

Center on the Legal Profession

HARVARD LAW SCHOOL

CORPORATE PURCHASING PROJECT

How S&P 500 Companies Evaluate Outside Counsel

A White Paper

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FOREWORD & ACKNOWLEDGMENTS

This white paper represents the inaugural effort of the Harvard Law School Program on the Legal Profession (the “Program”) to disseminate detailed findings of our groundbreaking empirical research in a format targeted to the broader legal practitioner and business communities. We look forward to your feedback and engagement.

The mission of the Program is to make a substantial contribution to the modern practice of law by increasing understanding of the structures, norms and dynamics of the global legal profession. To this end, we:

- ❖ Conduct, sponsor and publish world-class empirical **research** on the profession;
- ❖ Innovate and implement new methods and content for **teaching** law students, practicing lawyers and related professionals about the profession; and
- ❖ Foster broader and deeper connections **bridging** between the global universe of legal practitioners and the academy.

This report marks the culmination of our Corporate Purchasing Project – more than four years of scholarly research dedicated to examination of the ways in which S&P 500 legal departments hire and manage outside counsel. Specifically, it draws from six academic papers in varying stages of publication. The first listed below discusses the bulk of the empirical findings, while the others address more focused empirical findings or conceptual implications:

- ❖ Michele DeStefano Beardslee, John C. Coates IV, Ashish Nanda & David B. Wilkins, *Hiring Teams, Firms and Lawyers: Evidence of the Evolving Relationships in the Corporate Legal Market* (Law and Social Inquiry, forthcoming 2011).
- ❖ David B. Wilkins, *Team of Rivals? Toward a New Model of the Corporate Attorney-Client Relationship*, 78 Fordham L. Rev. 2067 (2010), available at http://www.fordhamlawreview.org/assets/pdfs/Vol_78/Wilkins_April_2009.pdf.
- ❖ Michele DeStefano Beardslee, *Advocacy in the Court of Public Opinion, Installment One: Broadening the Role of Corporate Attorneys*, 22 Geo. J. Legal Ethics 1259 (2009), available at <http://ssrn.com/abstract=1374595>.
- ❖ Michele DeStefano Beardslee, *Advocacy in the Court of Public Opinion, Installment Two: How Far Should Corporate Lawyers Go?* 23 Geo. J. Legal Ethics 1119 (2010), available at <http://ssrn.com/abstract=1573062>.

- ❖ David Wilkins & Young-Kyu Kim, *The Action After the Call: An Empirical Examination of the Role of Diversity in Corporate Hiring Decisions* (forthcoming, 2011).
- ❖ Ashish Nanda, *Partner Mobility Across Law Firms* (forthcoming, 2011).

Please note that all citations from these scholarly articles have been omitted here for the sake of streamlining. All citations to the material contained herein should therefore reference these primary articles and any relevant secondary attributions made therein.

In addition to our dedicated authors, we would like to thank Bob Nelson for his guidance and assistance, Sean Williams for his invaluable research and management skills, Nicola Seaholm for organizing and maintaining the survey data, Young-Kyu Kim for his research and analysis, and Bukola Ayanbule, Harold Birnbaum, Lee Brannon, Justin Liu, Steve Sorkin, and Jessica Steinhauer for their assistance in assembling and analyzing the data for this paper. Furthermore, we would like to acknowledge the tremendous assistance of Nicola Seaholm and Young-Kyu Kim in helping compile and create this white paper.

We also extend thanks to the many people who have discussed this project with us at various stages, including participating chief legal officers and their staff without whose participation and candor such research would be impossible. We also thank the following individuals specifically for their comments and input: Jeff Carp, Scott Edelman, Stephen Gates, Ben Heineman, members of the Advisory Board of the Program, participants in the Harvard Law School *Leadership in Law Firms* and *Leadership in Corporate Counsel* executive education programs, and workshop participants at Harvard Law School, Georgetown Law School, and the Conference on Empirical Legal Studies.

For funding, we are deeply grateful to Jack Cogan and the Sloan Foundation for providing initial and ongoing funding for this project and to Davis Polk & Wardwell and the Advisory Board of the Program for providing additional research and operational funding to sustain and effectively disseminate our findings.

On behalf of all of us at the Program on the Legal Profession, we thank you for your time and interest.



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SECTION 1: INTRODUCTION TO THE CORPORATE PURCHASING PROJECT

How are relationships between clients and service providers in the corporate legal market evolving, and why? Answering this critically important question requires both the availability of unbiased quantitative information about how large corporations make law firm hiring and assessment decisions and a robust qualitative and theoretical framework to evaluate broader variations and trends. Yet purchasing decisions by sophisticated in-house counsel are a vastly understudied aspect of legal practice and hardly any scholarly attention has been directed to assessing the ways in which corporate clients are responding to the numerous changes in law firms and the legal profession itself.

Prior research that focuses specifically on how large companies purchase services from law firms is scant and limited. Trade publications and general interest periodicals provide business insights and news, but rely on anecdote and often emphasize novelty for its own sake. Surveys of high-ranking in-house counsel by trade groups or consulting firms also provide useful information, but report low response rates or do not report response rates, do not compare respondents and non-respondents, and, most importantly, primarily study small or mid-sized privately held companies that together represent a relatively modest segment of the overall market for high-quality, strategic corporate legal services. Much of the available research on in-house counsel also focuses more on how general counsels attempt to contain costs, rather than how companies evaluate or manage the quality of elite legal services.

We conceived of the Corporate Purchasing Project as a way to establish and study a body of novel empirical data drawn from surveys and interviews of 166 chief legal officers (“CLOs”) of S&P 500 companies – one-third of all such large publicly traded companies. As detailed in the Methods section of this report, our data set comprised both written survey data from 139 companies and in-depth interview responses from 43 companies spread across a diverse range of manufacturing and service sectors.

Specifically we sought to explore four topics of substantial importance about which there is little systematic information:

- ❖ How do these companies evaluate the quality of legal service providers when making hiring and legal management decisions?
- ❖ Under what circumstances do these companies discipline or terminate their relationship with their law firms?
- ❖ How do these companies evaluate whether to follow ‘star’ lawyers when they change law firms?
- ❖ In what ways do these companies manage the intersection between law and public relations?

The resulting dataset is groundbreaking for its depth and breadth and provides a fascinating empirical look into the decision-making of CLOs as they seek to balance imperatives like cost control and legal matter outcomes with the value of long-term law firm relationships, such as relationship-specific capital, quality assurance and a soft guarantee of legal capacity when the need arises. Theoretical research published before our study suggests that the preeminence of individual lawyers and specialized teams within law firms (rather than firms themselves) combined with the growing sophistication of CLOs and other in-house counsel should decrease the value of long-term relationships. But our findings challenge this notion and suggest an enduring value to long-term corporation-firm relationships that should prove foundational to the ongoing evolution of the legal services sector.

There are, of course, limitations to our study. Foremost among these is that our data was collected between 2003 and 2006, and thus entirely pre-dates the financial crisis and economic recession that began in 2008. It is possible that our data and conclusions are not wholly representative of the current legal services environment, in which most large companies have cut back on expenditures of all kinds and many law firms have laid off significant numbers of attorneys and suffered various forms of distress. Nonetheless, we believe that our study has important descriptive power and enduring normative implications for the legal profession as it continues its dynamic evolution.

SECTION 2: PREFERRED PROVIDERS & THE WANING OF CONVERGENCE

The Convergence Phenomenon

Beginning in the mid-1990s, a growing number of large companies began to dramatically reduce the number of outside law firms to whom they gave a significant percentage of their work. DuPont Chemical was among the first to move in this direction when it recognized inefficiencies resulting from a protracted build-up in the number of its outside law firm providers – a build-up in turn resulting from organizational and global expansion and the competitive spot contracting approach to legal services purchasing prevalent in the 1980s and 90s.

In just two years, DuPont reduced the number of U.S. law firms it hired for significant business from 350 firms to just 34. During the first decade of the 21st century, many large companies followed the lead of DuPont in selecting a smaller roster of 'preferred providers' for the bulk of their work, a phenomenon known as 'convergence.'

Why Preferred Providers?

Large company CLOs have considerable incentives to establish networks of preferred provider law firms, among them:

- ❖ To leverage their marquee corporate status and high absolute legal budget to garner recognition as a 'trophy client' able to exact deeper discounts and draw the best legal team talent from within the firm
- ❖ To obtain better overall client service by bundling the company's more lucrative legal matters, like M&A and tax work, with lower-margin work like employment or regulatory compliance advice
- ❖ To enhance the predictability of their legal spending and global legal budget over the course of time and their ability to more readily measure outcomes against it; and
- ❖ To find and further cultivate lawyers who 'understand their business.'

