

New Competition for Your Clients' Work

The acquisition of Pangea3 by Thomson Reuters has many in the industry continuing to raise questions about the growing role of alternative suppliers of legal services, such as the legal process outsourcers.

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The deal sent a clear message that legal process outsourcing (LPO) is very much a part of the permanent legal landscape. Additionally, a growing number of clients are trying to determine how much and what types of work can best be sent to third-party LPO vendors, and law firms worldwide are realizing that they cannot continue to function by simply hoping LPO will fade away. Others are curious to see if other major legal publishers will emerge with competing LPO offerings and, in doing so, if they will begin competing with their own law firm clientele. Regardless, LPOs have already created competitive pressure — which will likely now increase — and are projected to have an even greater impact on how commodity legal work will be handled by 2020.

Meanwhile, the Great Recession and the continuing recovery have brought about a “new normal” that has challenged and accelerated changes to the law firm model. Perhaps the biggest long-term challenge, however, is the question of what type of work should be done by law firms. The answer will most likely have the largest impact on the profitability and structure of law firms in the future.

Disaggregation Is Inevitable

Up until a few years ago, clients would ship just about anything tangentially related to legal to their firms. Little regard was paid to cost effectiveness or efficiency. Clients generally felt comfortable with the quality of the work, and viewed the additional value of having the law firm imprimatur as worth the expense.

Today, however, increasing cost pressures — coupled with advances in technology-enabled collaboration — have clients asking whether using expensive firm attorneys is the best and only way to get work done. While all agree that law firms are the right choice to provide strategic legal advice (e.g., setting and executing litigation strategy, reviewing complex mergers and

acquisitions, studying tax matters), an increasing contingency of clients are realizing that much of the “downstream work” can be done much less expensively, often faster and sometimes better by sources operating outside the auspices of a law firm.

For example, the unprecedented proliferation of electronic documentation and email throughout the business world has caused an explosion in the amount of documents to be reviewed as part of the discovery process. While it makes sense for experienced litigators to determine the guidelines that can be used to determine if a document is responsive, many find that lower-level staff or outside resources can be deployed to follow those guidelines. Already clients have largely turned from using expensive law firm associates for these types of reviews, and instead are relying on the law firms to manage less expensive contract attorneys. Many types of “commodity” work can be done outside of big law firms via technology and contract attorneys, such as contract life-cycle management, patent portfolio updates and legal research.

People, Process and Technology

Legal process outsourcing firms are known for providing low-cost professionals, typically in overseas locations. But LPO vendors are not simply “international staffing companies;” instead, they consider themselves specialists in commodity legal work and they combine people, process and technology in their approach.

Legal technology companies, by their nature, try to solve every problem with technology, but the best technology is not always enough. Staffing agencies, by their nature, provide teams of low-cost people who can do a great deal of work at a low hourly rate, but are not necessarily focused on efficiency and typically leave day-to-day management to the client (or law firm). Both have their place, but can really only be considered tools. Through the combination of low-cost staff, innovative technology and a systemized project management approach, LPO vendors



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take these common forms of disaggregation one step further. Rather than just acting as a tool to be deployed by clients and their firms, LPO firms deliver work product to their clients.

Changing Industry Dynamics

As a result of the growing popularity of the new LPO approach, law firms and in-house legal departments alike are still grappling with the dynamics of the tripartite relationship between counsel, client and LPO vendor. While all three parties are still trying to find their place — including a growing divergence in law firm strategies regarding their approach to commodity level work — a number of trends are favoring LPO.

In addition to the validation demonstrated by respected players like Thomson Reuters entering the LPO market, a number of other trends strengthen the position of LPO. These include the growing demand for price certainty, both from LPO and law firms offering alternative fee arrangements (AFAs); improved technology, which eases communication across long distances; ethical clarity regarding third-party legal vendor collaboration; and the forthcoming changes in the United Kingdom with the Legal Services Act and alternative business structures (ABSs), which could tilt the legal profession toward a more innovative paradigm.

Further changes to the firm-client dynamic are simply a result of the different approach and increasingly divergent value proposition of LPO vendors. For example, contrary to popular belief, LPO firms aren't simply competing on cost. While cost pressure is undoubtedly a driver, outsourcers can offer better capacity management, more defensible quality standards (based on highly delineated standards and repeatable processes) and often higher quality work based on leveraging certain cultural advantages, such as the contentment of overseas attorneys working on projects that law firm associates might consider boring, repetitive and mundane.

What Does Partnership with a Legal Publisher Mean?

The acquisition of Pangea3 by Thomson Reuters has been a catalyst for asking many of these questions. Law firms have historically been able to defend against LPO vendors because of the outsourcers' small size, tight budgets and limited sales and marketing expertise, newness to the legal industry, and the plain-old outlandishness of having work done by strangers overseas. But ownership by Thomson Reuters obviates most of those arguments. The company is in a strong financial position with big marketing budgets and experienced management that knows how to sell legal-related services. The company is highly trusted by general counsel and already considered an “approved vendor” by legal and procurement departments. If anyone has the expertise, capacity and money to deliver the message of disaggregation, it is the large legal publishers.

