# Data and dialogue: a relationship redefined

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**Traditionally clients have focused on the hourly rates in trying to reduce external legal spend. Looking at a decade of fees and spend shows that focusing on price has not brought any gains for clients. Lawyers' fees have gradually risen and clients ended up paying more than they did before.**

**Fuelled by these poor results, a small group of avant garde clients have started to employ data analysis techniques on external law firms' billing. Focusing on efficiency, backed by data analytics, these companies have achieved remarkable savings of up to 25% on their legal spend. This focus on efficiency might fundamentally transform the legal industry.**

In 2007/2008 the world witnessed the financial crisis. This was the beginning of a rough time for many businesses. As demand declined, companies were looking for substantial cost savings to weather the storm. Legal spend was one of them, so it was in 2008 that the Association of Corporate Counsel (ACC) launched The Value Challenge.

In the years leading up to the financial crisis business was good and year after year profits soared. All this ended abruptly in 2008.

The Value Challenge was an initiative by the ACC – the world's largest association of in-house lawyers – to help its members develop ideas and exchange best practices in order to reduce legal spend, improve predictability and achieve better outcomes. With more than 40,000 members employed by over 10,000 organisations in 85 countries, ACC members benefit from a large pool of knowledge.

Over the past decade almost every conference for the legal profession has had General Counsels (GCs) telling the audience that the cost of external legal spend must go down. Clients had experimented with legal panels in the past, but it was only after 2008 that the formation of 'officially appointed' legal panels really took off.

This period also witnessed the start of the initially promising but troublesome relationship between the legal and the procurement departments. When procurement professionals first got involved in the selection process for panel firms, they had little or no experience with the legal market. In those days, even GCs did not favour their involvement due to the perceived lack of understanding of what the GC was looking for. Buying legal services was definitely different from buying office supplies.

Over the following years clients became better at negotiating deals with their external legal suppliers. The panel formation processes got more sophisticated and sometimes even involved online auctions where law firms aspiring to get on to the panel could see their pricing relative to the competition. Law firms were typically also required to offer free secondments and knowledge sharing. Given the macro-economic situation, law firms offered little or no resistance to this changing relationship.

After the financial crisis, clients became more focused on getting a better deal. The Value Challenge provided inspiration and a pool of knowledge and best practice on how to achieve this. However, the relationship between a client and his lawyer remained very much a personal one. One should not forget that clients and lawyers are partners and work together as a team. The consequence is that clients typically prefer to keep the same lawyer once they have built a relationship which they are happy with. This creates a tendency to subjectively favour an existing relationship over a new one even where a new relationship would bring economic benefits while objectively delivering the same quality.

In 2016 TGO Consulting published a report – "The Trend is Clear, the Blow is yet to Come" – on pricing in the legal market. One of the findings was that GCs and their in-house teams are legal insiders. This might seem obvious, but the consequence is that they are used to the high rates and to the way law firms write time and do their billing. What might seem strange to the CFO will probably be totally normal to the GC.

Being accustomed to a certain way of working, the vast majority of in-house lawyers preferred to stick to the hourly rate rather than adopt alternative fee arrangements. This has been a typical complaint from law firms. In trying to deliver better value to clients while avoiding plain discounted rates, many

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law firms started offering alternative fee arrangements only to discover that clients preferred the traditional hourly rate.

What has happened over the last decade is that clients have demanded and got discounted hourly rates. Larger clients also demanded and got further benefits such as secondments. At the same time, once a firm had been appointed to the panel, the relationship and the way of working basically remained the same. The result of 10 years' 'pressure on price' is that clients have ended up paying more instead of less. Revenue and profits of business law firms have steadily grown over the past decade and the clients are paying for this. Clearly, focusing on pricing and the hourly rate is not working.

**Efficiency**

Around the same time – about 10 years ago – a small number of large corporate legal departments started to analyse their external legal spend. At first they focused on calculating how much budget was spent per law firm, per business unit, per practice area, etc. Initially this data was applied to facilitate the procurement process in selecting panel firms and negotiating discounted rates. In the early days most of this data-gathering had to be done manually and was put into excel spreadsheets. Sometimes the client in part had to rely on data provided by their law firms. Data at that point was not perfect but was usable for the purpose.

Gradually these frontrunners shifted to mandatory e-billing which provided them with easier access and better data. Legal spend analysis became more accurate and was soon adopted in some form by many other legal departments. During that time we witnessed the rise of data analytics as a field in its own right. Originally pioneered by Silicon Valley, a new 'big data' industry had emerged. There was (and is) a real enthusiasm for the tremendous insight that data analysis can bring.