Convergence Is Real

Our survey confirms what the trade press has long reported – that convergence indeed has occurred at most large companies. However, significant variation in the number of preferred providers persists. By 2003:

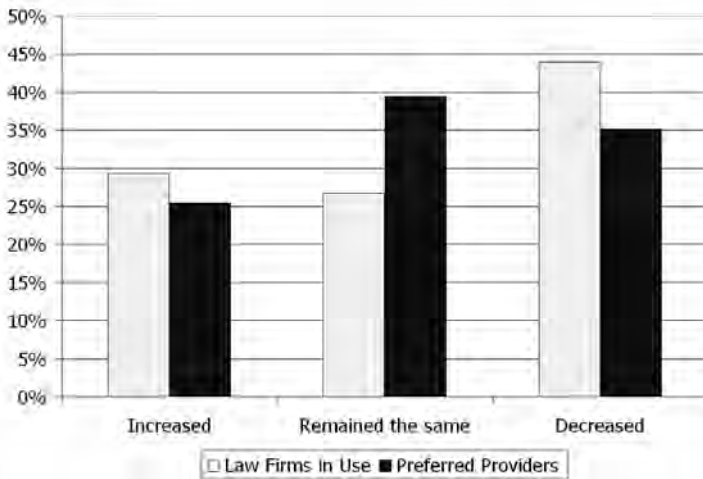
- ❖ more than 60% of our survey respondents allocated at least 80% of their outside legal spending to fewer than 25 law firms (a common benchmark for large company convergence); and
- ❖ 39% allocated at least 80% of their spending to fewer than 10 law firms.

2. Preferred Providers & the Waning of Convergence

Waning of the Convergence Trend

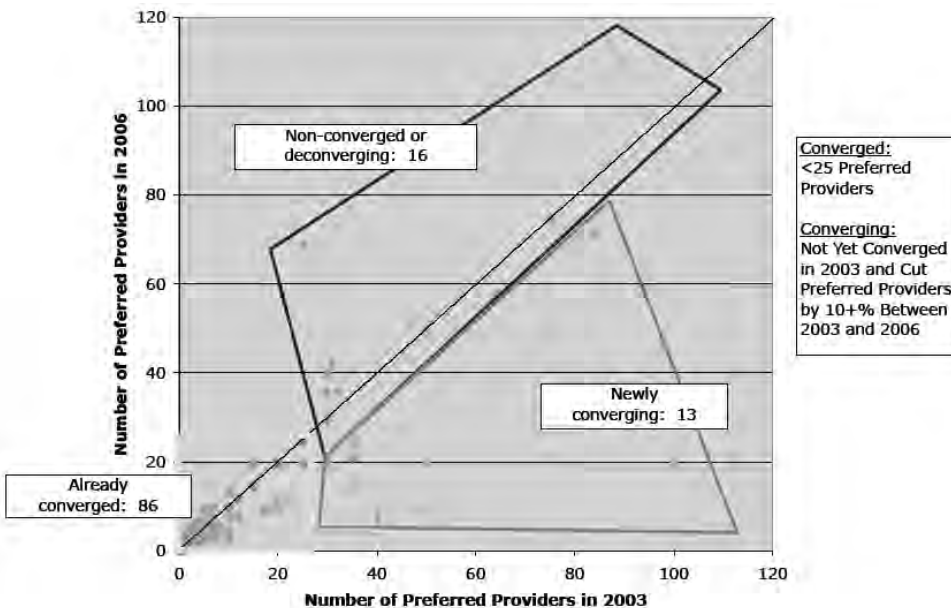
However, contrary to standard depictions in the trade press, we find that convergence had already reached a steady state across large companies by 2003. Most of our respondents reported very little further convergence between 2003 and 2006.

Figure 2.1 – Change in law firm use by respondents from 2003 to 2006



During this three year period, the median number of preferred providers remained essentially unchanged, at ten. More tellingly, the vast majority of respondents barely altered the number of preferred law firm providers, with more than 90% altering the number by less than five firms, and 86% by less than three firms.

Figure 2.2 – Net change in preferred provider roster from 2003 to 2006



SECTION 3: KEY FACTORS IN HIRING OUTSIDE COUNSEL

Understanding the value of a compact network of preferred outside counsel, how then do CLOs select law firms to handle a particular matter?

Hiring for Significant Matters

In order to focus our analysis of law firm hiring, we asked CLOs to identify the most recent 'very significant' matter – a matter of strategic importance – for which they retained an outside law firm. Most respondents identified high stakes litigation, such as a product liability or securities class action, or a strategic transaction such as a significant corporate acquisition. We found no significant differences in valuing different factors across the types of matters, suggesting an apples-to-apples comparison.

Figure 3.1 – Most recent 'very significant' matter

Type of Matters	N	%
Intellectual Property	13	9%
Litigation (class action, consumer, etc.)	69	50%
Regulation (antitrust, investigation, etc.)	17	12%
Strategic (corporate, tax, M&A, etc.)	35	25%
Other	5	4%
Total	139	100%

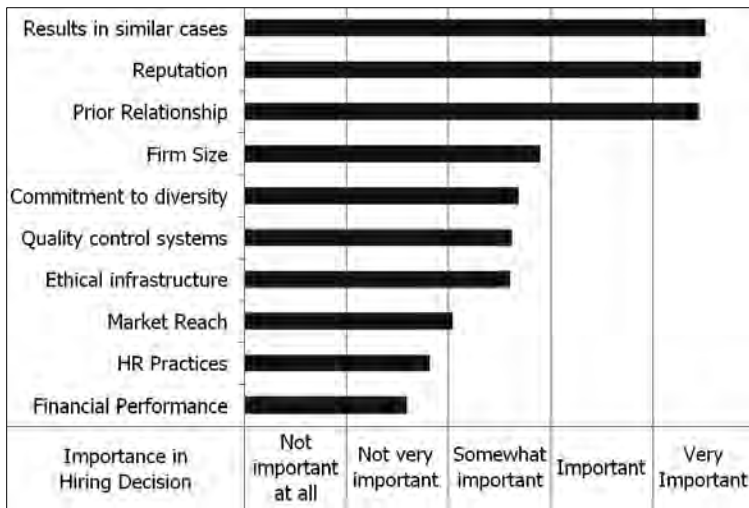
Key Selection Factors

According to general counsel we surveyed, there were three standout factors in deciding which law firm to hire for a matter:

- ❖ 'results in similar cases';
- ❖ 'reputation'; and
- ❖ 'prior relationship' between the firm and the company or CLO.

More than 60% of respondents rated these three factors as 'very important' whereas the remaining factors were almost never rated 'very important.' For instance, mid-ranked criteria such as 'commitment to diversity' and 'ethical infrastructure' were named 'very important' by less than 10% of respondents.

Figure 3.2 – What factors influence hiring?



An important reason why ‘prior relationship’ is such a powerful determinant of future engagement is that experience is considered a strong proxy for a critical, but ultimately difficult to evaluate, consideration – quality. As one interviewed CLO bluntly put it: “I don’t think quality is something that can be objectively measured [for] a lawyer.”

In addition to quality, interviewees noted the advantage of institutional knowledge when using a lawyer, team of lawyers, or law firm with whom they have a prior relationship – knowledge which often exceeds that of many CLOs, given their often short tenures. Outside lawyers with long-term experience with a company do not need to be reeducated with each matter.

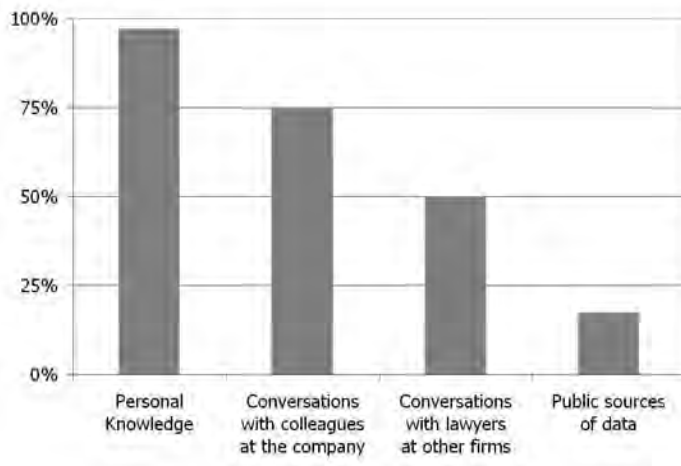
The other top-ranked selection factors also have strong relationship-driven elements. Objective data on a firm’s past ‘results with similar matters’ is highly context-dependent and often confidential (at least in part), making its use time-consuming if not inscrutable to those not who were not the clients in such prior matters. Overall reputational rankings may exist in various trade publications, but are widely viewed as either unduly tied to objective data such as firm profitability or inherently subjective, especially as applied to specific practice areas, offices or teams within law firms.

