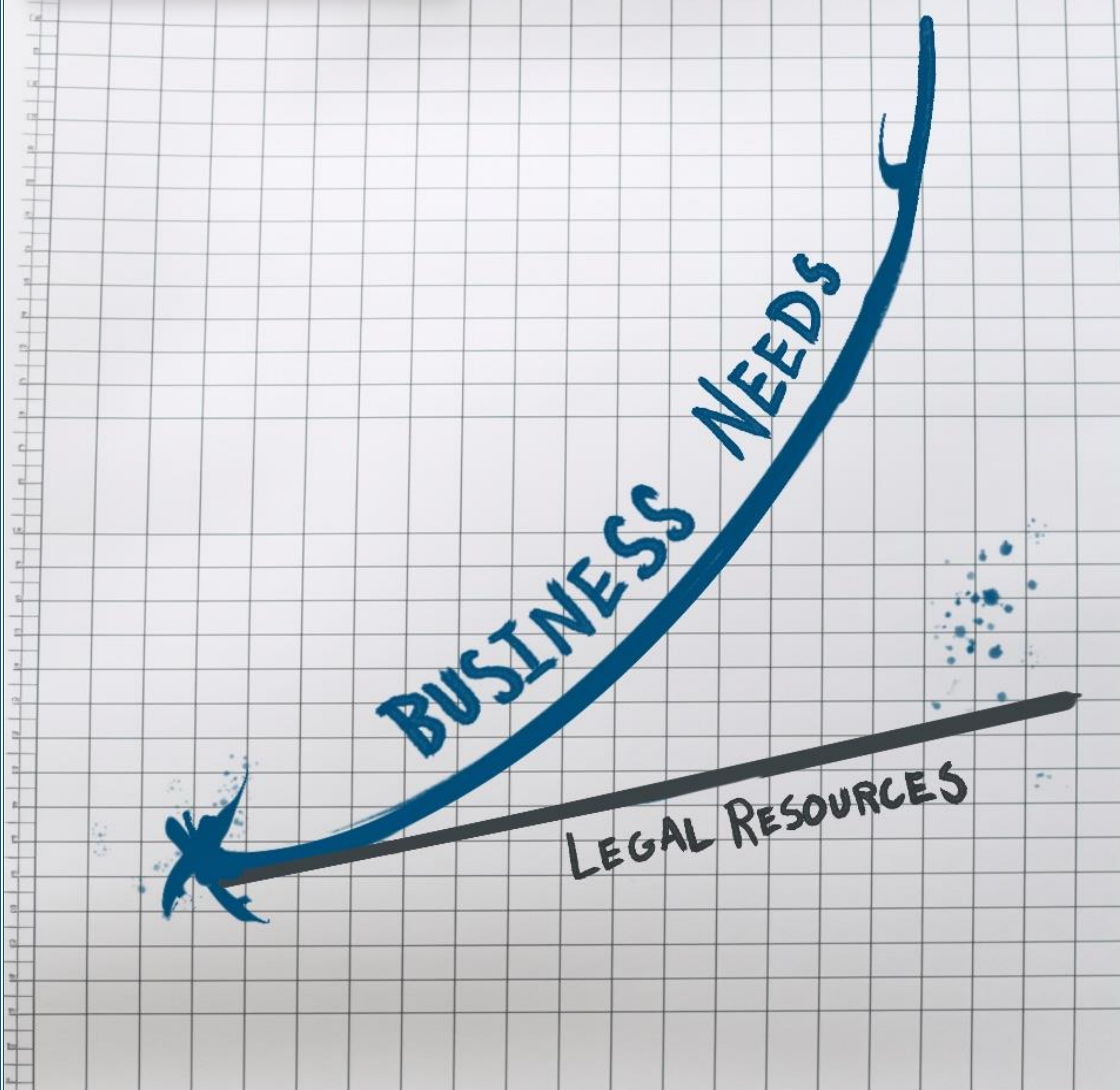

THE ROAD NOT TAKEN

an alternative path for preferred-provider programs

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EXECUTIVE SUMMARY

Structure. The evolution of the preferred-provider program would result in a four-part structure, two prongs of which would be mostly new:

1. *Portfolio* – strategic partnerships for large portfolios of work on predictable fees with declining unit costs built into multi-year contracts.
2. *Panel* – internally vetted providers for work too inconsistent for portfolios but sufficiently frequent and business critical to merit mutual investment in panel relationships.
3. *Marketplace* – searchable database of externally vetted providers for novel and infrequent work that falls outside portfolio or panel relationships.
4. *Extraordinary* – work with such significant business impact it warrants identifying and vetting firms not already onboarded through portfolio, panel, or marketplace arrangements.

Flow. Extraordinary exceptions (#4) are already available for step outs from the current panel (#2). The evolution would therefore be:

- Systematically packaging meaningful tranches of work and entering portfolio-level arrangements geared towards solving for scale. Importantly, portfolios can be packaged over time—every portfolio need not be implemented immediately nor simultaneously—and are not limited to traditional law firm relationships (e.g., Integrated Law).
- Reducing the number of smaller panel arrangements and enabling the marketplace to absorb less frequent panel work because panels naturally skew towards larger, more expensive firms and the effort required to offset this skew—i.e., enlarging the panel—reintroduces variants of the administrative burden the panel was created to redress.

Objectives. The primary objective is always to enable the business at scale and pace. The supporting objectives are to do so cost-effectively and sustainably. To further these core departmental objectives, the project objectives for transforming the preferred-provider program as outlined are:

- ☐ *Solving for scale*. Reducing the ratio of legal resource inputs to business outputs—not merely reducing the unit cost of legal labor (i.e., insourcing, discounts).
- ☐ *Right sourcing*. Ensuring internal labor is put to its highest use and external legal labor reflects the proper mix of expertise and price level.
- ☐ *Reducing administrative friction and refocusing administrative resources*. As the program matures, re-allocating attention from ‘who’ gets the work to ‘how’ the work gets done.
- ☐ *Reframing DEI efforts.* Centering the hiring and career progression of diverse professionals despite tradeoffs with other objectives (e.g., administrative burden, cost control).
- ☐ *Revisiting the entire value chain and utilizing all levers to drive cost-effectiveness.* Taking a total-cost-of-ownership perspective grounded in business value.

EXPLANATORY MEMORANDUM

Attention is in scarce supply. The single-page Executive Summary offers a digestible overview. The assignment, however, is to explore the adjacent possible. Change, rightfully, invites scrutiny. Different often demands detailed explanation. This Memorandum aims to add explanatory depth but is deliberately organized for skimming to enable readers to focus on areas of interest.

CONTENT

CONTEXT

1. ***The enterprise's legal needs are increasing.*** The business operating environment continues to become more legally complex. Expertly navigating this complexity is critical to the business.

2. ***The enterprise's willingness to allocate resources to the legal function does not, and will not, increase in a proportionate manner.*** Legal enables core activities but is not itself a core activity. Given the natural preference to allocate finite resources to core activities, the gap is growing between business needs and the legal resources available to satisfy those needs. This gap will continue to widen if current trajectories are maintained.

3. ***The status quo is unsustainable*****.** The principal mechanisms for addressing more business needs with relatively fewer legal resources have involved reducing/controlling legal labor costs (e.g., insourcing, discounts). Right sourcing entails finding the right personnel at the right price point. Right sourcing is essential but fundamentally concerned with the unit economics of legal labor—i.e., how much the labor costs. Right sourcing is necessary but not sufficient to bend the cost curve long term because it does nothing to address the total demand for legal labor, which continues to increase.

4. ***Economic uncertainty and unprecedented automation opportunities have only accelerated an inevitable reckoning*****.** The broader economic climate has subjected legal spend to heightened scrutiny. The rise of generative AI has recalibrated expectations of how knowledge work should be delivered while also introducing net new legal considerations that must be addressed to properly support the business's own efforts to modernize its operations. The law department will need to not only incorporate this next-generation tooling but also ensure technology is being properly employed throughout the legal value chain (i.e., more attention to 'how' work gets done, internally and externally).

5. ***Insourcing alone is not a viable, long-term approach*****.** Insourcing delivers immediate savings while also enhancing proximity/accessibility. But insourcing has natural limits (e.g., niche expertise, jurisdictional variety, peak load), and new headcount requests trigger objections that extend beyond the fiscal math of whether internal resources are less expensive than analogous external resources. Headcount is subject to soft and hard constraints, especially during periods of economic turmoil when savings pressure is most acute. Headcount also comes at the cost of agility—increasing communications overhead and encumbering change initiatives as it embeds labor-centric means of production.

6. ***Sustainable spend optimization is a more calibrated objective than immediate savings*****.** The path of least resistance has been to take advantage of simple labor arbitrage and capture the associated savings. But the path of least resistance leads to path dependence. Short-term easy is long-term hard. While cost discipline is essential business hygiene, the only viable path forward is investing in projects that progress the legal value chain's ability to meet business needs at scale and pace. Pursuing scale requires optimizing resource allocation over an extended time horizon rather than maximizing immediate savings.

7. ***To meet business needs, the legal function must solve for scale, internally and externally*****.** The only way to do more with less is to get more from less. Resources must therefore be allocated to projects that progressively reduce the ratio of legal-resource inputs to business outputs—i.e., moving beyond the unit economics of legal labor to the unit economics of enterprise outcomes, of which legal labor is only one component. This requirement extends to the selection and active management of external providers.