The front-running corporate legal departments soon started riding the wave and gathering even more data in order to do increasingly precise data analytics. The primary aspiration is to be able to do predictive analytics and know the costs before they occur. In order to do this, vast amounts of data are needed. Potentially these large corporate legal departments had the data, it just needed to be found and unlocked – easier said than done.

In 2012 Google famously succeeded in enabling the computer to identify pictures of cats. This achievement generally contributed to the development of artificial intelligence but has in reality more to do with old-fashioned human labour. In order to teach the computer how to identify a cat, millions of pictures first have to be classified manually. Thousands of low-paid people working from home – Amazon Turks – have classified the pictures one by one. This is a cat and this is not a cat. It is no surprise that Google initiated this project as only they had, through Google Drive, access to the millions of cat pictures needed to teach the system.

This example illustrates that in order to do analysis we need vast amounts of data and lots of manual labour. This also applies to analysis of legal spend. The first step would be finding the data. The adoption of e-billing obviously helped but for companies that operate globally and have many semi-independent business units, then huge challenges remain. The second step would be to clean the data. If taken directly from the source, all data will contain errors, inconsistencies and anomalies that, if not removed, will render the analysis useless. Thirdly, after cleaning, an analysis tool needs to be developed that will provide useful insights and will deliver reproducible results.

Let us start with step one – data mining. In order for the data to be usable, it needs to have a uniform format. For legal expenses this would mean that all invoices need to be structured in the same way. This might be more of a challenge than it seems. For instance, in some countries associates are billed per years of experience starting from the first day of employment as a lawyer, while in other countries it is immediately post-qualification, or others merely distinguish junior associates, associates and senior associates. Some law firms have additional ranks such as managing associates. One of the first steps in getting usable data is finding a way to make the input more uniform. This will not only include how the invoice is split-out per level of experience but also a precise description of the activity on which time has been spent and by whom. The billing data should be structured in a way that it generates data for future analysis.

Along with tackling the problem of making the data comparable, is the challenge of cleaning the

data. Sometimes a single matter is billed over several invoices. These invoices could even come from different offices of the law firm that might be in different countries. Sometimes more than one law firm is involved. It is important to label all of these invoices correctly and assign all invoices to the correct matter. This problem is, of course, not unique to the legal industry and all CFOs face similar challenges in attributing costs to the right project. Data cleaning is one of the most difficult aspects of big data analysis. All data is 'unclean' by definition. Using uncleaned data for analysis will produce bogus results which cannot be relied upon.

Once we have obtained the right data in the right format and cleaned it, we can start analysing and trying to find meaningful insights. We need to be cautious at this stage not to draw the wrong conclusions. These could, for example, be conclusions based on too few samples. For instance, if last year a car dealership sold one convertible and this year it sold two, technically it doubled its sales. However, the small number makes this information unfit in order to draw meaningful conclusions. This is something that could also easily happen when analysing legal billing data. Even if the whole dataset is large, a subset for a certain legal area could be too small for useful analysis.

A second mistake is mixing up the concept of *causality* and *correlation*. Even if one finds a clear relation between them, it does not necessarily mean there is a meaningful connection. To illustrate this we will use the 'life vest' example. Investigation of data on people who have drowned clearly shows that most people who drowned were wearing a life vest. Knowing this, one could be tempted to advise against wearing a life vest as it seems to increase the chances of drowning. In this case there clearly is a correlation. However, there no causality as most people exposed to perilous situations on the water will more often wear life vests than those who are just swimming in a guarded pool. *Correlation* and *causality* should therefore never be confused.

Even if we do everything described above correctly, we could still end up with a data analysis that is not useful. Let me illustrate this with M&A transactions. Let us say that we have built a database with thousands of M&A transactions and we want to use this data to help predict the price for future M&A transactions – we still would not be able to do this. How come? The reason is that some of the factors that are most detrimental to the complexity (and thus the price) of an M&A transaction are not in the data. For example, the matter may involve multiple jurisdictions, or both parties may be experienced M&A players or one or both of them may be inexperienced. Also, one of the parties may be a family-owned business and there may be intellectual property rights involved or serious competition issues, and so on. These external factors are extremely important in predicting future cost/pricing but will typically initially not be included in the dataset. This means we will have to enrich the data before we can draw any meaningful conclusions.