Source of Knowledge

So, contrary to several depictions of the legal market in recent decades, large companies continue to hire outside law firms based primarily on existing relationships. A full 97% of CLOs told us that the most important source of information in making hiring decisions is personal knowledge – either their own experience with the specific outside lawyers or law firm or their personal knowledge of the lawyers’ or law firm’s reputation.

3. Key Factors in Hiring Outside Counsel

Figure 3.3 – What information sources do CLOs use to assess law firms



Secondhand, intra-company knowledge, such as word-of-mouth among company colleagues about the company's experience or the law firm's reputation, is also important. More than 75% of interviewees cited it as a selection factor. Secondhand knowledge is relied upon from within the company, and particularly for relatively new CLOs, but rarely to the exclusion of first-hand experience. It may be that the CLO consults secondhand sources more for intra-firm political reasons than to obtain more information per se.

At the other end of the spectrum, public sources of objective data, such as league tables or court records, are only occasionally used. Only 17% of the CLOs interviewed reported consulting public sources to make the hiring decision, even as a supplement to personal or secondhand knowledge. Thus, despite the influx of objective measures into the field of law, the survey and interview data indicate that the way CLOs hire outside counsel has not yet materially changed.

3. Key Factors in Hiring Outside Counsel

Figure 3.4 – Average importance of factors in hiring decisions, overall and by source of knowledge

The average importance of the factors on the survey (based on a five point scale, ranging from 1 ('not important at all') to 5 ('very important') are listed in column (1) below and segmented in columns (2)-(5) based on sourcing.

	Internal Sources			External Sources	
	(1) Overall Average	(2) Average if Based on Personal Knowledge	(3) Average if Based on Intra-Firm Second- Hand Knowledge	(4) Average if Based on External Second-Hand Knowledge	(5) Average if Based on Public Data
Overall average		97% = yes	75% = yes	50% = yes	17%= yes
Prior experience with lawyer(s) or law firm	4.4	4.5	4.5	4.4	3.8
Reputation of lawyer(s) or law firm	4.5	4.5	4.5	4.5	4.2
Rankings in periodicals	1.9	1.9	1.9	2.1	2.2
Results in similar cases	4.5	4.5	4.6	4.6	4.5
Size	2.9	2.9	3.0	2.9	3.2
Geographic scope	2.6	2.5	2.7	2.7	3.0
Market share	2.2	2.2	2.3	2.2	2.4
Recent growth history	1.7	1.6	1.7	1.7	1.8
Leverage	1.8	1.8	1.9	2.0	2.0
Turnover rates	2.0	2.1	2.1	2.2	2.2
Partnership structure	1.4	1.4	1.4	1.5	1.7
Ancillary businesses	1.4	1.4	1.4	1.5	1.6
Pro bono	1.8	1.8	1.8	2.0	2.0
Commitment to diversity	2.7	2.7	2.8	2.9	3.0
Profits per partner	1.5	1.5	1.6	1.7	1.9
Partner compensation system	1.6	1.6	1.7	1.8	2.0
Associate compensation systems	2.0	2.0	2.2	2.2	2.3
Quality control systems	2.6	2.7	2.7	2.9	2.6
Ethical infrastructure	2.6	2.6	2.7	2.9	2.5

SECTION 4: DISCIPLINING FIRM TEAMS

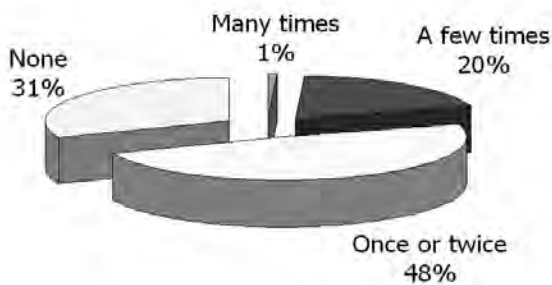
Of course, law firm hiring is rarely a short-term decision. The long duration of many episodic engagements like litigation and restructuring and continuous nature of counseling on strategic, governance and regulatory matters mean that there must be a process for ongoing monitoring and turnover of law firm relationships. How do large companies handle this?

Do Outside Counsel Get Fired?

Standard depictions of the corporate legal market over the past two decades would lead one to believe that large companies frequently terminate law firm relationships, as sophisticated CLOs – inspired by GE’s Ben Heineman, Jr. – shifted the purchasing model from relatively uncompetitive long-term static relationships between large companies and their law firms to spot contracting on individual matters.

Contrary to that story, however, relatively few survey respondents (about 20%) reported terminating preferred provider law firm relationships more than once or twice over the period from 2003 to 2006, and more than 30% report not having terminated any such relationships in that period.

Figure 4.1 – Terminations of relationships from 2003 to 2006



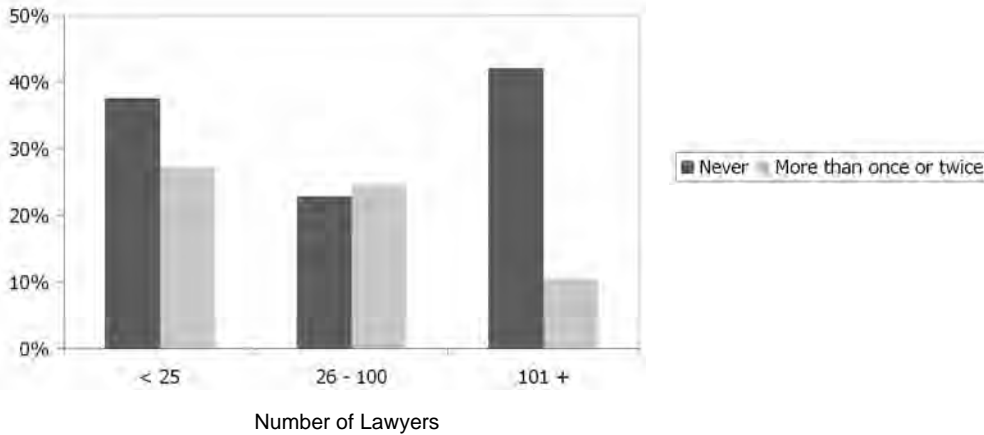
Interviewed CLOs instead explained that once they had successfully converged their outside counsel relationships and established a preferred provider roster, firing or taking a law firm off that preferred provider list became a significant corporate event. They reported trying to solve problems with preferred providers through varying degrees of formal intervention before problems escalated to that extent.

Structural Barriers to Discipline

Legal department size has a significant but non-linear relationship to the frequency with which survey respondents reported terminating preferred provider relationships. Companies with small- or medium-sized legal departments were more likely to terminate preferred providers than companies with large law departments, while medium-sized departments appear most active, with over 75% reporting firm turnover. The same non-linear trend is true of work reductions, discussed below. This may be because companies with small legal departments are more dependent on outside law firms, and that companies

with large legal departments have many redundant ties between different in-house lawyers and lawyers at their law firms, making both types of companies less likely to formally discipline their preferred providers.

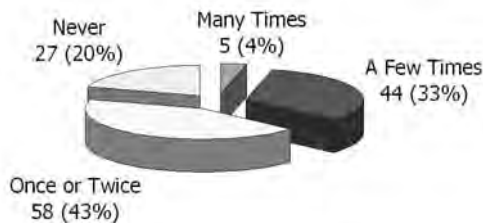
Figure 4.2 – Terminations in past three years by legal department size



'Penalty Box' Work Reductions Have Become Common

Work reductions – described to us by an interviewed CLO and separately by a large law firm managing partner as being “put in a penalty box” – seem to have become the tool of choice in recent years for CLOs seeking to manage law firm relationships. CLOs report that their companies reduce work given to particular preferred partners much more frequently than they terminate preferred provider relationships entirely. This seems partly due to the fact that the CLOs recognize firing a law firm may not solve their problems of poor service. Only 20% of CLOs report not having reduced work to a law firm as a disciplinary measure at all in the study period.