8. ***Traditional preferred-provider relationships are too ambiguous and too amorphous to drive adequate investments in innovation.*** Voicing vague expectations that preferred providers innovate because they have the opportunity to serially compete for diverse, uncertain mandates does not result in the requisite focus and investment. The commercial context needs to change to drive service-model innovation. Clients, explicitly and implicitly, set the commercial context.

9. ***Administrative resources are too concentrated on 'who' wins the work rather than 'how' the work is executed.*** Labor-intensive sourcing decisions from RFPs to step outs consume finite attention and crowd out efforts to scale delivery.

10. ***A matter is not always the appropriate unit, and law firms are not the only viable suppliers.*** Matters can be packaged into portfolios. So, too, can their component parts (e.g., diligence, document review). Managed-service relationships with law firms are entirely feasible, as are relationships with law-firm alternatives (e.g., law companies, Integrated Law).

11. ***There are immediate savings levers beyond direct labor costs.*** Electronic discovery. Diligence. Mediations and arbitrations. Court reporting. Subpoena responses. There is all manner of direct and indirect costs that, in aggregate, represent immediate savings opportunities. A holistic view of legal spend is a must. Otherwise, the design of the preferred-provider program will be compromised and over-indexed to meeting immediate savings targets through traditional means.

12. ***Valuing diversity requires willingness to pay the price for diversity.*** While cost discipline and reducing administrative burden are understandable points of emphasis, they often dampen DEI efforts. An effective DEI initiative must absorb the search costs of identifying diverse professionals and, in certain scenarios, should pay a premium for their services to ensure careers are not negatively impacted by servicing a client aggressively exercising its buying power. Most importantly, you must hold yourselves, not just your law firms, accountable for hiring diverse professionals.

13. ***There is no change without change.*** Your system is optimized to produce its current outputs. Dissatisfaction with those outputs is necessary but not sufficient to drive change. If you want different, you must accept different. Different decisions. Different decision makers. Different ways of working. Different definitions of success. This includes buying differently—different criteria driving different relationships with different suppliers and different supplier types.

14. ***Meaningful change requires leadership, choices, effort, attention, and patience.*** If it were easy, it would already be done. The longer you play the short game, the harder the long game becomes. There are no viable shortcuts. Under-resourced, aspirational exercises on infeasible timelines consume scarce resources. Quarter measures are often pure waste while half measures end in folly. Your objectives require sustained focus and true leadership buy-in. Leadership includes taking your people places they would never get to on their own. Buy-in means there is a price to paid in political capital to ensure skeptics—of which there will be many—disagree & commit rather than acquiesce & undermine. We do not change minds to change behavior. We change behavior to change minds. Consensus must be created, rather than merely expected.

15. ***There are no risk-free, tradeoff-free alternatives, including the status quo.*** You are placing bets on an uncertain future. Big bets should be interrogated thoroughly. Succumbing to inertia is betting big on the current direction of travel being sustainable. The status quo, however, is often exempted from critical analysis because doing nothing differently is the default. But choosing the devil you know is still a choice. Choices have consequences. Because choices have consequences, they are subject to challenge. Any choice to change will be challenged. Yet, it is not enough to surface the risks and tradeoffs of

change without subjecting the choice not to change to the same scrutiny. Regardless, a risk-free, tradeoff-free option will not present itself by process of elimination.

Law departments proceed from flawed premises. The flawed premise general to knowledge work is it should be organized like physical work—with static roles repeatedly performing the same sets of activities. Under this premise, knowledge outputs are a product of labor inputs—more output requires more labor. Most knowledge work, however, should be organized around projects that produce knowledge and embed that knowledge upstream in business processes to improve outcomes, velocity, and leverage (i.e., compliance by design).[1] Alternatively, projects should produce scalable programs that optimize resources to sustainably enable the enterprise.

The flawed premise specific to law departments is that legal functions are lower-cost alternatives to law firms that should be able continuously improve the delivery of legal services while also continuously decreasing the costs thereof *despite* largely adhering to the labor-centric law-firm model—with static roles repeatedly performing the same sets of activities. Under this premise, the primary path to legal cost reduction is to reduce the unit cost of legal labor through insourcing. Insourcing can deliver demonstrable savings. But the arbitrage of buying lawyer hours in bulk on flat fees does not decouple business needs from legal labor. Insourcing neither addresses demand drivers nor solves for scale.

Critically, these are premises. These premises predate the formation of the legal function. Enterprises create law departments to serve as captive law firms—and then continue to characterize them as such. The enterprise sets the time horizon (i.e., right now) on which law departments operate. While leverage/technology/innovation receive regular lip service, projects to produce leverage are almost always subordinate to performing legal work, which is all consuming. In-house lawyers are doing precisely what they are trained and hired to do. This is sufficient until it isn't—when workload outstrips capacity and budget.

Ultimately, a legal function starved of the resources required to meet increasing business needs will fail to meet business needs. As long as the relationship between business needs and legal labor remains linear—i.e., an increase in business needs results in a proportionate increase in the need for legal labor—the probability of not meeting business needs will be high because the probability of adequate resourcing will be low.

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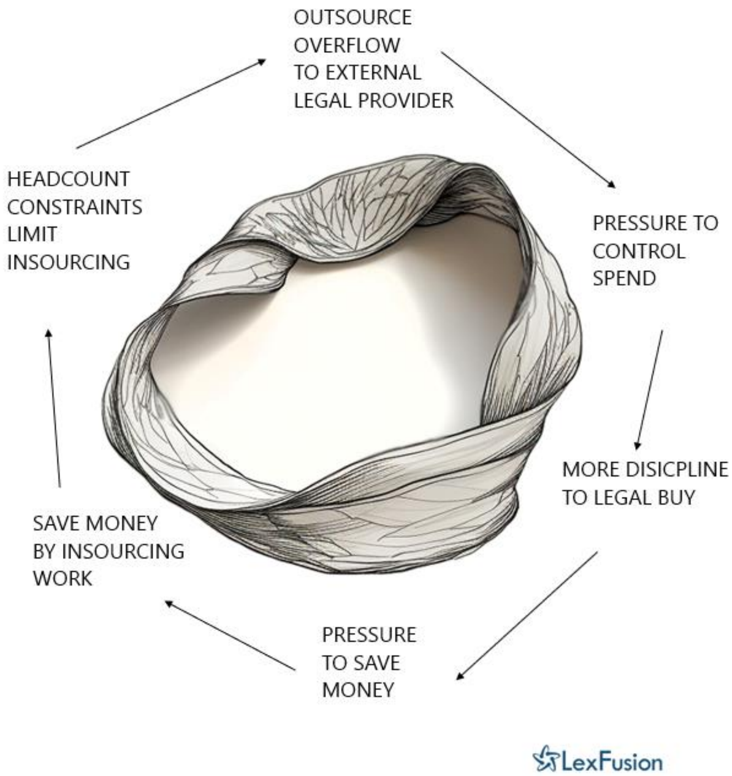
[1] Projects involve a series of planned activities designed to generate a deliverable (a new process, a program, a product, a service, an event). These activities, which can be anything from incremental improvements to transformational initiatives, are limited in time—i.e., have a clear start and definite end. Project are designed to create predetermined forms of value, impact, and benefits. These returns require investment in the form of fiscal, human, and organizational capital. To be a project, some aspect will have not been done before—every project has elements that are unique.

The self-perpetuating savings cycle. In the current paradigm, costs can be controlled *or* work can get done, but not both (over any extended time horizon).



This dynamic is often observed when the economic environment leads to the imposition of simultaneous (i) hiring pauses and (ii) cost-cutting mandates. Enterprises regularly find that, after an initial dip, total legal spend still increases because the pause on insourcing merely routes more work to expensive external providers—i.e., enterprises can't freeze their legal needs by fiat.

Intermittently, enterprises do experience raw reductions in legal spend. Enterprises that have gone for long periods without much insourcing or imposing discipline on external expenditures can capture considerable reductions in legal spend when they finally pluck the ripe, low-hanging fruit. But these levers merely reset the upward spend trajectory to a lower baseline—i.e., they do not fundamentally bend the cost curve.

The traditional levers are also subject to diminishing returns. Insourcing hits its limits, and external cost control reaches an equilibrium. Once you've right sourced (necessary) at market prices (necessary), there is not much room left to maneuver on labor costs. Meanwhile, demand for legal labor continues to rise, as does the cost index thereof. The resulting discontent with seemingly run-away legal spend only reduces the enterprise's willingness to allocate resources to the function—and the gap between business needs and legal resources continues to widen.

The frustrations of external legal resource management.

1. *Enterprises do not determine their own demand for legal services.* Enterprise demand for legal services is largely inelastic in the near term. If an enterprise decides to cut spend on marketing or R&D, those cuts hold until different decisions are made. But periods of economic turmoil often generate net new legal work—e.g., COVID-era policy panics; navigating a reduction in force. Regulatory reporting requirements do not abate. Lawsuits and investigations are not put on hold because their target desires to control

costs. Indeed, even if an enterprise experiences an extended period of fiscal stagnation, relative legal needs still increase due to net new regulations it did not ask for—i.e., many inescapable legal demand drivers are exogenous to the enterprise.

2. *The lack of control is paired with a lack of predictability.* There are an estimated 5 million regulatory bodies worldwide. New regulatory requirements come from all directions. Same for lawsuits and investigations. Likewise, enterprise pivots in reaction to a shifting economic landscape are business drivers of legal needs not within the law department's ambit of control. Volume volatility is exacerbated by the often intractable nature of the work itself. Legal-laden business activities frequently entail interacting with independent third parties—regulators, counterparties to contracts, opposing parties to lawsuits—whose decisions are cost drivers.

