In Conversation

Focus on: Outside Counsel Guidelines

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Terms of Business — A Critical Risk and Compliance Challenge

Dan Bressler: I'm delighted to talk to you today about an important trend and increasing challenge — responding to client outside counsel guidelines, and managing terms of business and engagement.

Yours is a critical voice in the industry's risk dialogue and I'm glad to reconnect, get a sense of your perspective and be "in conversation" once again.

Anthony Davis: It's always a pleasure to speak with you.

Dan: Excellent. Let's dive right in. You talk to a lot of firms and a lot experts and thinkers all across the spectrum. How would you summarize the state of the matter?

Anthony: Outside Counsel Guidelines ("OCGs") are a serious and growing problem, and are causing havoc and distress in multiple areas of law firm operation. To use the words that the English regulators have used to assess this phenomenon, what's going on really threatens the independence — in some instances, even potentially, the viability — of law firms that seek to represent large or increasingly, even mid-size corporations. It's a significant problem, with a number of different dimensions.

In general terms, OCGs are a problem because clients are making demands that are, or may be:

- impossible to agree to without putting the firms at risk
- impossible to agree to without severely limiting the firms' ability to practice for multiple clients
- dangerous because of the controls and limits placed on the ways in which law firms actually provide services to their clients
- increasingly burdensome administratively because of requirements such as the obligation to keep track and comply with the "guidelines" that firms do agree to accept.

You don't speak with a firm of any size anywhere in the U.S. or the UK without hearing that it's a problem. And a growing problem that is causing huge heartaches for law firms.

Cry Havoc, and Let Slip the Documents...

Dan: You called it havoc. You're not mincing words. I'm curious to start with the client perspective. Why are they raising such havoc with outside counsel? Is it conscious? Is it organic? From your perspective, do they understand the implications of what they're doing or causing to unfold?

Anthony: There are several layers to the answer. The first part of the answer, which may sound flip, but actually I think has a serious measure of reality — is that the clients are imposing OCGs because they can (or think they can). At root, the marketplace for legal services has changed, even for sophisticated services from the mega law firms.

The balance of power between clients and law firms has shifted. What was true right up until the recession, that the law firms were in the driver's seat, has simply been upended. The law firms no longer dictate the basis on which they represent clients. Now, clients are in the driver's seat, and they're using their power to the maximum extent they can get away with it.

The second part of the answer is that at least some of what we see, is that OCGs are frequently not driven by general counsel, but by procurement officers, who are insisting on putting in clauses for all vendor contracts regardless of relevance. So that some of the kitchen sink stuff that goes into what law firms see has nothing to do with lawyers or legal services. Many of the terms in OCGs are much more appropriate for the purchase of envelopes and paper clips or for contractors in construction projects. Indeed, when I hear law firms talking about what happens when they fight back, when they argue with the clients' general counsel, and when they try to get changes, they are often met with these kinds of very common responses:

- "Gee, I didn't know that was there." Frankly, if you believe that, I'll sell you a swamp in Florida.

Or:

- "Well, we had to put that in because the procurement officer or the chief financial officer said so. We have to do it with all our vendors."

Or:

- "Well, maybe we can make an exception for you"

Or:

- "Well, nobody else has raised that objection."

I've come to the conclusion in my discussions with law firm GCs that that last one is almost always a flat-out lie, because law firms are trying to negotiate and are trying very hard not to agree to at least the most egregious OCG provisions.

While corporate GCs will sometimes pretend it wasn't their fault, for some of the components of OCGs, this makes no sense at all — particularly in the area of conflicts of interest. In that arena GCs are deliberately enlarging the definition of what is a conflict and what representations a firm may not

undertake, going forward, if it takes this new engagement subject to the proposed guidelines. This has obviously huge implications for firms' businesses, and even their viability.

With respect to provisions relating to pricing, fees, staffing and human resources, some of those are ascribed to the fact that procurement officers and CFOs are demanding better accountability from their general counsel's offices. But at this point, the corporate GCs have co-opted this argument and are saying, "Gee, this is great. We can beat the firms up on fees." Again, you can lay part of the blame on the fact that the CFOs are the people writing the checks in corporations, but I don't think the GCs get away without a fair share of blame for what's going on here.

A Changing Dynamic and Changing Risks

Dan: In a certain sense, the way that you frame this dynamic is that clients may be, in fact, biting the hand that feeds them.

