BUCERIUS CENTER
ON THE LEGAL PROFESSION

Case Study

Click4Legal – How Deutsche Bank Manages its Suppliers of Legal Services

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Introduction

Times have changed…

Have they? Whether you look at it from a law firm's perspective or from that of an inhouse-counsel it seems to emerge that over time the relationship between external and inhouse counsel has not been subject of evolution but of a genuine revolution. This became apparent even to the most conservative member in the profession when Beat Hess, then GC of global oil giant Shell, said in a breakfast meeting: „*... Law firms have had Christmas for every day for decades now, but the party is over.*“

This quote did not only show that market conditions had changed, but that a considerable irritation, maybe even anger, existed. What was the substance of this? In broad terms, Beat Hess and many other GCs were stressing the value for money-issue, criticizing law firms for not proactively taking this into account. What GCs were missing is value for money, risk management, project management, efficiency and real understanding of client needs.

According to the „ACC Value Challenge“ (on www.acc.com), it seemed that „*for the past two decades, there has been an unrelenting drive by companies and their suppliers to reduce costs while increasing quality and value in their products and services. The only outlier seemed to be the law firms*“. Apparently according to recent studies cited by the ACC, in the United States large law firms' prices jumped almost 75% over the last 10 years – contrasted by a 20% increase of non-law firm costs in the same period.

To better understand this one has to look at the dynamics and the characteristics of legal markets. In brief, in every legal market in developed countries with mature economies one would tend to find more lawyers than work for lawyers, hence an oversupply of lawyers. This has serious impacts on pricing levels leading to year on year decrease on income per lawyer.

Prima vista this does not concur with the aforementioned price increases as one would expect quite the opposite, given the oversupply of legal workforce.
Why has this occurred – in a market where everybody has tried to reduce costs and increase efficiency?

Taking a closer look on the various segments of legal markets one has to note that at the top of every legal market demands for legal services exceeds supply. There are a number of reasons for this, but it seems that one reason in particular was the driving force for the economic success of commercial law firms: We assume that even though the number of lawyers has grown significantly in the last 10 years it was mainly the way companies used to buy legal services. It was quite common that large law firms as full service providers were first choice for companies for all of their legal demand – even in cases where one would have thought that there are more firms in the market – smaller, less expensive - being able to meet these needs. Hence, a rather small group of law firms benefitted from this – all or parts of the AmLaw 200, The Lawyer TOP100, Juve Top50 etc. These firms enjoyed (and enjoy) a strong brand reputation and are of significant size, and it was „easy“ for companies to instruct these firms („You can't go wrong buying IBM“).

Hence, demand exceeded supply significantly, bringing law firms in a position where they could leverage their market power – described as “Christmas” by Mr. Hess (see above).

In an „ideal market setting“ supply would have exceeded demand. The legal market is far from being an „ideal market setting“ as buyers focus on a small number of providers, irrespective of the number of providers (law firms) in the market. We call this „artificial excess in demand“.

With the economic meltdown, the scene has changed dramatically. Business activity and demand for legal services collapsed sharply, immediately changing the balance of power between law firms and clients: The excess in demand has been transformed into a supply surplus, nearly overnight. This has been described as "total reset".

Now, law firms are under immense pressure as they are "*facing losses of clients and business, reduced access to bank lines of credit, a need to downsize and better manage overhead, and keeping as many people employed as possible*" (ACC Value Challenge).

An important part of the role of inhouse counsels is to reduce legal spend/costs. They tend to expect the same level of quality for significantly lower rates, thinking about all sorts of alternative billing arrangements to achieve this goal. From a law firm's perspective this may seem unfair, but given the balance of power in the legal market we would not assume that this situation is going to change in the near future.

Companies/in-house lawyers have developed into "smart buyers", using their leverage to make their way – this study shows how Deutsche Bank has designed its procurement process for legal services. They have understood the broad spectrum of legal services, from rocket science to standardized services, and are no longer prepared to instruct the group of "usual suspects" mentioned above (LPO – Legal Process Outsourcing – has to be seen as part of this trend).

