

## Preferred Provider Networks Create Challenges, Cut Costs

### In-House Counsel Discuss Ways To Sidestep Implementation Issues

BY CATHLEEN FLAHARDY

"IT WAS THE \$50 million phone call." That's how Kevin Harrang refers to the call he received last spring from his CFO to inform him how much the legal department's budget had to be cut. The deputy general counsel of law and corporate affairs for Redmond, Wash.-based Microsoft Corp. knew his department would be facing budget reductions, but *that* number shocked him.

"I said, 'OK, where did \$50 million come from?'" Harrang says. "But, of course, numbers you get from your finance department are about spreading cost reductions, and so it was our job to figure out where to look for savings."

Harrang and his team already had been working to put cost-cutting measures in place. In the past year, he had implemented an e-billing system for all of its major providers, installed a matter-management program to manage cases, benchmarked against other companies and implemented an internal Six Sigma-based project management system.

But it was the \$50 million phone call that prompted Harrang to create a network of preferred providers. "Microsoft was using more than 500 law firms, and we lacked discount agreements with a vast majority of legal counsel," he says. "It was the obvious place to save money."

Harrang's situation isn't unique. To cut costs, more and more legal departments are scaling down their law firm lists to include only those that provide top-notch services at discounted rates. But creating the ideal preferred provider network can be tedious. And maintaining the legal

### COUNSEL to COUNSEL COVERAGE

department-law firm relationship can prove challenging.

In a recent Martindale-Hubbell Counsel to Counsel forum in Toronto titled "Preferred Providers: Designing and Implementing the Law Firm Network," participants discussed the challenges they

faced when implementing their preferred provider programs and explored the lessons they learned in the process.

### Micro-Management

For Microsoft, the task was especially grueling.

The company had gone from being an entrepreneurial up-and-comer to a corporate powerhouse almost overnight. With that success came myriad lawsuits in all shapes and sizes. And over the



(Clockwise from top left): **Kevin Harrang**, deputy general counsel, law and corporate affairs, Microsoft Corp.; **Robert Aziz**, senior vice president and assistant general counsel, The Bank of Nova Scotia; **Murray Aust**, senior counsel of RBC Financial Group; **George Eydt**, partner, Hodgson Russ.

## At A Glance: Martindale-Hubbell's Counsel to Counsel Forum

### “Preferred Providers: Designing and Implementing the Law Firm Network”

#### Co-Chairs:

> **Kevin Harrang**

Deputy General Counsel of  
Law and Corporate Affairs  
Microsoft Corp.

> **Bjarnie Anderson**

Former Director of Legal Operations  
Barclays Bank

#### Law Firm Co-Hosts:

> **Hodgson Russ**

> **McMillan Binch**

#### Facilitator:

> **Ann Lee Gibson**

Ann Lee Gibson Consulting

years, the company had accumulated hundreds of legal service providers—as well as astronomical legal expenses. Hitting the \$50 million savings target wasn't going to be easy.

Harrang's first step was to talk to other legal departments in major corporations that had experienced similar cutbacks.

“We hired a consultant to go around to 10 or 11 different major U.S. companies and their law departments, and talk to them about their best practices for reducing costs and managing excellence,” Harrang explains. “We spent a lot of time working on what we wanted to do based on what other companies had actually done.”

Through that benchmarking, Harrang discovered other companies were achieving cost-savings goals through preferred provider networks. And he decided it was time he create a program for Microsoft. But he had concerns.

“Not only were we thinking about how we were going to reduce our budget by \$50 million,” Harrang explains, “we also were worried about how we were going to improve the law firm relationships we had without endangering the basic services we were getting.”

Considering the amount of money he had to cut, he had little choice.

To narrow down the list of firms, Harrang and his team sent each firm a comprehensive set of guidelines, which included, among other things, rules on billing, diversity and staffing. After reviewing the list of guidelines, law firms made a presentation to Microsoft about why they would be ideal preferred providers and how they could save the department money.

“Preferred firms were expected to give us discounts in return for a deeper relationship with the company and broader access to work assignments,” Harrang says.

And that's where it got tricky.

### Bargain Hunting

Discounted rates play a major role in any selection of preferred providers. Before that list is in place, maintaining solid relationships while asking for discounts can prove challenging for both the legal department and the law firm.

Keeping that in mind, Harrang and his team offered preferred providers incentives for agreeing to the discounts.

“In one category of outside counsel work, we're trying out performance bonuses based on savings,” Harrang explains. He says they measure the performance of firms on quality, results, cost management and diversity. “In extraordinary cases, firms can do better than they would have had they not given us any discounts.”

While discounted rates are important, one participant says the key to saving money within a legal department is focusing on how outside counsel budget a matter.

“Getting discounts on rates is all well and good,” says Robert Aziz, senior vice president and assistant general counsel at TD Bank Financial Group in Toronto, “but it won't save you anything if there's no efficiency and no discipline to how the work's being done.”

