



LEGAL DEPARTMENT MANAGEMENT – THOUGHTS ON POTENTIAL STRATEGIC INITIATIVES TO DRIVE RESULTS, EFFICIENCIES AND COST SAVINGS

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A. Introduction

Vision without action is a daydream. Action without vision is a nightmare.

Japanese proverb.

Legal Department management is well served to view any advice, observations, and musings of outside counsel on the management of the corporate Legal Department with healthy skepticism. More often than not, outside counsel and consultants may be viewed as part of the “problem” and an impediment to achieving the desired return on the organization’s legal investment. The flip side of that coin, however, is that outside counsel must be part of the “solution” in any Legal Department’s quest for the delivery of efficient, effective, and the highest *appropriate* quality of legal services to the clients of the Legal Department.² Although a possible “outsider” permit the following thoughts on the critical “success” ingredients for the corporate Legal Departments of today and tomorrow from one who has worked in a corporate legal setting and has evolved into a huge supporter of process improvement practices. The critical “success” ingredients are: strong leadership; creating high functioning teams; the use of metrics; institutionalizing process and continuous improvement; considering the use of methodologies to evaluate risk; and employing basic and fundamental project management techniques. While the success ingredients appear to be fairly straight forward, the journey is not for the faint of heart.

B. Leadership

“Leadership is the art of getting someone else to do something you want done because he wants to do it.”

Dwight Eisenhower

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² The term “highest *appropriate* quality of legal services” is critical and does not mean the “highest quality of legal services.” To use an art analogy, where the issues in litigation are relatively straight forward and the exposure to the organization is minimal, the business client does not need a Rembrandt when a “stick man” drawing will suffice. While a Rembrandt may be the “highest quality” legal service, it is not necessarily appropriate, efficient or effective. Recognizing this distinction is often a significant challenge to Legal Department personnel and the outside counsel with whom they work as there is not a proper alignment or agreement upon the goals, objectives, and budget for the undertaking.

“If you want to build a ship, don’t drum up the men to gather wood, divide the work up and give orders. Instead, teach them to yearn for the vast and endless sea.”

Antoine De Saint-Exupery

Research and secondary source materials strongly indicate the following common perceptions negatively impact upon the reputation and the effectiveness of Legal Department personnel within many business organizations³:

Corporate attorneys are firefighters: Attorneys provide only reactive as opposed to proactive legal services to senior management and line functions.

Lawyers are naysayers: Attorneys only reject solutions (usually on legal grounds) and fail to provide legally-permissible alternatives. This behavior is often justified using the familiar phrase “it’s a business issue.”

The Legal Department is inefficient: The Legal Department fails to provide solutions quickly and in a cost effective manner.

The Legal Department is a cost center: The Legal Department cannot generate revenues.

It is self evident that to counter these perceptions a well functioning Legal Department requires strong leadership. The potential *power* of effective leadership from the office of the General Counsel cannot be underestimated. While there are ample articles and books on how to be an effective leader,⁴ and repeated attempts to describe those leadership characteristics that are critical,⁵ leaders of highly effective Legal Departments appear to have the following characteristics in common:⁶

1. Closely aligned with the business management of the organization whose business and legal counsel is sought and respected by management.
2. Has developed a strategic vision for the Legal Department and implements the metrics appropriate to determine if the Department is continuously improving and moving toward the objectives necessary to achieve the strategic vision.
3. Attracts and retains highly performing, diverse and motivated professionals who effectively work as a process driven team and is provided with the appropriate tools (IT, training, mentoring, and otherwise) to support the processes the team is expected to perform.

³ *Communicating the Legal Function’s Strategic Value to Senior Management*, General Counsel Roundtable (Executive Project Support, 2010).

⁴ See, e.g., *Are You A Good Boss or A Great One?*, Hill and Lineback, Harvard Business Review (February 2011); McFarland, *The Breakthrough Company* (Three Rivers Press, 2009); Tichy, *The Leadership Engine* (Harper Business, 1997).

⁵ Huntsman, Kiel, Lennick and Parker, *Essential Lessons on Leadership* (Harper, 2011); Maxwell, *The 21 Irrefutable Laws of Leadership* (Nelson, Thomas 2007); Kotter, *Leading Change* (Harvard Business Press, 1996).

⁶ Michael Weise, *Representing the Corporation: Strategies for Legal Counsel* (Aspen Law & Business, 1999)

If any of these ingredients are missing from the leadership of the Legal Department, the Department's potential will be compromised and the negative perceptions of Legal Department personnel will not be effectively countered.

C. Working as a High Functioning Team

**“Coming together is a beginning, Keeping together is progress.
Working together is success.”**

Henry Ford

There are very few individuals who are more comfortable working in egocentric “silos” than legal professionals. The most distressing aspects of this “silo” culture is that many legal professionals do not know how to work as part of a high functioning “Team” and fail experience the incredible power of the Team. Simply because one is a great lawyer does not mean one knows how to be a good Team member. Great lawyers, who have not developed the skills necessary to be an effective Team member, can do more to undercut the success of the Legal Department than is appropriate and such conduct must be modified. The successful Legal Department manager must change this paradigm and foster the creation and growth of high functioning Teams within the Legal Department. There cannot be much dispute that effective Teams are far more productive and creative than working in silos and there is absolutely nothing about the practice of law which is immune to the benefits that can be derived from working as a Team.⁷