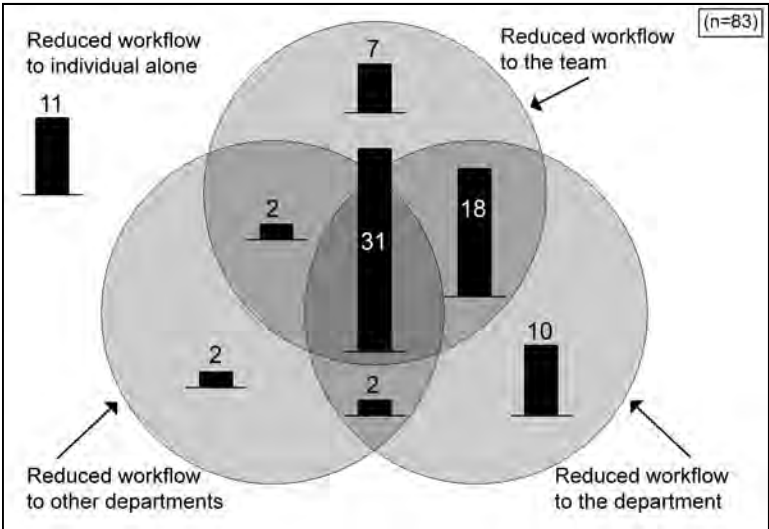
Figure 4.3 – Being put in a ‘penalty box’ – work reductions from 2003 to 2006



Penalty Box Reductions Are Only Partially Localized

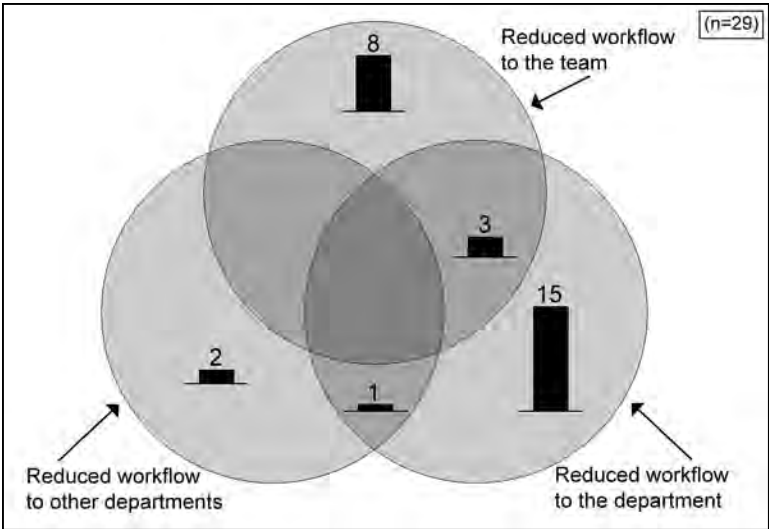
One might expect that many law firm performance issues are primarily attributable to the quality, responsiveness or lapse in judgment of a single law firm attorney. While this may be the case, resulting work reductions are seldom confined to the individual level. Instead, when CLOs reduced work given to the individual lawyer who underperformed, a majority of those reductions (54%) encompassed the entire team and/or department of the underperforming individual. Such intermediate-level work reductions occurred considerably more frequently than work reductions to the individual on his/her own (10%), or even to the law firm as a whole (36%).

Figure 4.4 – Work reductions where underperforming attorney receives less work



Even when the underperforming individual was *not* specifically identified as receiving less work, companies reduced work to teams and/or departments. Companies reduced work to the department but *not* to the individual in 16% of all work reductions, as compared to only 10% of reductions affecting the individual alone.

Figure 4.5 – Work reductions where underperforming attorney does not receive less work



These results are consistent with the theory that as law firms have grown in size and scope, the relevant units of choice for companies have shifted from law firms to teams and departments. CLOs of large companies are acting on the basis that individual lawyers can function as effective corporate counsel only in conjunction with other lawyers in the same functional unit at their firms. These developments are especially true for the partners who typically lead firm teams. Dissatisfaction with a lead partner spreads to the whole team.

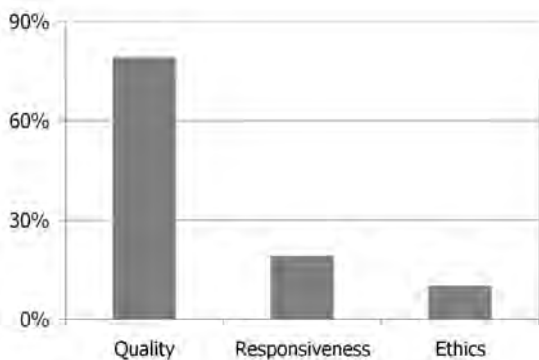
Reasons for Discipline

The dominant reason given for terminations and penalty box work reductions was the 'quality' of the services (60% of CLOs reporting terminations, 78% of those reporting reductions), and not cost. Given that we directed respondents to think about 'very significant' legal matters, it is perhaps not surprising that cost plays less of a dominant role than most anecdotal depictions imply.

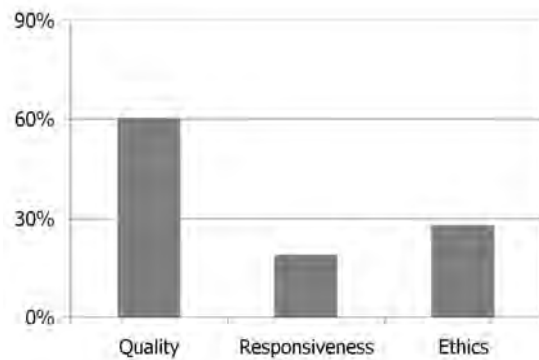
After quality, the most prevalent reasons for terminating law firms centered on ethics, particularly conflicts of interest. For example, if a law firm accepts work for a client's competitor on a matter on which the client would have an interest, giving rise to a possible future conflict, the client may see this as breaking a soft promise of capacity assurance. CLOs also cited other ethical issues leading to termination or work reduction, like unethical billing practices, that may incorporate some cost concerns as well as ethics alone.

Ethical issues are more likely to be associated with an outright termination than a work reduction. This suggests that – in contrast to the management of quality and responsiveness at the team or department level – ethics is perceived by CLOs as important to manage across the entire law firm. In this regard, that lapses by one lawyer or team reflect poorly on the firm as a whole.

Figure 4.6 – Reason for work reduction



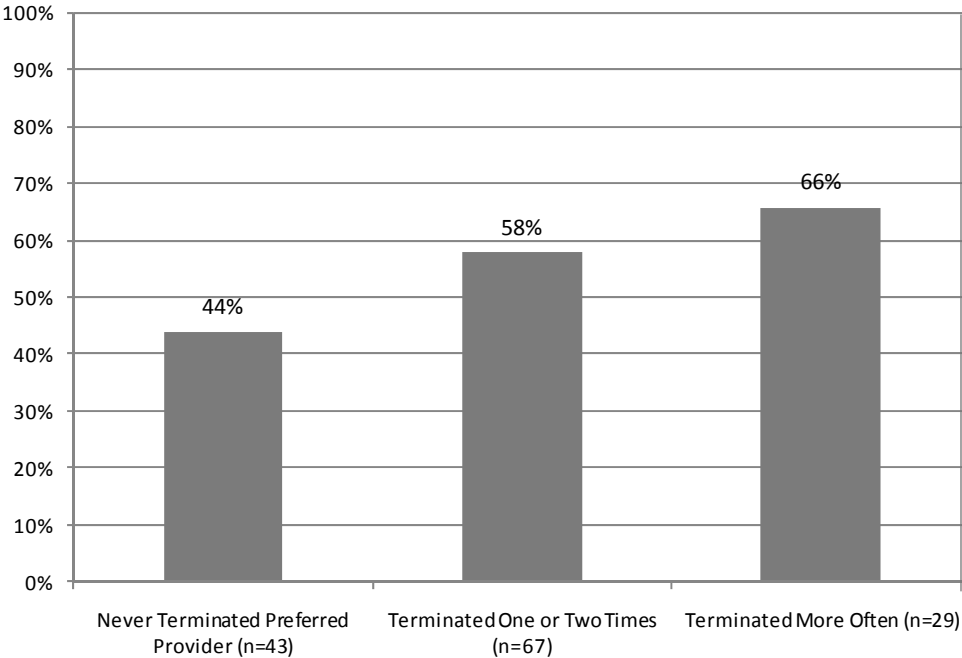
Reason for termination of relationship



A New Focus on Quality Control?

Our study also provides some indication that law firm quality control systems are a growing factor in law firm purchasing. In particular, large companies that have reported terminating law firms are much more likely to view quality control systems as important in hiring a law firm for a very important new matter. Over half of CLOs that did not report terminations in the 2003-2006 period said 'quality control systems' were not important in hiring decisions, whereas 66% of CLOs who reported more than one or two terminations in that period viewed such systems as important. The connection between quality control systems and terminations suggests that at least some CLOs are holding the law firm as a whole responsible for failing adequately to monitor the quality of individual lawyers.