3. *Data rich, information poor.* Information is data organized to be useful for decision making. While legal billing data is abundant, legal pricing information is scarce. Part of this is the semi-intractable nature of legal work involving independent parties, known unknowns, and unknown unknowns. Part of this is bad historical data habits, including the lack of industry-wide data standards (why everyone should support SALI). Part of this is intentional opacity. For example, the only reliable source for law-firm rate benchmarking, Thomson Reuter's Peer Monitor, is not available to law firms' corporate clients. And it is not just pricing. Most settlements (i.e., outcomes that typically dwarf the expenditures on legal services) are private and therefore impervious to analytics outside the enterprise's own limited data set. Fortunately, very few contracts, intellectual property protections, policy decisions, etc. are ever subject to legal action. Unfortunately, this means the quality thereof is rarely stress tested. Because we can't benchmark outcomes, we possess poor proxies for lawyer quality—not an experiential good but, rather, a credence good often treated as a Veblen good. The result is overreliance on relationships and the proxies of brand/pedigree/price.

4. *Quality matters, and quality costs*. Despite the absence of solid empirical measures, lawyer quality often has material business impact. Thus, not only is enterprise demand for legal services near-term inelastic, so, too, is the supply of lawyers able to properly meet that demand. Before the modern era, essentially all lawyers were external. The dominant practice was to source all legal work to a single law firm. The rise of large law departments fundamentally changed not only the locus of legal service delivery (most of which now occurs internally at large enterprises) but the approach to legal buy. Among the founding mantras of the in-house movement was "we hire lawyers, not law firms." Shedding the sole-source approach, hiring lawyers internally heightened the focus on hiring quality lawyers externally (conveniently, in-house lawyers themselves serve as the arbiters of quality). While law departments generally overstate the paucity of substitute goods at lower price points, outsiders operating without domain expertise (e.g., procurement) often profoundly overestimate fungibility. Lawyer quality, specialty, and (often) jurisdiction impact business outcomes—it is a bad business decision to hire just any lawyer, you require good lawyers fit to purpose.

5. *Search costs and switching costs are high*. Finding a good, fit-to-purpose lawyer can be a challenge. Finding an equivalent lawyer at a materially lower price point is even more challenging because of the way market prices work. Moreover, even if an equivalent lawyer is identified at a lower price point than an incumbent, the new provider must be onboarded. Ramp-up is resource intensive. Reaching minimum fluency with organizational context commands scarce attention from both internal and external resources. Onboarding new external resources creates drag in areas that often demand speed and consumes bandwidth in a bandwidth-constrained environment.

6. *Legal spend can be significant in raw dollars but is often a rounding error in relative dollars, especially in comparison to the priorities legal spend supports.* Among Global 200 companies, total legal spend averages ~0.10% of revenue. The internal/external split is roughly 50/50. External spend is therefore ~0.05% of revenue. Thus, a savings goal of 20% on external spend is ~0.001% of revenue (i.e., $10 for every $1,000,000 in revenue). No company is average. Many spend much more. Most have different splits. But the bottom line is that incremental savings on external legal spend have de minimis significance for the corporate bottom line even if the savings translate into rather large numbers in raw dollars (as everything does at large enterprises, inducing denominator blindness). Meanwhile, the initiatives this spend is directed at supporting range from annoyingly necessary to strategically vital, with orders of magnitude more business impact than some small variance in total legal spend.

   In short, controlling legal spend is far less of a priority than the priorities the spend supports. This is good because controlling aggregate legal spend has proven rather difficult despite law departments so frequently "winning" superficial price concessions from external providers—the primary outcome of most preferred providers programs.

Preferred-provider programs often fail to deliver. Anarchy is the natural state of retaining external legal resources. Autonomy-inclined stakeholders engage whatever legal provider they select at whatever price level is agreed. *We hire lawyers, not law firms* becomes expensive and cumbersome as the enterprise grows and needs diversify. The motivations for a preferred-provider program can be myriad but tend to boil down to controlling costs and reducing administrative burden.

Cost control is self-evident. Administrative burden is less glaring. Each new provider adds administrative effort in terms of onboarding and oversite—from paying invoices to ensuring compliance with data-security obligations. In theory, consolidating work with a subset of preferred providers alleviates administrative overload and enables the enterprise to concentrate its buying power to drive down costs—fewer negotiations, more negotiating leverage.

Countless awards have been won by law departments who have drastically reduced their provider count and secured fat discounts that translate into spectacular savings. There are, however, many reasons these achievements often fail to sustainably deliver the desired results in practice, including:

- **The savings are fake**. Simplistic savings math introduces perverse incentives to choose the most expensive option and then spend as much as possible—every incremental discounted hour *simultaneously* contributes to total spend *and* total "savings."
- **The discounts are fake**. As soon as demanding discounts became a norm, law firms, as rational economic actors, raised their rates to create flexibility to offer differentiated pricing.
- **These are largely one-time lifts**. A buyer of consequence who has never exercised its negotiating leverage to maximize discounts can secure major concessions, especially since firms have raised rates to offer differential pricing to other clients already demanding discounts. But once you've negotiated suppliers down to their lowest rate, the only direction thereafter is up, unless you are willing to switch to a lower-cost provider—a more fraught endeavor than capturing discounts from incumbents.
- **The goals are in tension**. The fewer providers, the more practice-area and jurisdictional coverage per provider—i.e., larger firms. Law-firm size is positively correlated with law-firm price tag. Larger firms are generally more expensive. Thus, in traditional programs, tradeoffs are unavoidable. An expansive network of preferred providers does little to reduce administrative burden. Yet a narrow network of preferred providers often skews toward larger, more expensive firms.

- **Administrative burden is more redistributed than reduced**. Selecting preferred providers is a project (work) that results in a program. For the program to function, it must be administered (more work). Administration includes ensuring the program actually awards preference—far from a natural occurrence.

  Frequently, a small team is instructed to design a preferred-provider program, but they are not empowered to award mandates to the selected providers. Rather, other in-house personnel retain selection discretion, and exercise it as they always have. The outcome is that work is distributed as it always has been. The project is pure waste excepting the discounts secured from providers the enterprise already engages on a regular basis—i.e., a self-aware project charter would have limited the scope to negotiating discounts with repeat providers.

  Alternatively, selection discretion is curtailed. But this increases the burden of handling novel work. A parade of unfamiliar issues is a by-product of the legal operating environment becoming more complex. Because prescience is in short supply, no providers are empaneled for the purpose of handling the unforeseeable. And search costs are higher within an artificially circumscribed talent pool.[2]

  Because the right lawyer cannot always be found within the preferred-provider network, step outs must be permitted. This becomes a process; a process autonomy-seeking in-house lawyers can exploit. The more step outs, the less effective the program. But fewer step outs mean greater administrative friction (to limit step outs) or less optimal provider selection (because step outs are made so onerous they discourage legitimate use).

  After implementing a preferred-provider program, many enterprises often still utilize more non-preferred providers than preferred providers while adding considerable administrative load to maintain and reconcile these dual tracks.

- **The main drivers remain unaddressed**. Billing rate is not price, but, rather, a multiplier of the primary variable: hours. Hours are a manifestation of demand. Most preferred-provider programs do nothing to control demand nor the relationship between demand and hours (i.e., 'how' work gets done). If demand continues to increase, so will outlays. A perfectly executed rate re-adjustment is, by definition, a one-time lift—driving providers down to market price. Market prices continue to increase. So, too, do hours. And, while there are lasting fiscal benefits to resetting the baseline, you will be on the same upward trajectory as before.

Some of this can be mitigated, but not without additional tradeoffs. For example, a few law departments have become more sophisticated at sourcing, programmatically utilizing mechanisms such as:

- *Matter-level RFPs*, including reverse auctions, to ensure providers compete on price
- *Matter-level negotiations* to further maximize price concessions
- *Matter-level safeguards* like budgets, caps, flat fees, or holdbacks to maintain price integrity

These processes can certainly be effective at keeping relative costs in check. But they introduce considerable friction to the point where, eventually, the preferred-provider program creates more administrative burden than it alleviates. The tradeoffs often pencil because the savings exceed the personnel cost of the additional

[2] Preferred providers are go-to firms for regular work. Search occurs for work where provider options are nonobvious. If we need to identify a niche expert to address a novel or obscure issue, we are more likely to surface clearly qualified candidates if we query 100 firms likely to have that expertise rather than 10 preferred providers who might. In the latter scenario, we also end up sorting through the not-quite-right options to justify a step out. Thus, higher search costs.

effort. Absent from the calculation, however, is the opportunity cost of finite attention—i.e., beyond consuming scarce internal bandwidth, with everyone fixated on *who* gets the work at the matter level, there is no capacity available to advance *how* the work gets done at the system level.

In sum, traditional preferred-provider programs can accomplish a fair amount in controlling relative costs, though are not automatically effective because of a natural skew towards larger, more expensive firms. Preferred providers programs that are effective in controlling costs tend to be far less effective at reducing administrative burden, and often increase it. And even successful cost control results in mostly one-time lifts that do not address demand drivers nor solve for scale—rather, the preoccupation with maximizing immediate savings crowds out efforts to drive systemic improvements with sustainable ROI.