Regarding brand value/brand recognition of law firms as an argument for high(er) prices: We see a shift from in-house counsel to procurement departments when it comes to discussing fee arrangements. People in procurement departments are – normally – not impressed by brand value of law firms but tend to stick to lower rates and more beneficial pricing models. In general, we would describe this as an evolution from reputation to expertise, the latter being more important to clients.

Finally, GCs have shown a certain tendency to do more work in-house as long as this can be justified, for several reasons: Inhouse counsel are "cheaper" than their external peers.

Another reason may be that in-house departments have grown so much that they have to justify their internal legal spend and, therefore, have a tendency to refrain from instructing external counsel. At the moment we see companies giving their overflow work and less complex work outside – to LPO-providers or to (smaller) law firms who are able to meet these needs in an cost-efficient manner. According to the annual "Managing Outside Counsel Survey" conducted by the Association of Corporate Counsel (ACC) and Serengeti, the ratio of expenditure on outside counsel as compared to inhouse counsel has shifted in favor of the latter: The median ratio used to be 2.0 in 2004 and declined to 1.6 in 2008/09.

However, these aggregated numbers disguise a lot of variation: According to another recent study of companies from various sectors, their percentage of total legal spending on external lawyers ranged from 12% to 93%.[1]

[1] Mari Sako, General Counsel with Power?, Oxford 2011, p. 6. Available at: http://www.sbs.ox.ac.uk/centres/professionalservices/Documents/Sako%20GC%20with%20Power%20Aug%202011.pdf (last visited Oct 22, 2011).

Deutsche Bank

Deutsche Bank describes itself on its website as “a leading global investment bank with a substantial private clients franchise. […] A leader in Germany and Europe, the bank is continuously growing in North America, Asia and key emerging markets. With more than 100,000 employees in 73 countries (as of September 30, 2011), Deutsche Bank offers unparalleled financial services throughout the world.”[2]

Deutsche Bank does not disclose its overall spend on external legal advisors. Nevertheless, Deutsche Bank confirmed a two to one ratio between external and internal legal spend, that is for every dollar spent on in-house lawyers two dollars were spent on outside advisors.

Given that Deutsche employs approximately 800 in-house legal staff both onshore and offshore, it is fair to assume that the overall volume of Deutsche Bank’s external legal spend represents a significant amount of money. According to Deutsche Bank the mentioned two to one ratio was stable over the last five years. Maybe this adds a bit of perspective to all the talk about the mixed future awaiting law firms; at least when looking at Deutsche’s experience a scenario stipulating that legal work will increasingly move in-house has so far failed to materialize.

About a third of Deutsche Bank’s overall legal spend is on litigation and regulatory work, about two thirds is on transactional work. During the recent financial crisis predictably the importance of litigation and regulatory work increased whereas transactions took a hit. Now, in November 2011, things are shifting and deal flow is increasing.

[2] http://www.db.com/en/content/company/company.htm (last visited Oct 22, 2011).

Click4Legal

1. Origins and Significance

Initially the idea of standardizing the instruction of External Counsel met huge resistance. As Rose Battaglia, Deutsche's Global COO for Legal and Compliance , recalled: "We were told this would never work in banking… Everyone thinks their transaction is non-standard or bespoke." However, Deutsche's in-house lawyers continued to discuss the idea in industry groups and in regular discussion groups of General Counsel and eventually introduced their IT-based system "Click4Legal" in November 2007.

According to an internal presentation the objective of the system was "to further control and obtain greater transparency **and reductions** on external Legal Services" (emphasis added by the authors of this case study).

Another goal was to facilitate a tracking process for External Legal Counsel instructions and billing.

The system was implemented in Deutsche Bank's "Global Markets" division and was to be used for "all transactions related spend on External Legal Counsel". Deutsche's "Global Markets" includes fixed income + equity prac-tice and is Deutsche Bank's largest area of legal spend. Initially not covered by Click4Legal was legal spend related to potential or threatened litigation, all regulatory investigations, potential defaults, workouts and HR issues. Currently about 50% of Global Market's external legal spend is managed through Click4Legal, but this figure is continuously increasing.