Figure 4.7 – CLOs reporting that quality control systems are important in hiring



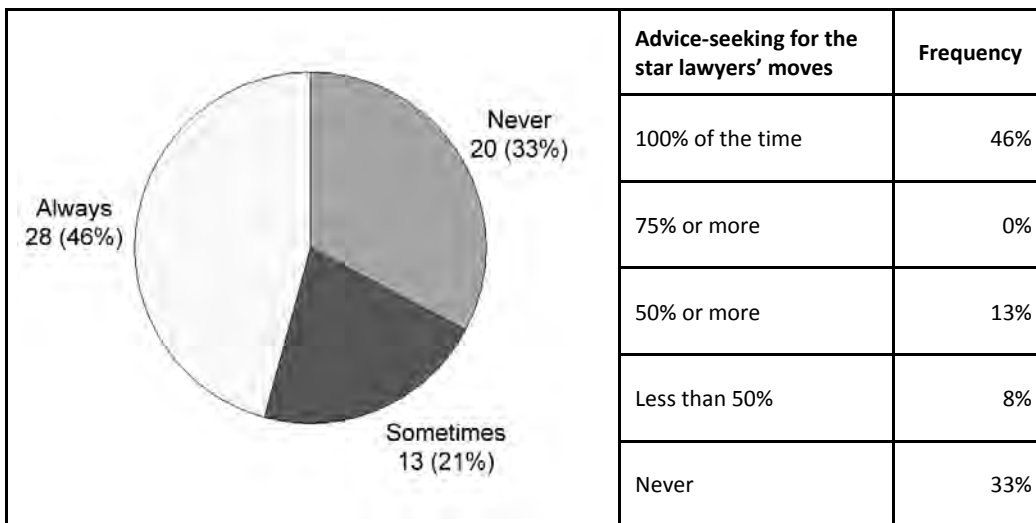
SECTION 5: LATERAL MOVES OF STAR LAWYERS

One of the most distinctive trends in large law firm practice over the past decade has been the vast increase in lateral movement of partners between firms. While this trend is well established, the ways in which S&P 500 company CLOs take part in and react to such movements has been little studied. In order to maximize comparability in our dataset, we asked CLOs to focus on the movement of high-profile (“star”) partners who served their companies.

CLOs Are Advisors not Matchmakers

Among our survey respondents, 54% of CLOs reported observing star lawyers at law firms they used move laterally during the three year study period. Of the star lawyers whose moves the CLOs recalled, 46% consulted with the CLOs every time they moved, 21% sometimes consulted on moves, and only 33% did not consult the CLOs.

Figure 5.1 – CLO consultations by star lawyers who moved

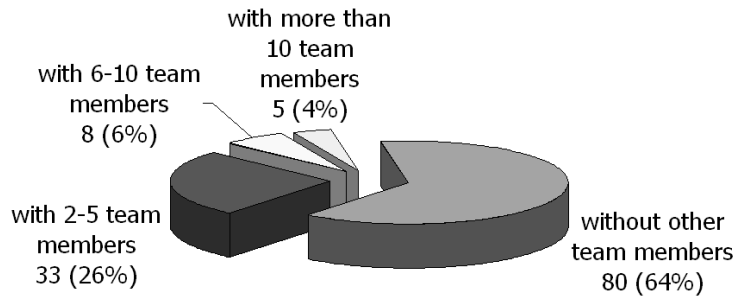


Although lawyers typically seek the advice of CLOs when moving between firms, those CLOs appear to view their role as largely reactive. Consulted CLOs proactively suggested that star attorneys join specific law firms in only 11% of surveyed cases. Interestingly, however, a significant minority (15%) of the CLOs reported that they actively engaged in ‘matchmaking’ even when they are not asked to do so, implying that CLOs can be important informational conduits in the labor market for star lawyers.

Stars Typically Move Alone or with a Small Team

CLOs reported that a majority of star lawyers who moved (64%) moved solo, whereas the remaining 36% left with other attorneys on their team.

Figure 5.2 – Moves by star lawyers

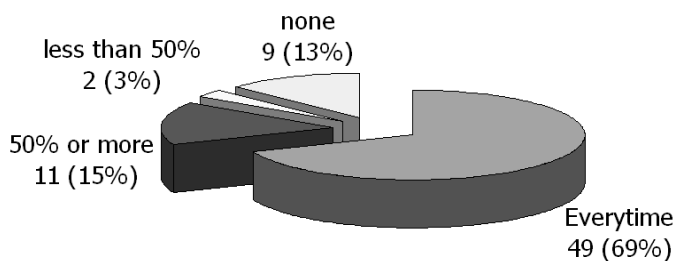


When star lawyers moved in teams, team sizes were generally small. Team size was greater than five in less than 30% of team movement cases and greater than ten for only 11% of the cases. CLOs with larger outside expenditure reported observing team movements more frequently than did CLOs with smaller outside expenditure. It may be that the complexity and service demands of a large book of business essentially require portability of a client-experienced multidisciplinary team whereas small to moderate sized portfolios default to solo moves that are quicker and less burdened by conflict clearance and competitive concerns, and then rebuild teams within their new firm.

Work Routinely Follows Moving Stars

While lateral moves can indeed involve daunting issues of conflict of interest and threats of broken relationships, the reality is that most CLOs move their work to the new firm that a star lawyer joins. Nearly 70% of CLOs said they do so 'every time' and 84% said they do so in a majority of instances. Perhaps not surprisingly given the added value of team-wide client-specific experience, it is also significantly more likely for CLOs to move work when the star lawyers moved as part of a team than when the star lawyer moved solo.

Figure 5.3 – Frequency of work moving along with star lawyers



5. Lateral Moves of Star Lawyers

While a full analysis of the quality effects of lateral moves was beyond the scope of our study, it is interesting to note that it was very rare for CLOs to report an adverse effect on quality following star lawyer moves. In about 75% of the cases where CLOs re-routed work to follow moving stars, they reported the quality of work did not change, whereas in about 20% of cases they reported the quality of work improved. This may compare favorably to lateral moves in other professional services sectors, where at least one study of security analysts found that decreases in quality were more likely to follow such moves than increases in quality.

SECTION 6: MANAGING THE INTERSECTION OF LAW & PUBLIC RELATIONS

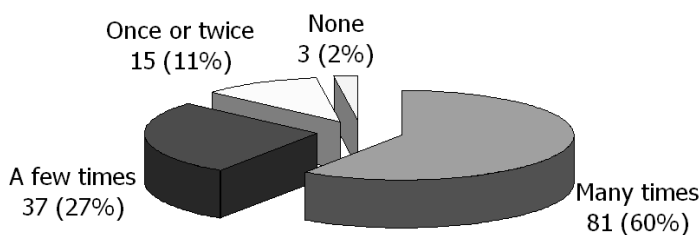
Current ethics rules and commentaries on the intersection of law and public relations focus largely on the role of lawyers as spokespersons for clients – for instance, the criminal defender speaking to the press on the courtroom steps. The role of CLOs and other in-house counsel in shaping and advising on corporate communications and helping to manage corporate public relations has received far less scholarly attention.

In addition to leveraging our primary survey and dataset, we focused on this important and understudied area by interviewing nearly sixty law firm partners, corporate communications executives, and CLOs of S&P 500 companies specifically about the role of the CLO in managing public relations.

Collaboration Between Legal and Communications is Frequent and Critical

What we found was that CLOs and other corporate counsel regularly and deeply interacted with corporate communications executives to actively manage public relations surrounding legal matters, disclosures and reputational risks. While such collaboration may not always relate to legal controversies, 98% of all firms have dealt with a legal controversy that has substantial publicity potential in the past three years.

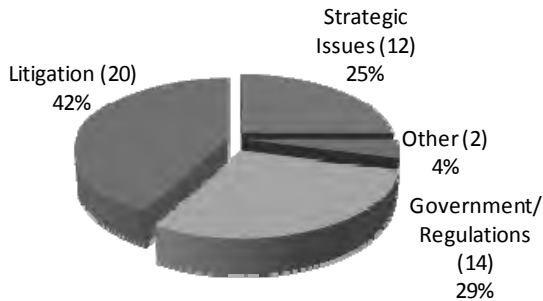
Figure 6.1 – Frequency in the past three years of legal controversies with potential substantial publicity



And respondents clearly thought that collaboration in these instances between legal and communications executives was warranted. Specifically, interviewees believed that the ‘court of public opinion’ and public relations initiatives can significantly influence whether a civil lawsuit is filed, what charges or claims are brought, relationships with government officials and regulators, negotiation power, legal strategies and case outcomes.

6. Managing the Intersection of Law & Public Relations

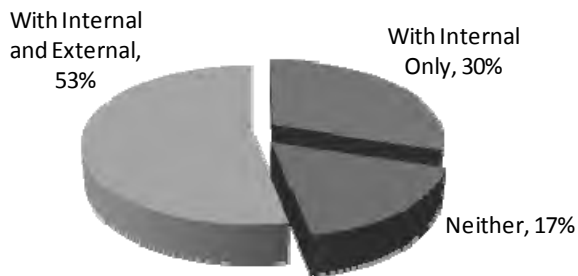
Figure 6.2 – Most recent type of legal matter with potential for substantial publicity



CLOs Are the Linchpins

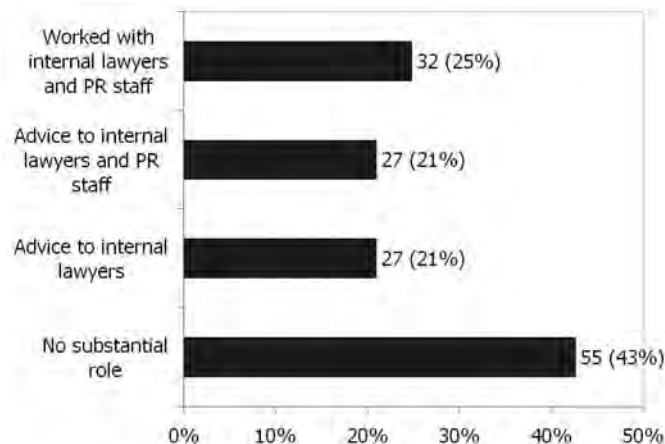
CLOs work with internal and external communications executives to actively manage legal public relations for their corporate clients. They felt comfortable openly communicating about legal matters with communications executives, including (to a lesser extent) external public relations consultants. Respondents reported this comfort extending to privileged communications and deemed such collaborations critical to effective legal public relations.