An example of an alternative: work packaging. Commencing with a composite exemplar may make the concept of packaging more accessible and concrete:

> A large in-house department targeted a discrete type of repeat litigation they inevitably faced (inherent to the business) across many jurisdictions. They broke from their traditional practice of hiring law firms on a matter-by-matter basis and instead selected firms as near-exclusive providers within delineated territories (the firms' coverage areas not only factored into selection but also informed territorial boundaries) on three-year, declining, flat-fee contracts with automatic adjustments if matter volume fell outside an expected range based on historical data. The contracts also introduced KPIs (e.g., settlement value, settlement stage, speed to resolution), a tailored data strategy, a requirement to produce shareable knowledge assets, and continuous-improvement commitments (each firm must demonstrably improve some aspect of their service-delivery infrastructure every year).
>
> In tandem with this programmatic approach, the in-house department undertook a project to automatically assemble and synthesize reports they'd previously manually collected and sent to outside counsel. Before the project, outside counsel expended an average of 8 hours per matter compiling the relevant, matter-specific information from disparate reports. After the project, outside counsel only needed to review the automatically generated synthesis (though the source materials were still provided in the delivery packet).
>
> The in-house department also consolidated all attendant ediscovery with a single provider, establishing a specialized review team and iterating on technology-assisted review models that could be applied across matters in the portfolio.
>
> Freed from the administrative burden of matter-by-matter firm selection and matter-level invoice reviews, as well as the communications overhead of dealing with so many firms, the in-house lawyers redirected their efforts to their own KPIs. Their objectives were to drive down (i) total volume on a relative basis (through root-cause analysis/prevention) and (ii) total cost of ownership (settlement values, internal resource load, business disruption). This entailed not only portfolio-level projects (e.g., the automated assembly of the reports) with an emphasis on moving upstream into the business but also propagating firm-level best practices and innovations across their consolidated provider network.

> The program will be re-assessed near the conclusion of the three-year term. The data strategy, knowledge assets, and tactical use of fallback firms should make the work more portable than it ever has been. But sustained investments in service delivery should rightfully earn incumbent firms a cumulative advantage on cost effectiveness when seeking renewal.

Work sorting is the foundation of the example. The portfolio approach is premised on identifying and grouping similar matters.

But not only matters. In the example, work was decomposed to permit the complementary packaging of tasks. The report assembly was about automating a specific task. Unbundling and re-packaging ediscovery was about bringing economies of scale to a discrete set of tasks—and, in fact, the ediscovery carve out was applied to other litigation profiles—and indicative of the opportunity to blend diverse supplier types (i.e., not only law firms) even within a single matter.

The direct cost savings were eventually significant but deliberately delayed. The program was cost neutral in year one. That decision, combined with the volume and multi-year term, afforded the law firms the opportunity to make the investments necessary to ensure the work would remain profitable even after payments declined in years two and three. The guardrails protected the firms from the downside risk of too much volume, and the client from the risk of too little. Volume also insulated the firms from pervasive matter-to-matter variances (the law of large numbers) while the flat fee provided the client with predictability.

The savings were also delayed because the law department funded the automated report assembly project instead of capturing the more immediate savings available from hiring internal resources to manually synthesize the reports. Humans are exceptionally plug-and-play. Labor arbitrage offers the fastest route to cost reduction. Replacing eight hours of billable time per matter, the savings math supporting new hires was strong. The savings from labor-centric insourcing also would have been guaranteed. The cost of the automation project was more than monetary expense, it introduced delay and the real risk of failure.

Moreover, the law department did not maximize cost control. They expressly eschewed 'shadow bills' for the purpose of calculating savings—a common practice that disincentivizes innovation.[3] Thus, they sacrificed the putative savings of capturing the manufactured delta from pairing aggressive rate increases with aggressive rate discounting. Under this alternative math, it is conceivable the law department could have shown even better by negotiating on a matter-by-matter basis.

Even more explicitly, the law department did not select the lowest bids. They selected competitive bids from firms suited to the new approach (service-model innovation, collaboration, accountability for continuous improvement) and most likely to secure the best net outcomes for the enterprise (because the monetary stakes far exceed the legal fees).

Further, they did not take full advantage of the portfolio arrangements, which were only "near exclusive." Much as manufacturers will send 5-10% of orders to a secondary supplier so they are not beholden to a single source of failure, the law department siphoned off a pre-determined percentage of portfolio matters to experiment and maintain relationships with fallback firms.

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[3] Many law departments are obsessed with "winning" and "losing" flat-fee arrangements. They use shadow bills to baseline. *How much would it have cost under a traditional billable hour approach?* If the shadow bills indicate a matter would have been less expensive under hourly fees, that is a loss. Some law departments have even asked their firms to write them a check to make up the difference, and are perversely proud of this fact. Such zero-sum thinking disincentivizes any effort by law firms to reduce hours or enable the use of lower cost resources.

The narrow use of fallback firms was one of many ways the law department chose not to maximize administrative ease. While they eliminated much of the matter-level administrative load (from RFPs to invoices), they added new administrative requirements with the KPIs, data strategy, knowledge assets, and continuous-improvement initiatives. And that was once the program was launched. The administrative investment in designing and implementing the program was far greater than constructing a panel.

There were many other tradeoffs and hiccups. Optimizing the aggregate performance of the portfolio in the service of sustainably improving business outcomes was an alien concept that took time to be internalized. Many tenured lawyers would still readily revert to the status quo ante because task-oriented oversite remains more in-line with their professional skillset. They were also not fond of losing dominion over law-firm selection. These autonomy-inclined professionals subsequently made a sport of identifying where the lawyer they would have chosen would have hypothetically outperformed the lawyer assigned by the portfolio firm. Hyperfocus on individual lawyer execution of isolated tasks was symptomatic of what proved to be a generally challenging transition from micro-management to macro-management. *Did this one lawyer do this one thing exactly as I would have liked?* is a more appealing question than *What directions are the KPIs moving in, and why?*

The internal and external change management required was considerable. The system remains imperfect. But it is better. This tranche of work is now on a more sustainable trajectory, oriented towards continuous improvement over a reasonable time horizon, and well calibrated to long-term enterprise enablement.

Work Packaging 101. Packaging work entails identifying significant tranches of tasks or matters where consolidation creates the conditions necessary for introducing economies of scale, including smoothing intra-matter variability. The resulting portfolio must be substantial enough to justify the initial packaging project and subsequent investments in continuous improvement—including more active management of external resources at the relationship (not just matter) level and for whom the size of the prize must also be sufficiently consequential to incentivize investment in innovation.

To be properly packaged, work must be sorted. Work sorting extends across the entire value chain (i.e., in-house, too) and includes:

- *Identification.* What work is being done? At what volume? By whom? But also <u>why</u>. What are the business drivers? Which business needs are increasing, decreasing, or flat?
- *Segmentation.* Moving beyond business need to business value. How does legal enable business strategy? How does business value inform tradeoffs with respect to resource, allocation, price sensitivity, risk tolerance, and velocity?
- *Decomposition.* Breaking down legal work into its constituent parts to identify, and understand, the tasks that consume finite bandwidth. How do tasks connect to each other, as well as demand drivers and business value? What is (i) the sequencing by which business activity generates legal needs and (ii) the flow by which some legal needs are entrusted to external resources?

In short, we need to know what people do, and why. Which sounds obvious. Except we have a strong tendency to inflate our level of insight on both counts. If we've done the work to understand the work then opportunities for packaging should be apparent.

Moreover, portfolio design decisions must be tuned towards the appropriate objectives. Portfolios, like panels, are not ends in themselves. As with panels, maximizing near-term savings and administrative ease are just as likely to prove long-term suboptimal. The objective remains spend optimization over a reasonable time horizon in the service of enterprise enablement at scale and pace. Where applicable, the portfolio is merely a more functional organizational approach than the matter-by-matter friction attendant to traditional law-firm relationships.

Towards Integrated Law. Integrated Law is the apex of work packaging.

Factor introduced the category of "Integrated Law" because labels like New Law, law company, alternative legal service provider, and managed-service provider proved inadequate.[4] Integrated Law combines the expertise of traditional law firms, the cost efficiency of managed services, and the close business alignment of in-house. Integrated Law teams aren't outsourced, they're embedded.

The key insight of Integrated Law is that of intersecting complexities:

- *Scale Complexity*: work that is complex due to its volume.
- *Legal Complexity*: work that is complex because it requires specialized expertise.
- *Systemic Complexity*: work that is complex because it requires an understanding of, and alignment with, the organization's culture, strategies, systems, and processes.

In a simple world, in-house departments address systemic complexity because of proximity to the business, law firms address legal complexity because of specialized expertise, and managed-service providers address scale complexity because they are purpose built to handle high-volume, repetitive work. Yet the adage holds, *make everything as simple as possible, but no simpler.*

Our world is not so simple. Oversimplification has resulted in misconceptions like the pervasive belief that law departments are being buried by an avalanche of routine tasks. Law departments are being buried. There is an avalanche of tasks (scale complexity). But many tasks are not routine—i.e., many tasks demand specialized domain expertise (legal complexity) and/or organizational context (systemic complexity). Indivisible and multi-dimensional, these tasks reflect the tangled reality that complexities frequently overlap and intersect in ways that confound simple solutions. Many managed-service outsourcing efforts have underdelivered because a simplicity assumption drove the selection and subsequent hands-off management of the least expensive option, rather than the selection of and subsequent integration push with the provider most capable of cost-effectively producing complex legal work at scale.