Anthony: There's no question that that's true. Any individual corporation is not going to recognize or acknowledge that, but collectively, that is exactly what's happening. One area I've written quite extensively about, where they are definitely biting the hand that feeds them, is in demanding indemnities. But on the whole, with some difficulty, many law firms are successfully beating back that particular demand.

I know of quite substantial law firms, where the client has said: "You sign this, or we take the work away." If the firm agrees, because it couldn't function without the work from that client, and it's a sufficiently important client, the consequence is that the law firm is putting in jeopardy the existence of its malpractice insurance, and putting all its assets at risk. I know of at least one instance where that's happened. There are also undoubtedly other instances, where it's happened because of the administrative challenges in tracking and keeping tabs on what is being signed, but the firms don't know about it because some partner signed a set of OCGs without getting approval beforehand.

Dan: Are there other areas that you would flag?

Anthony: Several. One is requirements about the management of matters — very often with litigation — especially incredibly detailed protocols, sometimes involving many pages of requirements. These spell out how law firms will go about not only staffing, but serving the client in a litigation context — detailing when they have to do things, how they have to do things, how many lawyers they can use on any given project, how many depositions they will take, and on and on and on and on. All of this is problematic because it shouldn't be necessary, because Rule 1.4 of the Rules of Professional Conduct says lawyers should keep their clients informed about material developments in the matter. For clients to need to write pages and pages and pages of what they expect is a sad reflection on the relationships that have grown up between law firms and their clients.

Another category of objectionable provisions relate to technology and cyber security. These are hugely burdensome. The real problem with these provisions is not that clients aren't absolutely right to be scrutinizing the degree of care which their lawyers are taking with their confidential information, but that firms are faced with multiple OCGs with different and sometimes inconsistent requirements. The big firms now have whole staffs dedicated to answering these demands, figuring out what they are and what they aren't doing in relation to what the clients are asking for, pushing back where they can, and keeping records. It can be an enormous administrative burden. The government regulators exacerbate this problem. Understandably, the law firms are fearful of collectively arguing with industries — although I know there is some of that going on — because they're afraid of being accused of engaging in antitrust activities. So this group of guidelines, while legitimate in the abstract, poses a huge problem.

Then there are provisions that, again, have some relevance in a few situations, but rarely in connection with the provision of legal services. The clients who say, "You must abide by our business code." (Whatever that is.) Sometimes they spell out what it requires, sometimes, they don't. The problem with these provisions is that they frequently have nothing to do with how law is practiced. What does a firm do? Say, "Yes, we will?" When it has nothing to do with the firm, even where the firm might violate it without even knowing?

Similarly, while in principle, nobody objects to having hiring and employment diversity requirements, some of those are so detailed that there are firms that are having to devote significant administrative time to creating extensive and repetitive reports to clients about their diversity programs. Is it fair for companies to impose these kinds of burdens in the same breath as saying, "We're going to pay you less?"

Then, there are many guidelines that demand compliance with statutes. Think about it. If there's a statute governing what advice a lawyer may give regarding how a client operates, why does the client need to include it? And it can become significant and problematic if they say, "Well, even though you're only operating in country A, we want you to operate under the statute in effect in country B" (which may have no application to the work being done in A).

An obvious example of this is the UK Bribery Act, which is different from, and in some ways broader than the U.S. Foreign Corrupt Practices Act. Why should that apply to a purely domestic U.S. firm? And the burden is that the firm will have to figure out what it's agreeing to or sign without understanding the implications – which can be momentous.

Many of these OCGs have demands for audits and access to records to determine whether firms, having signed, are in compliance. The problem with that is the minute a firm says that a third party, or even one client can come in and look at its records, the firm is jeopardizing the confidential information of all of its other clients. These demands are not only burdensome, but, in many instances, ask law firms to agree to things that are actually unethical.

Have I given you a big enough laundry list?

All About Client-Firm Relationships

Dan: Indeed. One interesting theme you've called out is about relationship management. The way that you framed this is clients telling law firms how to do their job at a very detailed level. It's really interesting to think about this in terms of trust and partnership between client and firm.

The procurement drivers are real. But this can also be considered a question of trust. Not that there's a belief that law firms won't act in their interest. But an implicit concern about whether firms will consistently invest, organize, communicate and work in ways that give comfort and demonstrate a focus on the client's ultimate objectives and their definition of success, not just the delivery of legal service.

Anthony: All I can say is yes, exactly. Here's an excerpt from one OCG to illustrate:

- "Relationship partner of the outside counsel, who is selected by the client. Must be designated at the firm and must be responsible for: being available and responding to the company's sense of urgency; for promoting diversity in the team working on the client's matter; for ensuring compliance with the guidelines; for monitoring and advising on conflicts of interest as defined in the guidelines; for and monitoring budgets."