Figure 6.3 – CLO-reported comfort sharing information with internal and external communications teams



However, according to both in-house and law firm respondents, outside counsel rarely play a substantial role in managing legal PR with in-house counsel and PR executives.

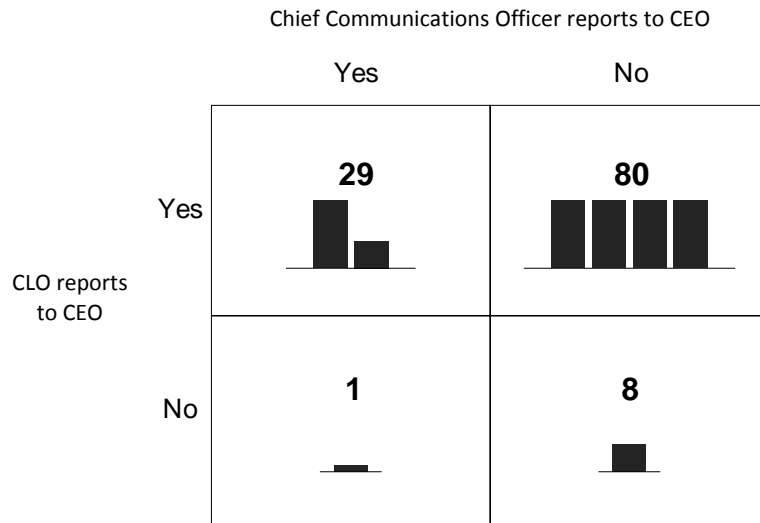
Figure 6.4 – Recent role of outside counsel in corporate communications matters



6. Managing the Intersection of Law & Public Relations

Although they work closely, our respondents reported that CLOs and corporate communications executives often have conflicting substantive and procedural perspectives on matters involving law and public relations. When disagreements arise, however, most agreed that CLOs – who often outrank communications executives and otherwise understandably receive greater judgmental deference in high-profile legal crises – typically prevail.

Figure 6.5 – Reporting structure for chief legal and communications executives



Together these factors point to the positioning of CLOs and other corporate counsel as the linchpin of managing legal public relations. While further study is clearly warranted, there appears to be a need to raise awareness of – and support for – in-house lawyers’ role in managing legal public relations and reputational risk for corporate clients. At the same time, it appears that a tension exists between in-house counsel and corporate communications executives that may be healthy for thoroughly vetting important matters affecting public relations and reputation, and should therefore be valued and safeguarded by both corporations and society.

SECTION 7: IMPLICATIONS FOR CORPORATE COUNSEL— NEW MANAGEMENT FRONTIERS

While our research was conducted before the current economic downturn, and a follow-up study would therefore be valuable, we believe that our findings have structural roots that likely transcend – and may even be exacerbated by – the increased scrutiny of law firms by large corporate clients that has been stimulated by the downturn.

Investing More in Systemic Understanding

When we conducted our first focus group of CLOs to gather background information for this project, we were struck by how little the sophisticated legal purchasing agents seemed to care about the internal policies and practices of the firms they employed, or the dynamics of the markets in which these firms worked. When asked if they inquired about partnership structure, compensation, or training policies, the standard response was that the company didn't get involved in the internal affairs of firms and that the only issue was whether they delivered legal services at the quality and price the CLO demanded. The fact that most of the CLOs in our survey rated such structural and compensation factors as 'unimportant' when making purchasing decisions confirmed that this attitude remains widespread.

Calling this mindset into question, our findings underscore that corporate clients have a greater stake in the health of their top law firms than the standard story about spot contracting suggests. CLOs drove convergence to cut costs by increasing their leverage over preferred providers. But the fact that convergence seems to have slowed reveals the limits and risks to the strategy of tying a company's fortunes to an ever-smaller group of firms to squeeze out costs. The slowing of convergence paired with the real constraints we observed on threatening termination of law firm relationships as a means of discipline means CLOs will now have to find more creative ways to manage their law firm relationships. To do so, CLOs and their companies will need to invest more in understanding how law firms operate and in understanding the market for legal services as a whole.

Innovating to Align Institutions...

Despite their stated reluctance to intervene in law firm affairs, many of these same CLOs are now experimenting with a range of new ways of managing down costs and increasing quality that will require more creative and sustained interventions in the management of law firms or the legal market more broadly. Many CLOs now believe that new forms of legal organizations, off-shoring, and continued pressure on the boundary between commodity and bespoke legal work will do more to constrain costs and enhance quality than discount mandates or beauty contests. Many are also pushing to replace the hourly billing system with alternative fee arrangements and other forms of risk and profit sharing with their law firms. While these and other similar innovations hold out great potential to improve the cost and quality

7. Implications for Corporate Counsel

of the legal services corporations receive, each is also fraught with risks to lawyer incentives, quality control, and legal matter outcomes.

To guard against these risks, CLOs may have to follow the lead of the small but significant minority who have begun to collect external, objective sources of information about legal quality. Law firms' management structures, compensation systems, and associate training procedures can be reviewed, evaluated and – with enough pressure – changed to improve law firm productivity. Some CLOs are already experimenting with firm-integrated strategic planning and introducing common technology linked with outside counsel for knowledge and matter management. CLOs may need to think about their legal departments as including not just the in-house lawyers who work as full-time employees for their companies, but also as including repeat service providers who (at least as a formal matter) work at autonomous law firms. This is particularly true if cost pressures on non-revenue-producing functions continue to lead companies to shrink or stagnate the number of in-house lawyers.

...But Also the Teams that Remain the Pivotal Service Providers

In addition, our data show that CLOs understand they are not just hiring individual lawyers or whole firms, but also hiring outside legal teams – teams that they expect both to monitor the performance of individual lawyers and to align the rest of the firm to the client's goals (for example, by preventing the firm from representing conflicting interests). Companies, therefore, have a significant stake in how firms organize, manage and support these semiautonomous groups of lawyers. Because teams may also move between law firms in the increasingly active lateral market, often taking existing CLO relationships and substantial books of business with them as a matter of course, objective measurement of the quality of these teams, such as transactional league tables and their potential analogs in other areas such as litigation and regulatory specialties, could help CLOs to more strategically assess the soundness of these practices.

SECTION 8: SIGNIFICANCE FOR LAW FIRMS— NEW SCRUTINY & INVESTMENT

Durable Relationships Don't Mean Hands Off

For law firms, the good news is that their relationships with large corporate clients are relatively durable, ensuring a reliable flow of revenues over time, absent serious lapses. Convergence has already run its course for most large companies, and there is little more companies can do to winnow preferred provider lists without causing excess dependency on a small set of law firms. The bad news is that CLOs are more informed and savvy purchasers of legal services than ever before. If what we have suggested above is correct, CLOs can be expected to turn their gaze from the relatively superficial traits like head count, geographic reach, practice composition and billing rates of outside law firms to internal systems and management, professional development and compensation practices within those law firms.

Preparing Firms for New Scrutiny

Law firms will need to justify many business practices that they have heretofore treated as internal. Corporate clients are already intervening in once purely internal areas such as staffing to specify particular partners and associates to work on their matters – and for how long. In the diversity area, some companies have gone further, requiring firms to report on the demographic composition of lawyers working on the company's matters, and in some instances mandating that firms change the 'relationship partner' who oversees the company's business. As many advocates in this area have long suspected, our survey confirms that diversity does not play a primary role when companies are deciding which firms to hire for an important matter. But the trends we identify also suggest that the mode of intervening in the internal affairs of firms now prevalent in the diversity area have at least the potential to spread to other firm attributes, as CLOs seek to align compensation systems and organizational structure of their preferred providers with their corporate goals.

More Centralized Investment by Firms

Firms are likely to respond to increased scrutiny by instituting mechanisms to signal that they are responsive to large client concerns. Dedicated client teams, client accessible knowledge and matter management platforms, law firm-run training programs for both in-house counsel and business units, and secondments of law firm lawyers to companies are all ways to signal commitment and potentially to increase transparency and business alignment. If the trends we have identified are any indication, pressure is likely to mount on firms to adopt more such measures in coming years.