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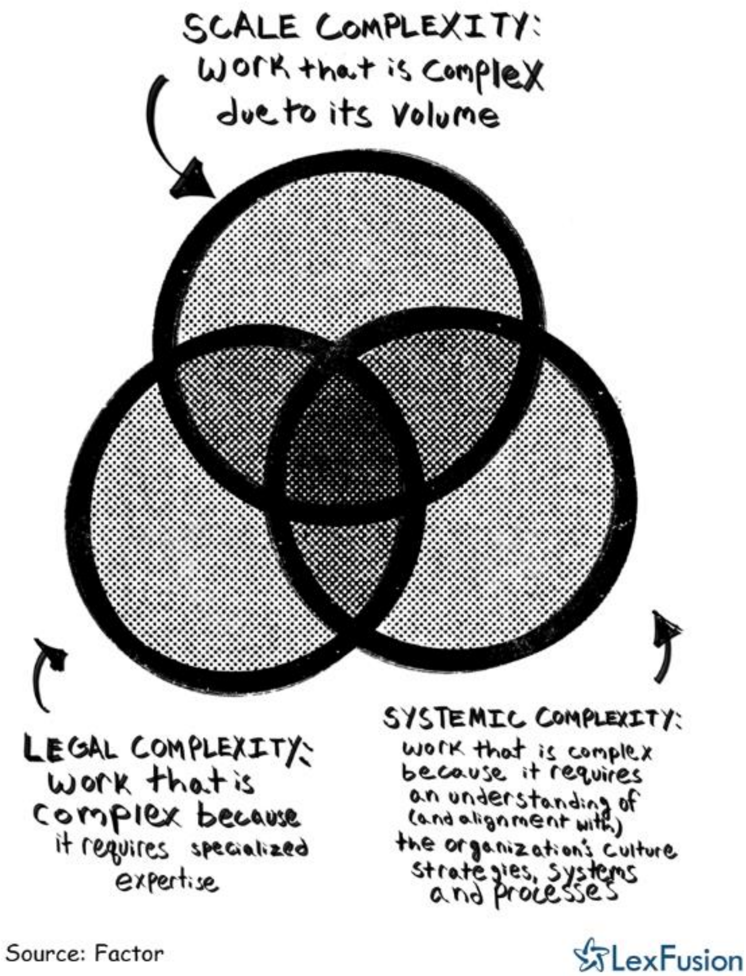
[4] This memorandum owes many intellectual debts (Jae Um, Jason Barnwell, Roger Martin, Bill Henderson, Dan Katz, et al.). I have avoided my usual link-heavy, citation-laden writing to provide a more fluid reading experience. There is a lengthy appendix (download here) containing attributions and links to reference materials. But I must make an exception for Factor's brilliant Integrated Law Whitepaper, which I was privileged to review in draft. The Whitepaper can be found here. Despite having express permission to borrow liberally, I would consider myself guilty of plagiarism if I did not credit that paper. Frankly, my adherence to the source material is a benefit to the reader. There is little to be improved upon.



But complex ≠ impossible. In the foregoing example, the law department took advantage of volume to better align external legal expertise with organizational needs. The department did not eliminate the complexities. Rather, the department engaged directly with the overlapping nature of the complexities and designed a sustainable, multi-modal approach to delivering complex legal work at scale. The example was deliberately taken from the litigation arena—generally the most inextricably external legal workstream. There is even greater potential for integrated approaches to support core business processes, like contracting.

Recurring transactional work is usually too high volume for the expense of traditional law-firm arrangements. Much high-volume contracting is also often too high touch, too complex, and too organizationally specific for traditional low-cost managed-service providers. Contracting has therefore largely fallen to internal resources and, by far, consumes the largest percentage of personnel time in most law departments. But, as we explored at the outset, internal resources end up subject to headcount restraints, even beyond their budgetary constraints—as business needs perennially outpace legal resources.

Integrated Law combines the logic of external relationships (volume and costs remain linked), the focus/accountability of an independent enterprise (complex legal work at scale is, literally, their business), and the advantages of proximity—delivering work inside the client ecosystem, aligned to enterprise needs, goals and operating models. Integrated Law teams embed within client systems and function, for all practical purposes, as a part of the in-house legal team, except with easier access to incremental resources—flexing up during high-volume periods and down during lulls to ameliorate the peak-load problem.

Yet, as embedded as they are, Integrated Law providers remain third parties. If they are not performant… if they are not investing in innovation to improve unit economics over time…if they cease being the best available option…if…, you can switch. Not painlessly. But far less painfully than trying to transform or move on from internal teams who are not executing or whose labor-intensive current state is incongruent with a tech-enabled future state. Integrated Law delivers the benefits of embeddedness without the encumbrances of permanent hires.

In-house lawyers remain indispensable. Integrated Law is grounded in the recognition that legal work almost invariably benefits from proximity to the business but that finite headcount will limit the functional availability of internal resources. If ww accept the premise that headcount is subject to soft and hard constraints, the dispositive question for allocating finite headcount then becomes "where does the business benefit most from proximity to legal?" The answer is: <u>embedded advisory</u>.

Embedded advisory is about being in the room where it happens—i.e., influencing the most significant business decisions. Embedded advisory exists at the point of greatest overlap between legal complexity, systemic complexity, and material business impact. In-house lawyers are ideally positioned to pair subject matter expertise with a deep understanding of organizational context to support the business in strategically placing its biggest bets.

Bets, by definition, entail risk. Declaring to a business decisionmaker "well, there's a risk" is essentially a content-free statement. Every business decision balances a variety of enterprise risks, only some of which are legal in nature. Attempting to eliminate risk, or minimize risk in ways that ignore net business impact, is how legal can be sidelined as the Department of No or the Department of Slow.

It is incumbent on us to identify legal risks and characterize those risks properly within the context of the business's strategic objectives and risk appetite. We need to intelligibly translate legal risk into potential business impact (probability, frequency, severity). Indeed, the dream is to price risk properly and integrate it directly into the business calculus. Which is another way of saying our role includes helping to advise the business on taking *smart risks* that properly balance legal exposure with commercial advantage.

Given headcount constraints, we need to purposefully create space for embedded advisory. That begins with self-awareness as to what is and is not advisory work. Many in-house lawyers are inclined to label whatever they do as "advice" and therefore not amenable to any form of systemization that would facilitate a change in their work mix. Many in-house lawyers, for example, would describe their involvement in repeat transactional matters as "advising on contracts." This frames each contract as a matter of first impression demanding the formulation of one-off advice. That is, they correctly recognize the work is legally complex but incorrectly conclude it is therefore immune to being delivered at scale.

From a resource allocation perspective, the consequence of this conclusion is reduced capacity for true enterprise enablement in the form of embedded advisory. From a sustainability perspective, this category error perpetuates the presumption that once workload exceeds labor capacity the only option becomes purchasing proportionately more labor—i.e., leaning harder into the untenable, linear relationship between business needs and legal labor.

Preferred-provider panels also still have their place. Regardless of in-house work mix, work will continue to flow to external providers. While Integrated Law is the apex of portfolio arrangements and packaging work into portfolios is key in orienting external provider relationships towards solving for scale, the end state is not wall-to-wall portfolio arrangements.

Not all work packaged as portfolios will have the business proximity necessary for true integration. Not all work is amenable to packaging due to volume, size, scope, frequency, and variability. Not all work amenable to packaging will be packaged immediately—these are labor-intensive projects that should be sequenced. Not all providers who handle substantial volumes of the enterprise's legal work will be awarded portfolios. Many providers awarded portfolios will also handle non-portfolio work. Any provider entrusted with highly sensitive work is subject to enhanced data-security scrutiny. Any provider relied on to deliver broad and diverse swathes of the enterprise's legal work should have a global rate card and be aligned with the enterprise's ways of working.

In short, preferred providers should not be limited to portfolio relationships. Portfolios are merely a key subset of preferred-provider relationships.

As with packaging, form should follow function. Work sorting should precede supplier sorting. Rather than starting with an arbitrary target number of providers, the work to be allocated should inform the rationalization of the supplier base.

Invariably, even with the best efforts at rationalization, a large organization with myriad, disparate legal needs will end up with an extensive provider network. Reducing the provider count only means partnering with bigger providers offering broader coverage—i.e., fewer providers does not necessarily shrink the size of the provider base. Reducing the provider count also does not reduce search costs, it increases them—because, traditionally, a global search is more apt to quickly surface fit-to-purpose options than a local search within a circumscribed talent pool that may not include an ideal fit (hence the necessity of step outs).

Reducing provider search costs and introducing marketplaces. The organization has already initiated a project to materially reduce search costs within the preferred-provider network.

Search occurs when the go-to preferred provider is not known for a particular issue or jurisdiction. Novelty is appurtenant to volatility, uncertainty, complexity, and ambiguity—i.e., VUCA. Novelty increases in frequency in a VUCA operating environment where enterprise legal needs evolve at a quickening pace.

When confronted with novelty, the default within law departments is for the responsible in-house lawyer to email their primary contacts at their primary law firms asking, "Can you handle this?" Generally, the law-firm contact responds promptly with an emphatic "Yes!" before forwarding the email to their entire firm inquiring, "Who can handle this?"

At present, the choice is between high manual search costs (finding the right fit) or suboptimal resource decisions (finding the best fit within a small set of options). Thus, following the standard path of information accessibility, expert curation must eventually be paired with tech-enabled search. Towards that end, Scout is a new tool the organization is bringing online to provide in-house lawyers with a searchable database of individual external resources at preferred providers. In-house professionals can search by specialty, jurisdiction, tenure, diversity, etc. to surface which preferred providers can supply the right resources for a particular question or matter. Scout will not only be crucial to optimizing resource decisions but also to limiting step outs—because it will lower search costs and increase the likelihood of identifying the right resource within the preferred provider network.