Guess what's missing? Responsibility for the quality of the legal service being provided. This is madness. Where's the priority here? Is this always about checking the boxes, or is this about providing a professional service?

Dan: If it's a relationship, you're describing what might be called a prenup.

Anthony: Yes, that's the analogy the client would make. You also used the word I have long since given up on in this context, which is trust. Where is there room for trust in a 130-page set of outside counsel guidelines?

Dan: Let's talk more about how firms are responding and coping today, and what insight and advice you'd offer.

Anthony: Let's start with the mechanics of law firm responses to OCGs. In terms of push-back and ongoing issues tied to compliance, I see several approaches. Some clients have basically designated staff to deal with this — they actually have a list of their in-house lawyers whom law firms can call, depending on what the issue is. I see lists of two-three pages in length of names, with their titles and the topics that you take to each of them.

One of the issues for the firms is who should do the push-back? The lawyer who's trying to bring in the business, who really wants to just sign anything that's put in front of her and get on with her work? Or the general counsel, trying to protect the interest of the firm? Or somebody from firm management? Or some combination of those three?

Of course, the answer varies case-to-case, firm-to-firm, client-to-client. And whoever is ultimately responsible, it takes a lot of time and effort, even after the firm has identified a problem. Time to find the right person at the client,

and get them to listen to sense. For instance, I've heard several general counsel say (as recently as last week) that it's taken six months to get an answer about modifying an indemnity provision. The whole exercise is burdensome and time consuming. I've even heard firm general counsel say, "The GC of the client refuses to talk to us, and we can't find anyone else to talk to."

Coming to Terms with Compliance

Dan: Right. There's the question of initial negotiation, and the operational issues in terms of ongoing compliance. And the broader question of how the profession can come to some sense of best or better practice in this arena.

Anthony: Yes, and of course, part of the problem for law firms is the general counsel's office in most firms is woefully understaffed compared to their opposite numbers on the client side. This is something that has become worse in the last few years — law firms just don't have the staff to deal with all of this, and they've got all other kinds of other risk management issues they're supposed to be addressing and covering.

It's a problem and it's burdensome and very, very difficult for firms to grapple with. As you know, law firms try to organize themselves — at least on this side of the Atlantic — in terms of very lean management and administration, and are sometimes very reluctant to put in all the resources actually needed to manage, oversee and address these issues adequately.

Dan: From your perspective there needs to be greater investment?

Anthony: Law firms of any size dealing with OCGs with any kind of frequency need a deputy general counsel focused on this. I know a few firms that have at least one person engaged full time in reviewing OCGs. And this is partly because the issues don't end with client intake. I mentioned earlier the second layer of problems — now you've agreed to these guidelines, you need to make sure that the lawyers are actually complying with all those guidelines about how you're going to manage the litigation, who is approved to work on the matters, and what the bills are going to look like.

So someone has to be in charge of making sure that the bills conform with the guidelines, that only the designated people are allowed to work on the matter, that they don't put in inappropriate time entries, so the bill doesn't get rejected, because the guidelines weren't adhered to. The administrative issues and risks don't stop with identifying the problem clauses, they continue with the relationship. The risks change, but continue.

Firms have a whole lot of needs, but the first and most important need that firms have is to know what has been proposed or imposed. I'm still talking to law firm general counsel who say: "We think we know what we've signed, but we have no way of knowing for sure. We've issued a policy. We have told people, but we really don't know what's in partners' desk drawers — what they may have signed but haven't told us about."

Firms need policies and systems which require central record keeping of all OCGs. And once they have got that in place, they have to figure out what they are agreeing to in each of the areas we've talked about, and whether it makes business sense to agree to it in the first place. What should be pushed back about? Which are the important battles?

Dan: Well, as you know, seeing these trends unfold over the past few years in much the same way you have, we've been making investments on the technology side.

There's a real opportunity for technology to address many of these issues: to centralize, catalog, and raise visibility of these requirements; to empower risk leaders to intervene; and to empower lawyers and staff to effectively comply, and to oversee that compliance.

You've been exposed to some of what we've been offering over the past year or so. What's been your perspective on what you've seen and the technology potential?

Anthony: I think your terms of business software is absolutely a just-in-time invention. It actually allows firms, if not to be in control, at least to stay in the saddle of the bucking bronco — rather than sitting in the dirt, waiting to be trampled on.