Aziz charged both his in-house staff and law firm lawyers with creating a budget for each project—and sticking to it.

“If you don't ask how much a project is going to cost at the onset and you don't proactively create guidelines for billing, then you can't complain when you get the bill,” he says.

Murray Aust, a participant in the forum, agrees. As senior counsel of Toronto-based RBC Financial Group, he also works with law firms to create a budget for each project—a practice he says

helps eliminate confusion over billing.

“Obviously we want to see that there's compliance with the rates we've negotiated and the bills are coming in the way they should be,” he says.

Aust points out that many in-house counsel are reluctant to address billing concerns with law firms when they arise. Therefore, relationships simply fall apart.

“Oftentimes, if in-house counsel have a problem with a law firm, they tend to just stop using it rather than working through the issue,” he explains. “And many potentially valuable relationships can be easily lost that way.”

A participant who wished to remain anonymous is one example.

### Live And Learn

As vice president and senior assistant secretary of a major bank in Toronto, it was the participant's job is to oversee the legal department's budget. Recently a lawyer from one of her preferred law firms went over her head to complain to her CEO that he was unhappy with the way the legal department handled an RFP issue.

“I can't tell you the ill-will that's created by that kind of behavior,” she explains. “By not calling the person designated internally to address those types of questions has resulted in executives getting upset with me. My job is hard enough as it is without having outside counsel poisoning the waters for me internally.”

From that experience, the participant now thinks twice before using that lawyer. But she also realized the department needed to establish better communication with the legal department's preferred providers.

“If you don't tell the law firm the relationship is not solid, it doesn't know to put extra resources into that,” she explains. “It's your job internally to build the bridge in that relationship.”

Now the bank's legal department makes an effort to get to know the outside counsel working on its projects. And the participant says the law firms are thankful, and that shows in the developing business relationships.

But lessons learned are par for the course when creating a preferred provider network.

Bjarnie Anderson, former director of legal operations at London-based Barclays Bank and a participant at the forum, faced several challenges when—as part of a restructuring of the legal department in

## Inside Scoop

Most general counsel are acutely aware of the need for good corporate governance and compliance programs. But it's not always easy to convince management that such programs are worth the time and expense they take.

Participants at a recent roundtable discussion titled, **"Best Practices In Managing Internal Investigations And Compliance Audits" at the Martindale-Hubbell Counsel-to-Counsel SuperForum in Washington, D.C.**, discussed the pitfalls to avoid and strategies for success in implementing and enforcing compliance policies.

Several in-house attorneys expressed frustration with managers who undermine their attempts to make compliance a priority—especially foreign executives who are unaware of the serious consequences that go along with violations of Sarbanes-Oxley and other U.S. governance regulations.

One GC recommended using scare tactics to make managers aware of the importance of compliance.

"Ten years ago, managers looked at you like the police officer who was going to get them in trouble," she said. "Now you can go to the newspaper and the DOJ Web site and give them the daily horror shows of executives being indicted. It's fairly easy today."

Another major issue participants encountered is juggling corporate objectives with compliance policies. One participant related a situation in which one of the company's best sales people was caught violating a policy regarding the legal review of contracts.

"It was pretty clear this person should have been terminated," the participant said. "But it's really hard to sell that sometimes when your compliance function is not completely independent of management, and the person is an asset to the company in other ways."

This attorney's solution was to tie the Sarbanes-Oxley certification process to the company's internal compliance policies. That way, upper management has no choice but to pay close attention and take action on any violations, because violations of policy could amount to violations of the law.

—Adele Nicholas

2000—he had to create a preferred provider network.

First, Anderson says it's essential to start the process early and ensure stakeholders are included in all decisions. "We didn't want to just announce to the business that the legal function has picked these firms," Anderson says. "As our internal client, they needed to know why and be included in the process."

Second, he says companies should establish specifications for each case a preferred provider handles at the beginning.

"And when you're evaluating the results that come in, use a balanced scorecard so you can put numerical value on things," he says. "And use the data appropriately."

Finally he says keep it confidential and don't outsource the process. "You can use a consultant, but for the most part, do it yourself."

Although it took time, Anderson ultimately scaled Barclays legal service providers from 300 to 33. He adds, no matter the size of the legal department, anyone creating a preferred provider net-

work should apply these rules during implementation.

There is no arguing the task of creating preferred provider networks is challenging. But participants agree the benefits outweigh the disadvantages.

"Overall, preferred provider networks have the potential to provide quality control, effective management of legal services and cost reduction for the legal department," says George Eydt, partner at Hodgson Russ in Toronto.

As for Microsoft, it's only in the beginning stages of its program. Although the company hasn't disclosed the number of law firms in its network, it has significantly scaled down from the original 500. And Harrang believes the program will be successful—even if his law firms aren't so sure.

"Understandably, [they] have a lot of skepticism about whether the program will really be mutually beneficial, or whether it's just me beating them up over rates," he says. "Right now, they're taking a wait-and-see attitude." ♦



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