Step outs will be reduced. Step outs will <u>not</u> be eliminated.

No panel, no matter how robust, well-constructed, or easy to search will ever provide complete coverage for every legal issue that may arise. But an open-world approach to filling gaps in the panel introduces the same challenges—lack of vetting, lack of cost control—that motivated the creation of the panel in the first instance.

Priori's other product, Marketplace, is the happy medium between a closed panel and open season. Marketplace provides law departments direct access to a massive pool of vetted lawyers at market prices from firms of all sizes. In fact, Scout was itself borne out of corporate law departments requesting to apply Marketplace's powerful search functionality to their own curated preferred providers.

Even with a rigorous, multi-stage vetting process that has a ~10% acceptance rate, Marketplace has onboarded thousands of lawyers onto the platform. This rigorous vetting supersedes the reliance on brand/price as proxies for quality. Searchability enhances both discovery and discoverability. Marketplace is an enabler for, and therefore home to, BigLaw refugees who have formed boutiques or struck out as solos—same lawyers, much lower price point. Marketplace provides large clients access to small, cost-effective firms sans the attendant burden of managing a massive, fluid supplier base.

Like Scout, Marketplace substantially reduces search costs. In your setup, Marketplace will serve as an extension of Scout. To the extent a Scout search turns up wanting (no fit-to-purpose resources within the preferred-provider network), the search can be continued on Marketplace.

To maintain fiscal rigor, Marketplace offers tools for running RFPs among top candidates and setting budgets with selected providers. To eliminate administrative burden, Marketplace centralizes billing so lawyers from the platform do not need to be onboarded for invoicing purposes.

Marketplace as a critical category. Priori's Marketplace is an offering. But just as Factor coined "Integrated Law," Priori has introduced "marketplace" as a new and vital concept to the broader legal ecosystem. Marketplaces as a category merit deeper exploration because thinking through the problems being solved helps to reframe many challenges that cause preferred-provider programs to underperform.

Calling back to the origin story of preferred-provider programs, the in-house counsel predisposition to *hire lawyers, not law firms* has merit. Lawyer quality matters. Quality includes fit. The aggregate impact, however, of hiring lawyers, not law firms, is the absence of cost discipline aggravated by the considerable administrative burden of managing a massive, fluid supplier network.

Introducing a preferred-provider program has its own drawbacks. The logic of limiting provider count militates toward empaneling the biggest firms with the broadest coverage. But brand is only a marginally useful proxy for quality, which is often uneven within large firms. And while these firms are big, they tend to offer economies of scope without corresponding economies of scale. Size also tends to correlate with expense. Moreover, in a pre-Scout world, artificially limiting the talent pool dramatically increases search costs. Even in a post-Scout world, step outs remain necessary because no panel can cover every contingency. Indeed, efforts to enlarge the panel only re-introduce the administrative burden the panel was intended to alleviate while also forcing many providers to jump through onboarding hoops only to never be engaged—wasting everyone's (legitimately) precious time.

A well-crafted marketplace obviates much of this. In-house counsel can hire lawyers (not just law firms) from a pre-vetted network (quality control) with a broad mix of practice areas and jurisdictions. The law department can implement price thresholds (cost control) and take advantage of centralized billing (administrative ease) without the added effort and friction associated with vetting and onboarding. In fact, if in-house counsel identify a non-panel lawyer they would like to consider for an opportunity, it should be easier on everyone to send that lawyer to the marketplace than have them directly onboarded to the enterprise system. This approach is also superior for external lawyers because participation in the marketplace makes them accessible to other enterprise clients—i.e., they benefit even if the organization that recommended the marketplace never ends up using them, as is so often the case with preferred-provider programs that award no preference.

Where a single enterprise has reasons to limit the number of panel firms due to administrative load, a marketplace thrives on network effects. Every additional lawyer and every additional client amplifies the benefits of the network for all its participants. As long as vetting discipline and solid data practices are maintained, a marketplace should be the preferred method for sourcing novel, intermittent, and irregular needs.

On repeat and/or larger matters, the need will remain to hire law firms, not only individual lawyers. Just as portfolios do not replace preferred-provider relationships, a marketplace does not supplant a panel. A marketplace is a complement configured for certain matter profiles. A marketplace therefore enables a more targeted preferred-provider program because the marketplace absorbs much of the flotsam and jetsam that frustrate program design. And, of course, repeat providers can graduate from a marketplace to preferred provider or portfolio arrangements when and where the work profile merits mutual investment in such a relationship.

It all requires investment, in one form or another. A marketplace is not free. Priori's charges are transparent, starting at a 20% mark-up (much less than the hidden 60% to 115% markup for most legal staffing, a sub-genre that Marketplace also addresses). These fees are offset by the enhanced access to smaller, more price-competitive resources and cover the costs of vetting, administration, and tech—costs that would have been incurred anyway but not so clearly accounted for.

There are no cost-free alternatives. There are *more cost-effective* and *less cost-effective* uses of finite resources. Effectiveness is, in part, defined by perspectives and priorities, which not only govern how you hire but whom.

Diversity costs and is worth the price. While cost discipline is essential business hygiene, savings on legal spend are too miniscule as a percentage of revenue—a fraction of a fraction—to ever be an enterprise priority. DEI is an enterprise priority and should be supported accordingly.

At core, DEI initiatives are about meritocracy, not charity. DEI efforts require effort to overcome arbitrary impediments to meritocracy resulting from systemic biases that distribute advantages and disadvantages with no basis in merit. Any notion that achieving diversity requires sacrificing quality is confused. Explicably, much of that confusion stems from the reality that systemic distortions demand more effort to identify diverse talent—i.e., search costs. *There are <u>no</u> competent, diverse lawyers* is almost certainly false in any given instance.[5] *I don't <u>know</u> of competent, diverse lawyers* is often true, and a problem worth solving.

Fortunately, both Scout and Marketplace have robust search capabilities that reduce search costs for diverse candidates. Similarly, all manner of organizations from the Minority Corporate Counsel Association and NAMWOLF to the National Bar Association, Hispanic Bar Association, and NAPABA (just to name a few) exist to help create connections with diverse attorneys, as well as minority- and women-owned law firms. Finding diverse talent is easier than it ever has been but still requires more effort than it should.

It is not enough, however, to have the means to identify diverse talent. To honor your DEI commitments, you must be purposeful in hiring diverse talent. This responsibility cannot be outsourced. You must hold yourselves accountable. First, do your own internal hiring patterns reflect your DEI commitments? Second, are your DEI

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[5] As professional issue spotters, lawyers are inclined to pick apart categorical statements. The observation that there are almost always qualified, diverse attorneys—even if you don't know of them—often runs headlong into this penchant and inspires the conjuring of extreme hypotheticals where an obscure specialty has a limited talent pool. In the extraordinary scenario where the talent pool is microscopic, then it is what it is. But, in the real world, the far more pressing concern is operating as if the talent pool is sharply limited when it is not. This often includes narrowing the definition of "qualified" in a manner that reinforces, rather than counteracts, systemic distortions within the least diverse profession.

commitments manifest in your *direct* hiring of external lawyers? As you refresh your preferred-provider program, the latter question is of particular moment.

Unfortunately, the primary point of emphasis in many law department DEI initiatives has been *indirect* hiring of diverse professionals. There is absolutely a place for not only understanding but impacting how work is allocated to ensure that diverse professionals are staffed on your matters and entrusted with tasks that further their career development. But it is a supplement to, not a substitute for, directing walletshare to diverse talent in the first instance. Who you hire is also easier to track than who-you-hire-assigns-work-to because of the common challenge of self-identification mucking up what is already a data rich but information poor operating environment.

Moreover, while there is much to recommend not just reporting requirements but actual requirements to staff matters with diverse professionals, there is an often unappreciated tension with the parallel pursuit of maximal price concessions and cost controls. Clients with the buying power to demand diverse professionals be staffed on their matters are also the clients with the buying power to secure the deepest discounts and impose the most rigid commercial constraints. This results in the staffing of diverse professionals on the least profitable matters with the lowest revenue per hour and the worst realizations. Diverse professionals' financial performance, and their case for career advancement, suffers when well-intentioned DEI initiatives are paired with aggressive cost control.

You could just exempt diverse professionals from mandatory discounts. This bolsters their financial performance and supports their career advancement. It acts as a carrot, rather than a stick, for law firms to staff matters with diverse talent. It also incentivizes self-identification without the messiness endemic to the survey process.

I did, in fact, just suggest you spend more money to promote diversity. I stand by it. But if that is a bridge too far, then invest even more effort in utilizing minority- and women-owned firms or, at least, diverse partners from non-mega firms, to make good on your DEI commitments while simultaneously lowering the average price point of external expertise.

Valuing diversity means paying for diversity, from incurring search costs to directing walletshare. "Value" is not defined as what customers say they want but, rather, what customers are willing to pay for. If it is a priority, it is worth paying for. Otherwise, it is merely a nice-to-have.

Priorities function as the organizing principles of resource allocation. *Money>Words*.

Extraordinary spend should be segregated. The law department is responsible for directing its finite resources towards supporting seemingly infinite enterprise priorities. This frequently begets accountability without authority. Business stakeholders initiate some endeavor that legal must support—in the doing and/or in the dealing with the fallout. The business stakeholders declare that price is no object. Parallel conversations with finance confirm, however, that price is very much an object.