2. Initiating the Tendering Process

Workflow through the system starts inside Deutsche Bank with the Business Person (Requestor) who needs legal assistance. He or she logs onto the system and initiates a "Legal Services Request". Fields that have to be filled in include requested services, primary jurisdiction coverage, details of service requested, service delivery date, expected deal revenue and expected legal spend. Expected legal spend has to be allocated to an internal cost center. Finally the request is given a "Request ID" so that Requestors can check the current status of their various requests online. The request is then forwarded to the Requestor's Business Manager for approval and to confirm where the cost will be charged.

Next, there are two possibilities. Usually the request goes through Deutsche Bank's in-house legal department (DB Legal). DB Legal's role is to: "identify External Legal Counsel able to deliver requested services, obtain and capture all relevant quotes, select and instruct appropriate External Counsel and notify [the Requestor]".

However, sometimes the Requestor can go straight to External Counsel without prior involvement of DB Legal by checking a "Desk Instruction" box in the original request. Only pre-vetted "approved" law-firms can be instructed via "Desk Instruction" and only about 13% of all requests qualify for "Desk Instruction".

Irrespective of whether the Business Desk itself or DB Legal is tendering the request common "tendering guidelines" apply for all transactions in click4Legal. Deutsche Bank will "tender quotes from at least two, preferably three External Counsel for all transactions, including new product development and pre-deal research."

3. Permitted Exceptions to the Standard Quotation Process

In certain instances the system allows the Requestor or DB Legal to approach an External Counsel without the need for competitive tendering.

Legal will not tender when:

- Any modification to previous ISDA, netting or other opinion is needed from the external counsel who provided the original opinion.
- A specific transaction is being modified or repurchased where external counsel has provided the previous deal documents.
- The transaction is part of a program (a bundle or a group of trades) that has been tendered within the last 12 months. Opportunities will be sought for discounts based on increasing volumes under the program.
- An authorizing party (e.g. external client or lead bank in a syndicate) selects the outside counsel who will handle the transaction.
- Matters of corporate housekeeping when there is a law firm in place handling corporate housekeeping for that entity.
- There is no alternative expertise that can be obtained in specific emerging markets, unique jurisdictions or areas of expertise. A list of these […] is maintained by the LST (Legal Services Team) and reviewed annually.

4. Tendering Process - Continued

The Legal Services Team (LST), like DB Legal a subdivision of Deutsche's Risk Division, has the mission "to ensure a seamless implementation and adoption by External Counsel" of Click4Legal. The LST is made up of paralegals and analysts, not lawyers and provides administrative assistance to both sides, Deutsche Bank and External Legal Counsel.

LST personnel fill in one half of a so-called Standard Quote Template (SQT), the other half is filled in by those External Legal Counsels who wish to participate in the tendering process for a particular Request. The Legal Services Team has to make sure the Standard Quote Template contains a brief summary of the term sheet details needed for External Counsel to properly formulate a quote. It has to be indicated whether templates for the transaction already exist, whether the Request is a potential repeat transaction and whether an accurate (capped) or an hourly quote is required. Hourly quotes are only used for some particular pieces of work, never for the bulk of a transaction.

5. Bids by Law Firms

Only panel firms are invited to tender unless a specific legal knowledge is not available within DB's panel firms, then a non panel firm will be invited to compete. The External Legal Counsel then has to fill in the SQT including "entering a detailed description of the services which will be provided, including indicating if drafting will be template based or specialized/tailored contract drafting and if translations are required" and "specify the number of documents required by document type and provide an explanation/specific reason for each document requested". Estimated staffing levels required to complete the transaction have to be provided in detail. Finally and obviously a quote has to be proposed.

Usually the best (i.e. cheapest) quote wins. There is an exception process for when a DB lawyer does not think the cheapest firm is the right firm to select. However, this is discouraged and requires a strong justification but will be granted if appropriate, according to Deutsche Bank's Rose Battaglia.

6. Regular Feedback to External Suppliers of Legal Services

An interesting part of Deutsche Bank's Click4Legal system is the feedback given to External Counsel. Regular reports are provided to several of the top-tier law firms participating in the tendering process through Click4Legal. For a given period of time these reports indicate how often the law firm bid for work, which bids were successful and – this is the crucial part – for those bids which were unsuccessful the report indicates the percentage by which the law firm's bid was above the winning bid. This practice enables law firms to re-evaluate their bidding strategies and for example decide that it is no longer viable to bid for a certain type of work which is done much cheaper by a competitor.