Investments in management, collaborative technology, quality controls, and ethics systems require prioritizing centralized firm leadership and operational systems and will no doubt encounter resistance from some front-line lawyers, including rainmakers. Law firm leaders face a difficult challenge of manag-

ing their in-house rivals while also managing their star performers. That many relationships are strongest at the team or department level will likely exacerbate these difficulties for firm leaders. Powerful subunits may undermine efforts to centralize management or, in the worst case, split off altogether with important clients in tow. Finding creative ways to manage tensions while preserving the firm is likely to be every bit as difficult for law firm leaders as the task of building sustainable relationships with preferred providers that preserve both cooperation and competition. The success of these efforts depends on the ability and willingness of law firm lawyers to identify and implement innovative and jointly maximizing solutions to these complex problems.

SECTION 9: LESSONS FOR LAW SCHOOLS— RESEARCH & TEACHING ABOUT MODERN PRACTICE

For law schools, our findings have striking implications. Law schools have changed only modestly since Langdell pioneered the case method at Harvard Law School in the 1870s. That curriculum was out of date by the time it became standard in the early twentieth century, much less today. Many law faculties place great value on autonomy – which they then use, ironically, to preserve tradition. Given resistance to change, any prediction that law schools will rapidly adapt to prepare students to meet the challenges we describe here must be made with extreme caution.

Management Skills and Teamwork as Professional Development Anchors

The fact that the legal and corporate sectors are highly interpenetrated, with long-term relationships still prevalent and work organized and evaluated at the team rather than just the individual or firm level – suggests that students anticipating jobs in large law firms should more appropriately view themselves as entering careers in firm/company joint ventures. In such a corporate setting, legal skills need to be complemented by business skills: strategy, value, marketing, team-building, leadership, budgeting, planning, public relations, and control systems. Where those skills are best learned remains uncertain, but law schools could play a role in teaching students to work in teams, as business schools have long done.

Innovation and Reform in Legal Education

In the last few years, law schools have taken some small but significant steps toward making legal education more relevant to careers that necessarily will need to embrace the increasingly globalized business of law. Northwestern allows law students to earn a JD in two years, while the University of Pennsylvania makes it possible to obtain a joint JD/MBA in three. Washington & Lee has turned their entire third year into a series of clinical, externship, and simulation opportunities. Harvard Law School recently created a required Problem Solving Workshop for all first year students to introduce students to the way that lawyers encounter legal problems through a series of business school-type case studies in which teams of students work to identify and assess legal problems in circumstances where both the facts and the applicable law have yet to be determined. Six law schools across three countries are participating in LawWithoutWalls, a new part-virtual academic model designed to produce legal innovation, hone business and entrepreneurial skills, and break down barriers between faculty and students, business and law, professors and practitioners, education and practice.

It is too early to tell whether these or other similar efforts are likely to loosen the stranglehold that the traditional Langdellian curriculum has held over legal education. What our study indicates is the price that students and the profession are likely to pay if these efforts do not flourish.

The Need for Scholarship on the Evolving Legal Profession

This brings us finally to the role of scholarship. Law schools, of course, produce more than students. They also produce scholarship. Yet until recently, these institutions have produced little scholarship about the profession they purportedly serve. Serious interdisciplinary scholarship on the profession, although it exists, is rare. Even fewer academics of any stripe have shown much inclination to engage with lawyers about how they are experiencing and adapting to changes in practice.

What is needed, we submit, is a sustained dialogue among scholars from a variety of disciplines – and sophisticated practitioners – about the organization and development of the legal profession. Management of social conflict – one of the legal profession’s core tasks – is increasingly important in a diverse but globalizing world. The problems we have identified in this white paper all have analogues in fields such as management science, industrial organization, institutional economics, sociology, anthropology, and psychology – to name only the most obvious ones that come to mind. In this study, we have attempted to demonstrate how debates in all of these fields can be illuminated by quantitative and qualitative methodologies that bring the voices and experiences of practitioners into broader theoretical debates about the relationships between companies and suppliers. We look forward to continuing the conversation.

SECTION 10: METHODS

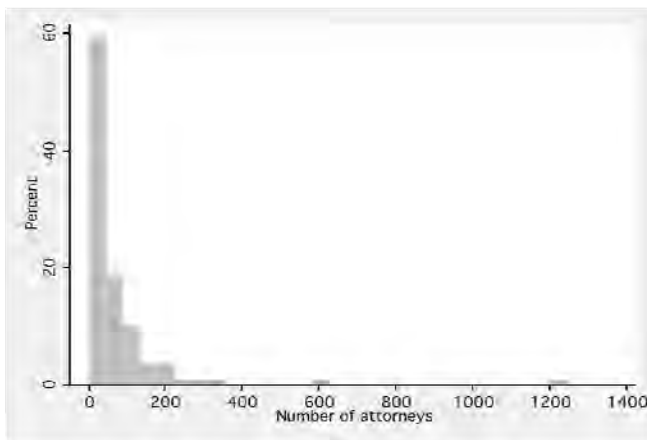
We are pleased to share the following supplemental information about the empirical data and methodologies behind the Corporate Purchasing Project.

Overall Study Sample

Our study sample was drawn from the companies included in the S&P 500 Index in 2006. The S&P 500 Index is intended to be a representative sampling of publicly traded corporations in leading industries of the U.S. economy, with a focus on the large-cap segment, and constitutes over 75% of the total equity market capitalization of U.S. stock markets. As detailed further below, 139 S&P 500 CLOs responded to our survey and 43 participated in interviews. There was an overlap of 17 CLOs who did both, resulting in a total study sample of 166 CLOs, representing one-third of the overall S&P 500.

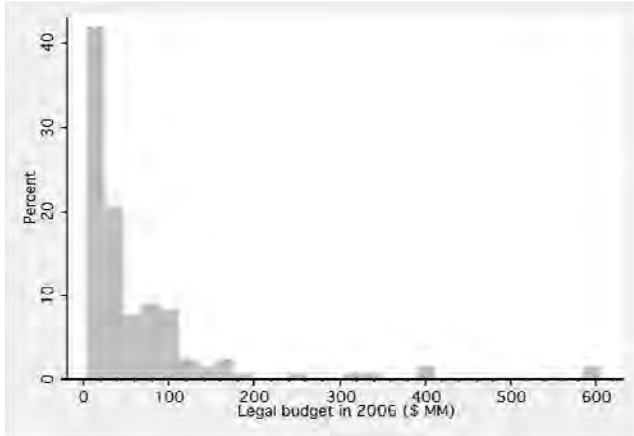
Within this overall sample of responding corporations, the size of the legal departments varied to a great extent. For example, one respondent had wholly outsourced its legal function, whereas another company employed 1250 lawyers, which is comparable in size to the largest law firms.

Figure 10.1 – Size of responding legal departments



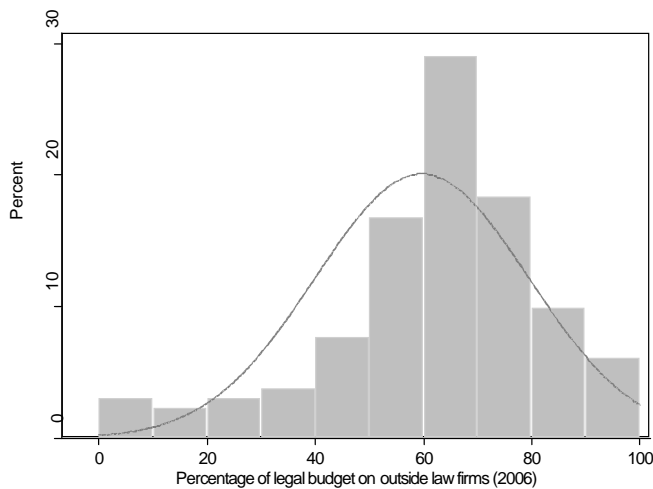
The size of legal budgets also varied significantly among respondents. Legal budgets of our study respondents typically fell in the \$25 to 50 million range. However, the company that had the largest legal budget spent more than \$600 million in 2006.

Figure 10.2 – 2006 legal budget of respondents



Outside spend – the share of legal budget paid to outside law firms – also varied among study respondents, though less than total legal budgets. Five companies with the largest legal departments (ranging from 220 to 1250 lawyers) spent more than the average on outside law firms (73% vs. 60%).

Figure 10.3 – Outside spend as a percentage of legal budget of respondents



Survey Data

Our data included a survey sent on December 31, 2006 to all S&P 500 CLOs, which elicited a 28% response rate. Based on statistical analysis, we confirmed that our survey sample that consists of 139 companies well represents the S&P 500 companies.