In certain respects, accountability without authority is intrinsic to the legal function. Much is beyond the law department's ambit of control but within its sphere of responsibility. Still, it is best practice to properly account for extraordinary spend—singular exigencies with material business impact and substantial budgetary implications that often warrant bypassing programmatic sourcing controls.

Extraordinary spend overwhelmingly flows to external resources, especially premier law firms because extraordinary scenarios are fundamental to the premier law value proposition. Premier law firms were purpose built to address intermittent or unpredictable business needs raising complex or novel legal questions in high-consequence matters. Premier law firms offer deep benches of pedigreed lawyers in aligned practice specialties who can be formed into ad hoc tactical teams to serve as top-level advisors—at sky high rates. This is valuable. Value costs.

When business impact is extraordinary, ordinary cost discipline is often abandoned. The enterprise may go off panel to hire a firm (or firms, including constructing an all-star virtual firm) at above panel rates without applying the standard rigor to negotiations or tenacity in ensuring budget adherence.

Which is fine, in theory. It is the enterprise's money. But, in practice, even when procedural discipline is maintained, big surprises can blow up the law department's budget and make fiscal diligence appear to be profligacy. Extraordinary spend is important to track for future discussions around proper stewardship of corporate resources—accounting records tend to outlast both human and institutional memories.

For our present purposes, however, extraordinary spend should be segregated for internal accounting simply because it is not helpful for planning and tracking in the normal course. To the extent future KPIs will be assessed with respect to percentage spend on portfolio partnerships, marketplace resources, different supplier types, etc., extraordinary spend is noise that will obscure our signals of progress, or lack thereof, as the program matures.

Solving for now with a holistic view of cost takeout and external spend. The preceding pages espouse the long view, centered on spend optimization over a reasonable time horizon to sustainably meet business needs at scale and pace. Which is all well and good. But, sometimes, time horizons are unavoidably unreasonable. A long-term ethos does not alter the short-term reality that many enterprises expect legal to share in the fiscal pain of deteriorating economic conditions. No business stakeholders are presently interested in better understanding how legal needs (i) are near-term inelastic, (ii) often increase during periods of economic turbulence, and (iii) are not within the law department's ambit of control regardless of how effective the law department is at value storytelling.

Unless handled deftly, now is not an ideal time to be re-imagining a multi-year preferred-provider program. The understandable temptation will be to configure the program to satisfy urgent expectations. It would be nonsensical to pretend these expectations can be ignored. But it would be unfortunate if short-term easy resulted in even more long-term hard.

Ironically, indiscriminate cost cutting is cruelest to the most discriminating departments. Lean legal teams that have spent years diligently negotiating external providers down to market prices seemingly have little room to maneuver without reducing service levels. Moreover, the enduring rate obsession means the most common lever pressed in these scenarios—demanding deeper discounts from incumbent law firms—tends to have minimal impact. To the extent cost-cutting mandates are merely performative, some superficial rate concessions may be sufficient. If there are hard fiscal targets, however, discounts often prove insufficient.

To not sacrifice program objectives on the altar of short termism, a more holistic and sustainable approach to immediate cost takeout is required.

Labor arbitrage still works. Building on the previous sections, an expedient path to utilizing both Integrated Law and Marketplace is to lift and shift work from expensive external resources to less expensive external resources. This is classic labor arbitrage, which, again, is effective in the near term (the focus of this section) even if it is necessary but not sufficient over the long term.

A more sophisticated approach is to enable internal resources to quickly offload more routine work (the kind that was brought in-house because the savings math was so compelling) to less expensive Integrated Law and Marketplace resources so in-house resources can retain work currently flowing to relatively more expensive external resources. This is also labor arbitrage but requires higher-order systems thinking—i.e., understanding the interdependencies of labor stocks and work flows.

Again, tasks are frequently the most useful level of resolution. Many right-sourcing opportunities materialize once the addition of an unbundling frame broadens our possibilities. For example, a matter type that is considered 95% routine labor and 5% high-end expertise might currently be sourced to a Tier 2 firm because their labor costs are materially lower than a Tier 1 firm. In a re-configured delivery dynamic, a Tier 1 expert (higher end expertise) can be paired with Integrated Law or Marketplace resources (even more economical labor costs) to improve quality while also reducing external expenditures.

Efficiency gains can be impactful. Another route to reducing external expenditures is to keep more work in-house. Handling more work internally may seem unpromising in an environment where hiring is frozen (can't add headcount to substitute for external hours) and in-house resources are already stretched. Moreover, the suggestion to handle more work in-house may also seem incongruent with all the preceding warnings about the limitations of insourcing (still accurate). There are, however, material differences between adding headcount and making existing headcount more efficient (*remember this word*).

Assuming internal resources have an average of 1600 eligible hours for producing outputs that would otherwise flow to external resource and an average external resource cost of $300/hr, below is a chart of the cost-takeout impact of efficiency gains.

Cost Takeout from Efficiency Gains

Avg Efficiency Gains

Team Size	5%	10%	20%	40%
10 FTEs	$240k	$480k	$960k	$1.9m
25 FTEs	$600k	$1.2m	$2.4m	$4.8m
50 FTEs	$1.2m	$2.4m	$4.8m	$9.6m
100 FTEs	$2.4m	$4.8m	$9.6m	$19.2m
250 FTEs	$6m	$12m	$24m	$48m
500 FTEs	$12m	$24m	$48m	$96m
1000 FTEs	$24m	$48m	$96m	$192m
2000 FTEs	$48m	$96m	$192m	$384m

Assumptions:
- 1600 /hrs yr per FTE
- $300/ hr avg external spend

The same math applies to directly making outside counsel more efficient ('how' work gets done).

This, however, is cost takeout. Cost takeout will not necessarily manifest as spend reduction because the volume of work is not static. In one world, spend could fall simply because volume does. In another world, spend could increase even with substantial cost takeout because volume increases at an even greater rate (i.e., demand drivers can never be ignored).

Moreover, these are average improvements across individuals, teams, and workstreams. One role within a team could be transformed while another does not change. One team might translate every hour gained into multiple hours that no longer flow through to external resources while a different team's workload has no impact on external resource utilization. An hour retained by one workstream may translate into $800/hr in external cost takeout while another may translate into only $150/hr.

You are encouraged to do more granular calculations tailored to your context. A compelling benefit of comprehensive work sorting is understanding the various strands of your value chain: how business activity drives legal demand and then how demand flows through, or not, to external resources at various price points.

Resource preservation math is counterintuitive because efficiency ≠ productivity.

Which of the following productivity improvements is most impactful? © LexFusion

A. Improving throughput from reviewing one contract per hour to two contracts per hour (+1 contract per hour; 2x improvement)

or

B. Improving throughput from reviewing two contracts per hour to ten contracts per hour (+8 contracts per hour; 5x improvement)

or

C. Improving throughput from reviewing ten contracts per hour to one-hundred contracts per hour (+90 contracts per hour; 10x improvement)

If your gut tells you (C), your gut is correct. From the perspective of the business, a 90-unit increase in productivity dwarfs an 8-unit increase, let alone a 1-unit increase.

But if your gut also senses the word "counterintuitive" is in the subheading for a reason, your gut is doubly correct. From the departmental perspective, (A) preserves more resources than (B) and (C) combined because once we cut current resource consumption in half, there is nothing we can do beyond eliminate the activity that will ever again conserve the same level of resources. To wit, the question reworded to lead to the alternative conclusion:

Which of the following efficiency improvements is most impactful? © LexFusion

A. Cutting contract review time from one hour to 30 minutes? (-30 minutes per contract; 50% reduction)

or

B. Cutting contract review time from 30 minutes to 6 minutes? (-24 minutes per contract; 80% reduction)

or

C. Cutting contract review time from 6 minutes to 1 minute? (-5 minutes per contract; 83% reduction)

If seeing the arithmetic helps:

