to a Deloitte Financial Advisory Services survey in November of 2006 said they needed more training on their records retention policies. More than half said they do not make backup records beyond what is in their networks. The rule changes have already gone into effect which means that many companies will have to work quickly to develop strategies, implement those strategies and to educate employees about compliance.

Another major issue affecting e-discovery and records management is the Sarbanes Oxley legislation. ⇒

⇒ Sarbanes Oxley caused a major reaction among public companies. These companies had to review their internal controls and spend millions of dollars on compliance-related internal and external resources. There have been many articles published along with many studies to evaluate the efficacy of the SOX rules and their effect on smaller companies.

Sarbanes Oxley, among other things, defined criminal offences for concealing or destroying documents with intent to obstruct or impede an investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States government. This law, coupled with the changes in the FRCP, creates a broad need for corporations to better understand what records or ESI they are keeping, why they are keeping them and how long must they keep them. I'm sure better guidance on these matters will be decided in the courts but I doubt that most companies want to be in the position of being the primary party in those court decisions.

A third major area of change in e-discovery is caused by a trend or new development in the United States business environment. This trend or development is the stepped-up level of government investigations or inquiries into a number of different practices of public companies. The attorney generals of several states, most notably Elliot Spitzer and the New York State Attorney General's office have looked into practices of a number of different companies including those in the mutual fund industry and the insurance industry.

Federal Agencies including the Securities & Exchange Commission and the Department of Justice have been investigating recent activities such as corporate stock options backdating and pharmaceutical companies' potential off-label marketing practices. These investigations and their related subpoenas can be quite broad in their requests for ESI. Several companies that I am aware of have had to respond to requests for data or records going back over a decade. Determining whether that data is available is a costly process, not to mention restoring back-up tapes and processing the ESI for production to the government. There is a major need for corporations to better understand what data needs to be retained and consequently to implement the systems necessary to effectively store and retrieve that data or ESI.

One step that companies are taking or considering is a litigation records repository. We have a number of clients design and implement an online records repository that contains documents, e-mails and other ESI that has been responsive to past litigation or investigations. ⇒

⇒ Retaining the *history* of these records reduces the cost of future discovery. It also is a powerful tool to assist in meeting the requirements of the new Federal Rules of Civil Procedure. Once you pay to *discover* a document and process it for litigation or an investigation, you should not pay to re-discover the document over and over in future litigations or investigations. A litigation records repository is a good way to avoid those redundant costs.

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Make business process costs your mantra

According to the IT company Civica, local government in the UK should place greater emphasis on streamlining overall business-process costs rather than taking a more narrow view of reducing ICT expenditure ahead of anticipated tougher targets in the 2007 spending review.

Commenting on SOCITM's IT Trends survey, which points to a fall in ICT spending, Civica UK managing director David Roots said "Despite the public sector's considerable success in achieving efficiencies in recent years, there needs to be a sustained high-level focus on the virtue of re-engineering processes to combine front line service improvement with back office efficiency and savings. This wider focus will deliver the overall operational efficiency desired by local government.

"Whilst public sector expenditure on ICT continues to be squeezed in line with budgets as departments seek to achieve savings, those programmes which identify strategic-level process improvements present a far more compelling business case for funding support. These process-led projects are driving ICT expenditure in the longer term, especially in key areas of workflow, document and information management."

Roots continued "Our involvement in service transformations at Liverpool and Edinburgh city councils shows the progress local government is making in establishing authority-wide service platforms. We are also seeing smaller authorities successfully adopting 'invest to save' strategies with innovations such as shared services bringing operational and procurement cost savings. The pressures are immense but public sector executives must resist the temptation to focus narrowly on short term efficiency and make overall business process costs their mantra this year. This high-level approach is essential to balance the demands of the Government's service transformation vision and the rigours of the 2007 spending review," Roots added.

Spending survey

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This increase was reflected in both the number of management lawyer positions and the number of general lawyers. "The size of this increase (19%) is a bit surprising. We'll have to wait to see if it denotes an upswing in the hiring of in-house lawyers," Wilber said. ⇒

⇒ In looking at the average distribution of lawyers by practice areas within the law department, the survey reports 23.8% of in-house lawyers specialise in commercial and contracts law, 9.4% are litigation specialists and 7.8% focus on IP law.

Operational Issues

Perhaps related to the difficulty controlling outside legal expense, law departments continue to favour the more traditional billing arrangements with their outside counsel. Most frequently used methods are hourly billing, reduced hourly billing and time and expenses. 40.2% of reporting law departments never use alternative fee arrangements, while an additional 35.6% report negotiating non-standard fee arrangements for only 1-20% of fees.

The use of e-billing systems that allow outside counsel to submit their invoices electronically continues to increase slowly. In 2005, 13% of law departments used e-billing, up from 10.3% the previous year.

- The *Altman Weil Law Department Metrics Benchmarking Survey* includes data from 138 companies, data was collected in the spring of 2006 and reflects fiscal year 2005.

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