Figure 10.4 – Survey respondents vs. non-respondents by industry

2-digit SIC codes	Industry (SIC Divisions)	Total				
		S&P 500	% Responding	Respondents	Non-respondents	p-value
01-09	Agriculture, Forestry, and Fishing	1	100%	1	0	0.1071
10-14	Energy, Mining, Oil, Gas	21	19%	4	17	0.3707
15-17	Construction	6	33%	2	4	0.7622
20-39	Manufacturing	211	24%	50	161	0.1834
40-49	Transportation, Communications, Electric, Gas, And Sanitary Services	63	38%	24	39	0.0682
50-51	Wholesale Trade	9	33%	3	6	0.7110
52-59	Retail Trade	39	28%	11	28	0.9550
60-67	Finance, Insurance, and Real Estate	97	29%	28	69	0.8147
70-89	Services	49	29%	14	35	0.9041
91-99	Public Administration	3	67%	2	1	0.1329
	Total	499	28%	139	360	

Data Sources: Compustat; SIC Division categories from OSHA

Survey respondents' companies had, on average, assets of \$62 billion and revenues of \$23 billion. Respondents' companies were generally profitable – less than 5% of respondents' companies had net losses in 2006. They were important employers, with between 2000 and 280,000 employees.

Figure 10.5 – Summary statistics on companies of survey respondents

Year:	2005			2006		
Survey Respondents	N	Mean	Standard Deviation	N	Mean	Standard Deviation
Assets – Total (\$MM)	133	56954.23	165474.50	135	61974.66	180699.70
Long-Term Debt – Total (\$MM)	133	13015.16	48639.81	135	13687.40	49274.52
Earnings Before Interest + Taxes (\$MM)	134	3032.75	6408.99	133	3742.48	7717.35
Employees (000)	134	66.35	171.12	135	66.41	170.42
Net Income (Loss) (\$MM)	134	1452.21	2981.66	135	1748.85	3510.19
Revenue (\$MM)	134	21929.33	40948.77	135	23448.51	42000.47
Operating Expenses – Total (\$MM)	134	17991.19	36441.24	135	18782.75	36704.79

Data Source: Compustat

The legal departments overseen by our survey respondents varied in size and importance. 89% of the CLOs responding to the survey report directly to the CEOs of their companies. CLOs that report directly to the CEO work for smaller companies in assets (\$49 billion vs. \$171 billion) than the rest of CLOs, but not in the other size dimensions such as the size of legal departments and revenues of their companies. Combining with other available data sources, we can infer (1) rapid CLO turnover, including a median 3 years of CLO tenure, (2) that a majority (56%) of CLOs are internally promoted, (3) that CLOs are typically among the top five most highly compensated executives at their companies with a median salary of \$420,000, and (4) that a majority (87%) of CLOs are male.

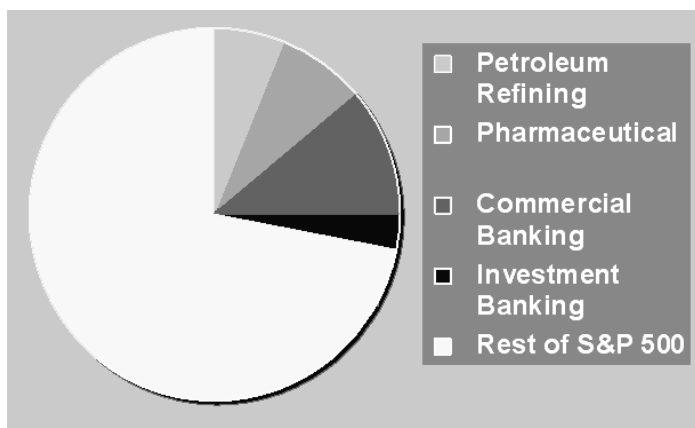
Figure 10.6 – Summary statistics on legal departments of survey respondents

	Mean	Minimum	25 th p-tile	Median	75 th p-tile	Maximum	N
Data from Survey Respondents							
2006 legal budget (excluding compliance) (\$MM)	65.42	3.50	15.00	37.00	76.00	606.00	131
% of 2006 legal budget spent on law firms	60%	2%	20%	60%	70%	97%	130
Number of law firms used in 2006	127.05	5	30	65	150	1000	133
Number of law firms used in 2003	141.82	4	27	75	170	1000	117
Number of law firms accounting for 80% of 2006 outside legal expenditures	15.09	1	5	10	20	110	135
Number of law firms accounting for 80% of 2003 outside legal expenditures	17.31	1	5	10	25	100	115
Change in number of law firms accounting for 80% of outside legal expenditures from 2003 to 2006	-2.2	-80	-2	0	1	44	114
Number of lawyers overseen by CLO	68.85	0	17	35	75	1250	134
% of CLOs reporting to CEO	89.2%						139
% of CLOs male	80.0%						80
Data on Survey Respondents from Other Sources							
Tenure of CLOs as CLOs [1]	4.6	1	2	3	7	19	80
Tenure of CLOs at company [1]	9.6	1	3	6.5	14	35	86
CLO promoted from within company [1]	56.4%						78
CLO salary in 2006 (\$000) [2]	468.6	201.92	356.00	420.42	517.50	1513.20	46
CLO total compensation in 2006 (\$000) [2]	2459.9	463.53	1287.16	2208.32	3099.67	7278.61	39
% CLOs male [2]	87.0%						46
Data sources : [1] <i>American Lawyer</i> 2007 Survey of Fortune 500 Legal Departments; [2] Execucomp							

Interview Data

Our interview sample consisted of 43 companies in three major industries – 26 in financial services (investment and commercial banks), 8 in pharmaceuticals, and 6 in petroleum industries. These three sectors were selected for oversampling because prior research had established that each of these sectors had high legal services costs.

Figure 10.7 – Oversampled sectors as share of 2006 S&P 500 market cap



Interviews were conducted from July 2006 to November 2007. Fifteen were conducted in person, the rest by phone. No one participated other than respondents and one or two interviewers. Interviews averaged 76 minutes in length. All interviews were carefully treated to ensure anonymity and all but five interviews were recorded and transcribed. Each interview began with closed-ended questions around employment background, title, department size, and legal spending. Thereafter, each interviewee was asked the open-ended questions about the way in which their companies purchased, assessed, and monitored legal services.

Interview participants worked for larger companies on average than survey respondents, with average 2006 assets of \$309 billion, revenues of \$46 billion, earnings of \$5.7 billion, and cash flow of \$19.1 billion. The year-to-year correlations for these measures of company size were very high, suggesting that aggregate legal demand was relatively stable in our study period.

Figure 10.8 – Summary statistics on companies of interview respondents

Year:	2005			2006		
	N	Mean	Standard Deviation	N	Mean	Standard Deviation
Assets – Total (\$MM)	42	262800.09	388155.65	41	308824.33	463026.59
Long-Term Debt – Total (\$MM)	42	48824.00	101748.80	41	58302.39	109442.11
Earnings Before Interest + Taxes (\$MM)	42	11434.31	14725.72	39	15391.33	19181.47
Employees (000)	41	43.78	58.07	41	46.05	63.39
Net Income (Loss) (\$MM)	42	4615.43	7108.04	41	5714.68	8190.79
Revenue (\$MM)	42	39265.70	62276.51	41	45995.58	67136.08
Operating Expenses – Total (\$MM)	42	26665.45	51265.98	41	29863.03	52785.83

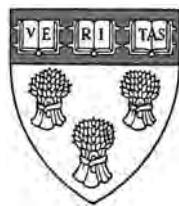
Data Source: Compustat

The legal departments overseen by interview respondents also varied in size and importance. Only 56% of CLOs in our interview sample reported directly to CEOs. This low proportion relative to the survey respondent group is because CLOs were less likely to report directly to the CEO at financial institutions (60% vs. 94%, p-value < .001), implying a more hierarchical internal structure for those companies. In our interview sample, 81% of CLOs reported overseeing compliance functions as well as legal.

Figure 10.9 – Summary statistics on legal departments of interview respondents

	Mean	Minimum	25 th p-tile	Median	75 th p-tile	Maximum	N
2006 legal budget (excluding compliance) (\$MM)	210.79	10.00	40.00	91.50	332.64	750.00	18
% of outside budget spent on law firms	53%	20%	40%	50%	64%	90%	27
Number of law firms used in 2006	239.86	6	40	150	300	1000	29
Number of law firms accounting for 80% of 2006 outside legal expenditures	20.00	1	5	10	20	100	31
Use of preferred provider lists	60%						40
% of preferred provider lists that are mandatory	17.5%						40
Number of lawyers overseen by CLO	161.07	2	40	100	150	1480	41
Number of non-lawyers in legal department	112.17	3	112	75	112	500	23
% of CLOs reporting to CEO	59.5%						41
% of CLOs male	76.7%						41
% of CLOs overseeing compliance	81.0%						40

Data sources : [1] *American Lawyer* 2007 Survey of Fortune 500 Legal Departments; [2] Execucomp



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