A saves 25% more time than B and 544% more time than C

A

$$\frac{1000\ contracts}{1\ contract\ per\ hr} = 1000\ hours$$

$$\frac{1000\ contracts}{2\ contracts\ per\ hr} = 500\ hours$$

$$1000\ hours - 500\ hours = \mathbf{500}\ hours_{saved}$$

B

$$\frac{1000\ contracts}{2\ contracts\ per\ hr} = 500\ hours$$

$$\frac{1000\ contracts}{10\ contracts\ per\ hr} = 100\ hours$$

$$500\ hours - 100\ hours = \mathbf{400}\ hours_{saved}$$

C

$$\frac{1000\ contracts}{10\ contracts\ per\ hr} = 100\ hours$$

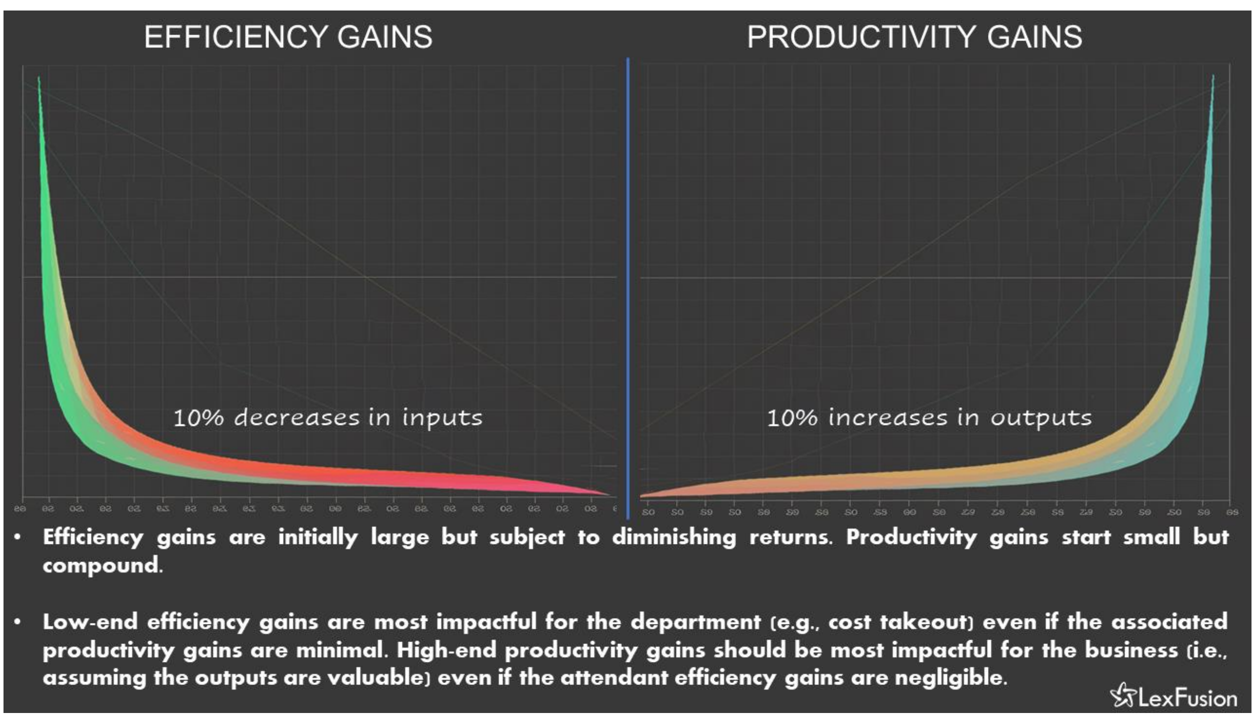
$$\frac{1000\ contracts}{100\ contracts\ per\ hr} = 10\ hours$$

$$100\ hours - 10\ hours = \mathbf{90}\ hours_{saved}$$

Such calculations hold for any legal unit of production: contracts, product reviews, marketing reviews, trademarks, etc. This is more than a fun math trick.

The foregoing highlights that the local resource interests of the department are not perfectly aligned with the global productivity needs of the business. This is unavoidable. Yet to the extent freeing up departmental resources is the only presently available path to meeting evolving business needs, the math also surfaces the potential impact of tackling low-end friction even if the apparent productivity gains present as paltry. The math informs decisions about which improvement initiatives to prioritize, and how to appropriately characterize ROI.

Efficiency (resource consumption) and productivity (output) are different frames. Efficiency has diminishing returns—solving for low-end friction has the greatest impact. Productivity has compounding returns—the more productive a system, the larger the impact of each incremental improvement. It is first efficiency gains and then productivity gains that ultimately influence unit economics. From this perspective, labor unit cost is one, but only one, aspect of efficiency (time as a finite resource consumed in the production process; time = money).



This is key to understanding the preceding matrix with respect to cost takeout and efficiency gains. Efficiency can be achieved and drive material cost takeout without representing substantial upgrades in productivity.

Many seemingly small, incremental improvement projects could deliver considerable efficiency gains but often get dismissed because a productivity lens is applied.

Long-term, productivity is what matters for meeting business needs. Near-term, efficiency is what frees up finite resources to do so. In normal times, we pursue efficiency plays to unlock resources to direct towards projects that drive productivity. In not normal times, we identify efficiency opportunities to tread water while achieving cost takeout.

From a cost-takeout perspective, the math also informs how to characterize and prioritize improvement initiatives among your external providers.

There are other external spend optimization opportunities that can deliver near-term savings. Law firms consume the largest chunk of external legal spend. But there are many other direct costs and passthroughs that, in aggregate, represent significant sums (again, a matter is not always the proper level of resolution). Electronic discovery. Due diligence. Mediations & arbitrations. Court reporting. Subpoena responses. Corporate governance. Routine IP management. There are many costs that present low-hanging fruit in an environment where we have already been applying maximum downward pressure on law firm pricing for years and are unlikely to squeeze out much more near-term cost savings from longtime incumbents.

Moreover, many of these savings opportunities are also opportunities to upgrade service levels and deliver additional cost takeout. Systematizing ediscovery and due diligence should not only reduce direct costs but also have knock-on effects, including better and more consistent quality, for all the matters such systems support. A new mediation and arbitration platform can not only offer immediate direct cost reductions but also streamline the matters referred to the platform in ways that drastically reduce time to resolution and total cost of ownership (e.g., attorney fees).

There are many levers to be pressed. Avoid Maslow's Hammer, which makes everything look like a nail. Doubling down on extracting price concessions from incumbent providers will not double the results. Spend optimization across the entire value chain can contribute immediate savings that do not sacrifice the long term for the near term.

Though the near term certainly projects to be nothing if not interesting.

Accelerants: economic turbulence and the non-linear progress of Generative AI. Economic conditions are not conducive to patience. Layoffs. Hiring freezes. Cost-cutting mandates. The pressure is acute, if not unprecedented.

The rise of generative AI, however, is unprecedented. Simultaneous to deteriorating fiscal conditions sharpening efficiency mandates, non-linear progress in technology is rapidly ratcheting up productivity expectations. ChatGPT had over 100,000,000 users within the first two months—the largest public beta in history. Conceptions as to what is possible in organizing and delivering knowledge work have changed to a degree, at scale, and within a timeframe that previously seemed unthinkable.

The collective mindset currently favors speed over caution. The law department in its advisory role will have a critical part to play in enabling the enterprise to navigate uncharted technological waters. As a function, the law department will also find itself on the other side of the looking glass (and possibly running a new kind of Red Queen's Race). This is a rare phase shift where the world is changing and failing to keep pace is not a viable option. This is happening. It will be done *by* you or it will be done *to* you. The business will ask serious questions about how the function is taking advantage of a technological inflection point. The business will expect serious answers.

In particular, law departments should anticipate digital transformation teams from prominent consultancies will be dazzling C-Suites with talk of modernizing core business processes to improve velocity and quality while reducing labor costs—with a non-trivial portion of that disintermediated labor currently residing in the law department (this will be considered a feature, not a bug). Some law departments won't even be in the room for this conversation. And protests about the ineffable, bespoke, and artisanal nature of legal work are more likely than ever to fall on deaf ears.

Without the budget to do so, the law department will be expected to not only responsibly incorporate new tools into legal service delivery but also reconfigure around these tools to find new ways to add value to the enterprise. This challenge extends to proactive management of external resources. Indeed, with cutbacks and resource prioritization within the enterprise, most law departments will gain most of their initial exposure to next-generation tools via their external providers. Learning to talk to and work with external providers on 'how' work gets done is more important than ever.

The revamp of the preferred-provider program comes at pivot point in the evolution of legal services. The next few years will change the relationship between the law department and the enterprise, as well as the relationships between the law department and external providers. Short-term wins in the form of superficial price concessions are likely to be rendered moot in the not-so-long-term by seismic changes in both the expectations and realities of enabling the enterprise at scale and pace. It is mission critical to design a program oriented around sustainable spend optimization in the service of rapidly evolving business needs.

There is little time to waste. The world is only speeding up.

Parting thoughts. Is the law department properly enabling the business? Is it doing so cost effectively? Is it doing so sustainably given the current (divergent) trajectories of business needs and the legal resources available to meet those needs?

With respect to sustainability, every law department should be able to calculate the percentage of their total spend currently dedicated to projects that once complete will progress their ability to meet business needs at scale and pace.[6] As part of that calculation, every law department should know what percentage of their external spend is flowing to relationships that are designed to scale (e.g., portfolios, Integrated Law).

While continuously seeking to better leverage legal labor, law departments benefit from a nuanced approach to where legal labor should come from—i.e., diverse relationship structures, diverse supplier types, diverse supplier mixes, and truly diverse professionals. Likewise, law departments will increase their optionality by taking a holistic view of legal spend and broadening the levers available to drive spend optimization.

Progress towards scale can be measured by the number of business operations that can be executed without thinking (i.e., compliance by design). Progress, however, depends on the lateral thinking that makes such automaticity possible, profitable, and sustainable. Progress starts with creativity, graduates to heuristic, and matures to system. Creativity is about invention. System is about repetition. Law departments traditionally get stuck in the middle, at the heuristic stage, where judgment borne from training + experience remains imperative for competent decision making.

[6] Projects should not be confused with programs. To the extent previous projects resulted in programs that constitute an improvement over what came before in terms of delivering at scale, that's great but also backwards looking, not forward looking. The resources dedicated to programs, including the personnel, should not be included in the allocation calculation. Also, financial commitment is a far more telling measure than project count. *Money>Words*. Many departments have more projects than people with most of the projects ranging from shower thought to aspiration to folly. Real money. Real projects. Real results.

To get unstuck, law departments need to foster greater creativity in building scalable systems. Being creative will include accepting that, by definition, no truly new idea can be proven in advance analytically and that punctuational change is not possible without experiments bold enough to fail. Which is all far easier said than done. It is certainly not easy to re-tool the machine without ever being permitted to take it offline. We, however, are supposed to be expert at doing the hard things well.

I'm here to help, not to judge. Perfection is a useful target but an impossible standard. We're all in this together. And I can assure you no one else has it all figured out either. I wish you the very best.

Fortis Fortuna Aduivat