But what does this mean for Thomson Reuters' law firm client base? Are they now competitors? Despite the lack of fanfare, legal publishers have been “competing” with law firms for many years. All three major legal publishers (Thomson, LexisNexis and Wolters Kluwer) sell electronic billing software, which is designed to help clients reduce law firm costs. In fact, the publishers' core research databases are themselves efficiency tools that allow attorneys to do more work in less time, and thus bill less.

How Should Law Firms React?

Law firms have frequently competed thus far by calling into question the viability of LPO vendors or the quality of their work, or claiming LPOs by nature violate legal ethics. Some take a more tactful, but equally intentioned, approach, expounding upon the superlative sophistication of every piece of work performed by their firm. In short, the argument is that

nothing an LPO vendor claims they can do is capable of being performed by anyone or anything except a big firm.

Of course, LPO vendors are maturing and clients are questioning how much work must be done at the law firm level, making these defenses unlikely to hold much longer. In fact, some — including (now former) Howrey CEO, Robert Ruyak — told *The Wall Street Journal* that challenges from LPO and other alternative legal vendors undercutting law firm pricing were one of the reasons for the law firm's recent demise. "Another challenge was the rise of third-party document-discovery specialists that could provide litigation support services at substantially lower rates," Ruyak said.

With the LPO industry — at least as part of the broader community of alternative legal service providers — now having the ability to rock some of the pillars of the legal profession, it certainly conveys a significant and growing strategic importance to law firms. Even firms far from demise are seeing profitability being chipped away. From a strategic perspective, we see there are three viable paths for law firms to follow: collaborating with third-party LPO vendors, developing internal captives or eschewing commodity work altogether.

Rather than ignoring and distancing themselves from the work that can be done by LPO, firms can either embrace LPO vendors and form partnerships with them, or create new business models to deliver commodity work on a similar basis. Law firms might not be able to continue to bill associate rates for work that can be done just as effectively by contractors (onshore or offshore,) but by working closely with LPO firms, they can ensure they control the deal, collect fees for project management and quality control, and remain a trusted advisor by providing clients with new, innovative and cost-saving solutions. This approach is likely to become increasingly favorable as law firms embrace alternative and fixed fee structures, which can reward innovation and efficiency.

Alternately, law firms can build low-cost operations within their walls. Many are already managing contract attorneys, and some firms have created special practices to deliver commodity work outside the partnership track. Much can be said for this model, as clients already trust their law firms and prefer to work with them enough to be willing to pay a premium to do so. How big a premium and how well firms will be able to keep pace with the innovation culture of alternative vendors are still open questions.

A third option, of course, is to eschew commodity work altogether. There will always be room for firms that focus only on delivering high-level strategic advice, and even in these times there has been limited rate pressure on that type of work.



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However, it has been high-volume commodity work that has been pushing the profitability of many firms for the past 25 years. A firm willing to deliver only strategic work, with no leverage, will likely succeed, but might not be able to grow. Also, some significant changes to the law firm structure and culture might be required. But the days of providing legal-related services that need not be done by expensive, partnership-track attorneys are coming to an end for most firms.

A Time to Reconsider

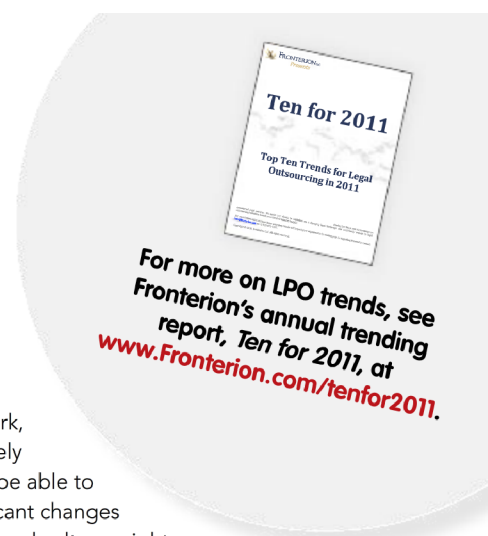
The legitimacy and investment of legal publishers joining the LPO industry does mark the need for firms to perhaps reconsider the implications, bearing in mind that many of the barriers to LPO collaboration are successively falling away. Law firms are finding themselves in a three-part (client, firm, vendor) relationship, rather than the symbiotic partnership they were so comfortable with for so long.

LPO vendors provide services differently than traditional law firms. They provide a unique value proposition that combines elements of staffing agencies, legal technology vendors and rigorous project management, and are positioned to do commodity work at a level against which law firms really cannot compete. Responding with simple rate cuts is not the answer. Firms have a choice of several approaches and, while a single model might be elusive, it is clear that choosing the right path is crucial for long-term survival.

LPO vendors are definitely on the rise and disaggregation is here to stay. By 2020, we believe that clients will be comfortably in the habit of asking themselves if a traditional, big law firm approach is required for each and every piece of work. Alternative legal service providers, such as technology solutions, staffing companies and LPO vendors, will carry more and more of the burden. Law firms with a strategic plan that takes that into account, either by staffing appropriately to deliver only high-level work or leveraging firms' historical trusted-advisor relationship to improve profitability, will thrive. **ILTA**



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For more on LPO trends, see Fronterion's annual trending report, *Ten for 2011*, at www.Fronterion.com/tenfor2011.