7. Evolution of the System

So far the introduction of Click4Legal has been a success story for Deutsche Bank. With the help of the system, Deutsche managed to reduced its legal fees by approx. €20 million in 2010. Other GC's interest in the system is running high and DB has been in discussion with an e-billing vendor to integrate its software with the system.

After Global Markets, Deutsche rolled out Click4Legal in its other divisions, such as Global Banking, Asset Management and Private Wealth Management. Equally, after an initial focus on transactions-related legal spend Click4Legal is increasingly used to manage legal spend on litigation or regulatory matters as well.

Click4Legal may be a unique system but its main goal – reducing costs – is also pursued by other major companies through "reverse auctions". The Wall Street Journal writes: "Reverse auctions put multiple law firms against each other in an online chat room where they anonymously submit quotes for a particular job.

Firms then race against the clock to tender incremental discounts against competing bids. If someone introduces a new low price in the last minute or two of the session, it can be extended for several minutes—launching another round of calculations and lower offers."3 To repeat once more the observation of Deutsche Bank's Rose Battaglia: "Everyone thinks their transaction is non-standard or bespoke." That may be the case or not, apparently this is no longer an obstacle to "their transactions" being subject to competitive tendering.

[3] http://online.wsj.com/article/SB10001424053111904292504576482243557793536.html (last visited Oct 22, 2011).

Possible Lessons for Law Firms

1. Get Out - Avoid the System by Offering Only Premium Work

We need to avoid that! Usually this is still the initial reaction of most law firm leaders when confronted with a report about such a system. Competitive auctions are associated with low-margin commodity-type legal work and so far hardly any traditional law firms have officially embraced a strategy focused on this market segment. However, the amount of legal work which can be marketed and sold in the "traditional" way is shrinking. Maybe in future only advice on important bet-the-company issues and personal legal advice to the boardroom will continue to be based on the billable hour.

In most jurisdictions it is quite clear which two or three law firms at the top end of the market can reasonably hope to survive with a strategy entirely focused on such extreme premium work. Although everyone seeks to emulate them, potential competitors face almost insurmountable barriers to entry into this market segment. At least that is the conclusion one might draw when looking at the remarkable stability of law firm rankings: in most jurisdictions, the perceived top end players have not changed over the last decade.

Even if some law firms managed to break into the market for extreme premium work, it is nevertheless impossible for all traditional law firms to move up-market at once and leave “regular” transactions to someone else. Most law firms will have to get used to the idea of competing in a market increasingly shaped by systems such as Click4Legal.

2. Get In - Achieving Competitive Advantage on the Spot Contracting Market

2.1. The Consequences of Online Bidding– Change of Processes or simply Margin Compression?

Currently there is no consensus as to the effects of online bidding procedures on law firm's behavior. Some observers think law firms are reluctantly playing along for now but really are waiting for a better business climate, when legal services will again become a seller's market.[4] In the meantime these law firms achieve the required cost reductions through margin compression, not altering their fundamental business model much.

On the other hand, you may accept the proposition that systems such as Click4Legal permanently killed the billable hour for certain types of legal work. This has important consequences for a law firm's business model and internal culture. Currently there are enormous variations in how far law firms have respectively embraced or resisted this change. According to Deutsche Bank law firms from the UK found it much easier to adapt to Click4Legal's fixed fee system than their US counterparts. One reason may be that UK firms have had to compete in a more competitive market for a long time and therefore developed better internal processes, such as legal project management, than US law firms. One may even discuss whether lockstep-based compensation systems adapt better to alternative billing arrangements than merit-based compensation systems which perhaps currently rely to a greater extent on the billable hour to measure the contribution of individual partners to the firm.

[4] Mari Sako, General Counsel with Power?, Oxford 2011, p. 11, available at: http://www.sbs.ox.ac.uk/centres/professionalservices/Documents/Sako%20GC%20with%20Power%20Aug%202011.pdf (last visited Oct 22, 2011).

In any event, it is probably fair to conclude that alternative billing arrangements accelerate a shift from traditional "professional partnership" models towards models often characterized as "managed professional businesses". Internal knowledge management systems, legal IT and legal process outsourcing are just some of the management issues which need to be addressed.