If it's well-used, it does allow the firm to do all the pieces that it needs to do: to identify what's being demanded, to break down the provisions into the component areas of risk: What are we agreeing to in the area of conflicts? What

are we agreeing to in the area of indemnity? What are we agreeing to in the area of cyber? What are we agreeing to in terms of billing systems? What are we agreeing to in terms of knowledge management? And on and on and on.

The software also enables firms to break down who's responsible, for the push-back that we've talked about, and, once they have signed the agreement, for making sure that it's complied with.

If a firm is getting one set of OCGs a month, it may not need your tool. If it's getting one of them a week, it needs your software. If it's getting one of these a day, it's absolutely critical. Heaven knows how firms in that position could operate without your tool, without regularly getting into trouble.

Dan: Well, that's certainly encouraging. Thank you.

Anthony: It's true. The fact is somebody had to do it. You've done it. And the firms that are trying to do it manually, on the back of an envelope, or with a card index, or perhaps even a spreadsheet, they're perfectly aware that their system is going to break down sooner or later.

I've talked to general counsel who said: "We lost an enormous piece of business because somebody had taken on an engagement which this client defined as a conflict, and we didn't know we'd signed it. So we couldn't take a large piece of business because somebody had signed somebody else's guidelines without getting approval or even telling anyone."

It only takes one significant event like that to show what your software is worth. The firms that don't have very coherent management of what they've agreed to as a conflict with all their clients — over and above what the rules say — they're going to lose business on a regular basis by signing these things.

Dan: There really is a complex industry dynamic at play. And, clearly, it's a problem that isn't going away.

I wanted to revisit one thing that we touched on earlier, because I know that you've been doing some thinking in terms of that level of response to the trend.

Not how the firms cope, and navigate, and protect themselves — but as an industry, the options and opportunities you see. It will give us an opportunity to end our conversation on an optimistic note. Can you share some of your thinking?

Anthony: I'm not sure it's quite a positive note, but I want to share two things. At the UK Risk Forum Conference in May, which we co-host with Clyde & Co, we had a speaker who's an expert in antitrust on both sides of the Atlantic. It's very clear there's really very little the firms can do collectively. The profession can do things, but the firms are really hog-tied.

And the ironic thing is that the OCGs being imposed by corporations on their law firms are themselves essentially anti-competitive. But the firms have no collective power, or even the right to fight back collectively.

To respond to this, I have come up with a theory that I don't think any individual firm, as the rule is now written, would dare raise, because the rule isn't well-framed. Rule 5.6 of The Model Rules, and the actual equivalent rule in most states, does prohibit lawyers from entering into agreements which limit the freedom of lawyers to practice law.

Now that has always been interpreted to mean that you can't have a restrictive covenant in the U.S., when lawyers move laterally, and you can't penalize lawyers from making lateral moves or mergers.

In addition, there's a second arm of Rule 5.6 which says lawyers may not enter into agreements as part of a settlement of a controversy that limit the rights of lawyers to practice law.

My proposal is for a very simple, but highly material amendment to that rule. I'm suggesting that Rule 5.6 should be amended to provide that lawyers may not enter into an agreement in the terms of engagement between lawyers and clients which limit the freedom of a lawyer or law firm to practice law.

In other words, what I would like to do is to make it unethical for in-house general counsel to ask, or for law firms to enter into agreements which expand the conflicts rules beyond what the rules of professional conduct require.

Provisions such as:

- "You may not do any work for competitors even if it's unrelated."
- "You may not take on a position which might be injurious to any position we might want to take in the future."

Those kinds of OCGs ought to be unethical and law firms ought to have a stick to beat the clients back with. And in most cases the clients are represented by in-house lawyers who shouldn't be asking for those things.

We'll see if this proposal has any legs and if it goes anywhere. We're working on an article to articulate it, and are hopeful that we can get the ABA Ethics Committee to consider it in due course. Clearly the ACC, the Association of Corporate Counsel, will fight it tooth and nail, but I would like to see the ABA and the states say "that these terms of agreement, these OCGs have gone too far."

Law firms have lost the ability to be independent and to make sensible judgments within the constraints of the traditional rules, and need the profession to take a collective stand on their behalf. We'll see if it goes anywhere.

Dan: Now that's a fascinating idea.

Anthony, it was great to talk to you. I always welcome the dialogue and insight, and I know that our readers will.

Anthony: My pleasure. Thank you for the opportunity. ■