Despite the fact that data analysis is a minefield, a small avant garde of the large in-house legal departments have achieved remarkable results. Over the years they have overcome most of the hurdles and have built enormous databases containing thousands and thousands of matters classified per law firm, per jurisdiction and per area of legal expertise. After more than five years in the making, many of these in-house departments know precisely how long a certain matter should take an external law firm to complete and what level of experience is required. The availability of this type of data has initiated a shift from focus on hourly rate to focus on efficiency and time spent. For the legal industry this means a fundamental shift in paradigm.

**Data and dialogue**

Today every single legal matter is littered with inefficiencies. Clients are aware that this is not all the law firm's fault. Sometimes clients want three conference calls where one would suffice. Sometimes, after a period of time clients send the law firm an important document which should have been part of the original file. However, sophisticated in-house legal departments are aware of this and are also hunting down inefficiencies on their own side. Based on analysis of the data, the goal is achieving greater value by finding and dealing with inefficiencies that do not contribute to the final result.

Clients looking to achieve more value out of the relationship with their external law firms is not a new concept – the process started back in 2008 with the launch of The Value Challenge. It is also something that clients want to achieve through a meaningful dialogue with their panel firms. Clients do not want to put law firms out of business, they just want a relationship that works for both parties, and increasing value is a central part of that.

What will be the result if it is no longer the hourly rate, but efficiency which becomes central to the conversations that clients will be having with the law firms handling their business? Just having this conversation consistently and repeatedly will by itself lead to an increase in efficiency. In 2017 the legal department of Shell won The Value Challenge because it had achieved a reduction of 25% on external legal spend over that year. This was the result of a data-based focus on efficiency. Other multinationals have achieved similar results. Through focus on efficiency rather than rates, clients are for the first time actually getting more value and a better deal.

**Sharing the data**

As illustrated with the example of Google and identifying cats, meaningful analysis will need large amounts of data. The big multinationals are well positioned for this type of data analysis as they spend huge sums of money on external legal counsel each year. Five or more years of data will be a good start for data-based analysis. But what if the data were shared with other in-house departments. Provided the data is formatted correctly and cleaned this would create a super database that would potentially benefit all in-house departments, including those which do not have the capacity to build their own data set for analysis. This is an initiative that I have recently been discussing with the leadership of the ACC. I believe the database should be an open source and should be managed by an independent party that is not looking to monetise the data. The ACC or the CLOC may be well positioned to manage a large database to which all in-house departments contribute and which will be accessible free of charge to every in-house department. Such a database will cause a seismic shift in the relationship between in-house and law firms. It is important to state that all data in such a database needs to be anonymised with no trace to the law firm or the client. It would give only a precise description of the matter, the jurisdiction and the time spent by level of expertise. This open source database would revolutionise the relationship and lead to unprecedented value for clients.

**What about law firms?**

For law firms, a focus on efficiency would have an enormous impact. The current business model of the leveraged hour is not easily compatible with increased efficiency. Performance measurement in most law firms monitors billable hours. Partners and associates are rewarded for making more billable hours. Not only do the incentives need to be adapted, but a more fundamental change is needed. Most lawyers are primed to do everything possible in order to achieve from a legal perspective the best result for the client. In order to achieve this, every risk is identified and every scenario is taken into consideration. If lawyers were plumbers, they would most likely instal gold plumbing as it would never corrode and never leak. However, the reality is that unless you are building a space station, you do not need gold plumbing – PVC pipes will do. The same goes for clients. In the majority of cases clients will be perfectly served with solutions that bear a certain risk. Clients themselves are used to working with the concept of 'risk appetite'. For a law firm this would mean a complete departure from the present way of working.

**Conclusions**

Experience has shown that focusing on the hourly rate is not an effective way for clients to get better value. A small number of forward-thinking legal departments of the big multinational companies have been putting a lot of effort into gathering data and making it usable for analysis. They have achieved phenomenal results and for the first time clients are saving on their legal spend. The 25% that Shell managed to achieve is a good example.

In order to make data available for each in-house department we need to create an open source platform that will not be commercially monetised. The ACC might be the ideal party to host this service.

Law firms will increasingly have conversations with their clients about how they can increase their efficiency. This will inevitably lead to more efficiency forcing the law firms to rethink and adapt their present business model from the leveraged hourly rate towards some form of value-based billing.

This shift in paradigm towards greater efficiency will transform the legal sector in an unprecedented way. Time to get ready for legal market 2.0.

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