2.2. The Importance of Knowledge Management

If clients have systems in place telling them which transactions are merely a "modification or repurchase of previous deal documents" law firms need to have internal processes enabling them to fulfill the associated expectation of fast and inexpensive service. While this may indeed be no big deal if the same lawyer can simply repeat his or her transaction from a few weeks ago, is your law firm sure that it could easily and profitably do this even if the transaction in question was done two years ago and the lawyer who worked on it has since left the firm? "Reinventing the wheel" may have been a profitable approach in the old billable hour world but in the new Click4Legal world an important driver of law firm profitability will be the firm-wide availability - and use - of precedents.

2.3. The Importance of Legal IT

Although easily forgotten, the integration of information technology into the work flow of law firms has resulted in considerable productivity improvements over the last two decades. It seems foolish to assume that we have reached the end of possible developments here, however law firms differ considerably in how far they embrace strategies based on the innovative use of IT. Take for example automated document generation, a classic example is "Wilson Sonsini's Term Sheet Generator". Some law firms actively seek to achieve a competitive edge in automated document generation whereas others adopt a strategy best described as 'wait and see' policy.

2.4. Legal Process Outsourcing (LPO)

Another development, made possible by advances in information technology, is the use of outsourcing. Whereas the legal process outsourcing sector in India has not yet achieved the explosive growth predicted a few years ago, other locations such as

South Africa or Australia are successfully taking on work previously done in London. In the medium term the most promising development seems to be "near-shoring", "on-shoring" or "farm-shoring", the use of lower cost business locations in the home jurisdiction. Deutsche Bank itself set up internal "outsourcing" operations not only in Mumbai, but also in Jacksonville (Florida), Birmingham and Berlin.[5] As the example of Berlin shows, "near-shoring" may be how LPO-markets for non-English language legal work will develop. However, quite a few law firms whose work primarily covers non-English language jurisdictions still think of LPO as a subject only relevant to common law based legal advisors.

3. Get Out, Second Attempt - Avoid the System Through Comprehensive Service Agreements

There is another development in the market for legal services that goes beyond the spot-contracting approach epitomized by systems such as Click4Legal: comprehensive service agreements. The prototype of these deals is often seen in a 2006 agreement between Tyco and the law firm Eversheds:[6] Tyco took the radical step of reducing the number of external law firms the company used from 250 to a single provider. This agreement moved beyond being a massive $20 million per year fixed fee arrangement and sought to achieve a better alignment of interests between client and law firm, for example containing incentives for Eversheds to help Tyco avoid legal trouble in the first place:

Eversheds could win a substantial bonus if it helped to reduce the number of lawsuits filed against Tyco by fifteen percent over the number filed the previous year.

In Germany Deutsche Bank took a similar approach to litigation. In a widely reported move it tendered all its litigation needs in Germany to a single law firm, Noerr.[7] Noerr will neither receive a fixed fee nor bill by the hour - instead the deal rests on using the

[5] http://www.legalweek.com/legal-week/news/2036352/deutsche-expand-adviser-line-create-team?WT.rss_f=Simmons+%26+simmons+-+Law+firms&WT.rss_a=Deutsche+expands+adviser+line-up+and+sets+up+Berlin+'near-shoring'+arm (last visited Oct 22, 2011).
[6] For an excellent description of this relationship, see: David B. Wilkins, Team of Rivals? Toward a New Model of the Corporate Attorney-Client Relationship, 78 Fordham L. Rev. 2067 (2010), at 2100.
[7] http://www.juve.de/nachrichten/namenundnachrichten/2010/09/prozesse-deutsche-bank-lagert-litigation-auf-noerr-aus (last visited Oct 22, 2011).

German statutory fee scale (“RVG”), an instrument usually not much used by large corporate law firms.

It remains to be seen to what extent clients will opt for streamlined spot contracting procedures such as Click4Legal and to what extent comprehensive service agreements will be preferred. However, the practical lessons for law firms seeking to achieve profitability as party to such comprehensive service agreements are broadly the same as they are for law firms who feel more at ease in a flexible spot contracting environment: Much more attention to management issues such as the ones we chose to highlight above (internal knowledge management systems, legal IT, legal process outsourcing…) will be needed in future.

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