Effective teams don't “just happen” and establishing effective Teams requires “multipliers” as leaders. A relatively recent study summarizes the pitfalls well:

Some leaders drain all the intelligence and capability out of their teams. Because they need to be the smartest, most capable person in the room, these managers often shut down the smarts of others, ultimately stifling the flow of ideas. You know these people because you've worked with them... At the other extreme are leaders who, as capable as they are, care less about flaunting their own IQs and more about fostering a culture of intelligence in their organization. Under the leadership of these “multipliers,” employees don't just feel smarter, they become smarter.⁸

The General Counsel office must and should demand better of the Legal Department and its Team leaders. An effective Team requires five relatively straight forward and seemingly simple requirements. The challenge in establishing the appropriate setting that should not be underestimated as it requires a way of thinking and interacting that may be foreign to most

⁷ Blanchard, *Go Team* (Barrett-Koehler, 2007).

⁸ *Bringing out the Best in Your People*, Wiseman and McKeown, Harvard Business Review (May 2010). This premise is also the theme of *Emotional Intelligence* (Diamond 2011); Goleman and Lantieri, *Building Emotional Intelligence*, (2008). Studies on the subject clearly reflect there is a higher correlation between “success” and emotional quotient (EQ) than intelligence quotient (IQ). Goleman, *The Brain and Emotional Intelligence* (Harper, 2011); Stein and Book, *Emotional Intelligence and Your Success* (Jossey, Bass 2006); Thompson and Biro, *Unleashed: Expecting Greatness and Other Secrets of Coaching for Exceptional Performance* (SelectBooks, 2006).

lawyers. To work effectively, the Team members must have trust in each other, embrace and participate in positive conflict, be committed, individually accountable to each other and the organization, and focus on results.⁹ Teams that do not have these characteristics, whether work teams, project teams, problem solving teams, or leadership teams, will be neither high performing nor effective.¹⁰

1. Trust matters:

"Could a greater miracle take place than for us to look through each other's eyes for an instant?"

Henry David Thoreau

Trust in a team is the belief that one will be treated with respect, listened to, told the truth, and have one's legitimate needs and concerns dealt with. When there is trust, creative conflicts can and should be raised within the team and effectively addressed without negative consequences to the Team or the organization.

Trust lies at the heart of a functioning, cohesive team. Without it, teamwork is all but impossible. Unfortunately, the word "trust" is used and misused so often that it has lost some of its impact and begins to sound like motherhood and apple pie. In the context of building a team, trust is the confidence among team members that their peer's intentions are good, and there is no reason to be protective or careful around the group. Effective Teams know "what is done in the Team stays in the Team." In essence, teammates must be comfortable with being vulnerable with one another.

This description stands in contrast to a more standard definition that centers around the ability to predict a person's behavior based on past experience. True trust requires team members to make themselves vulnerable to one another and be confident that their respective vulnerabilities will not be exploited. As "soft" as this might sound, it is only when team members are truly comfortable being exposed to one another that they begin to act without concern for protecting themselves. As a result, they can focus their energies and attention completely on the objectives and problems that calls out for resolution. Achieving vulnerability based trust is difficult because in the course of career advancement and education most successful people learn to be competitive with their peers or other professionals and protective of their reputations – this is often especially true with lawyers.

Personal goals and aspirations must be subordinated to the mission of the team and all team members must believe this is the sole motivator of each team member. If any team member violates the team's rule and permits personal egos and agendas to subordinate the

⁹ Blanchard and Bowles, *Gung Ho!* (William Morrow and Company, 1998); Maxwell, *The 17 Indisputable Laws of Teamwork*, (Thomas Nelson, 2001).

¹⁰ See, e.g., Lencioni, *The Five Dysfunctions of a Team* (Wiley, John and Sons, 2010); Dyer, Dyer, Dyer and Schein, *Team Building* (Wiley, John and Sons 2010); Huszyczko, *Tools for Team Excellence* (Davies-Black Publishing, 1996).

objectives of the team, then team leadership must act and act quickly and decisively. Otherwise, the trust necessary for an effective team will not exist.

2. Conflict

"Conflict lies at the core of innovation."

Emanuel R. Pior

Conflict in a well functioning team is inevitable, desired, and an extremely powerful tool for innovation and creativity. Positive conflict typically involves the priorities, goals, and choices the team will be called upon to make or recommend. Positive conflict generates the discussions within teams and organizations that maximize the best decision-making. When positive conflict is suppressed decision-making will suffer. For conflict to thrive without crippling an organization there needs to be trust. Trust creates the environment that facilitates not only discussion, even contentious discussion, but also for the contention to come to an end when a decision is made. Once the decision is made, the effective Team's sole focus, collectively and individually, is to support the Team's decision and action plan.

Unfortunately, conflict is considered taboo in many situations, especially at work. The higher one goes in an organization, the more one might find people spending inordinate time and energy trying to avoid the kind of passionate debates that are essential to any great Team. It is important to distinguish productive ideological conflict from destructive fighting and interpersonal politics. Ideological conflict is limited to concepts and ideas and avoids personality-focused, mean-spirited attacks. Teams that engage in productive conflict know the only purpose is to produce the best possible solutions in the shortest period of time. They discuss and resolve issues more quickly and completely and emerge from the debates with no residual or collateral damage but with an eagerness and readiness to take on the important issues that must be addressed.

There are times when conflict is centered on one person's issues, a clash of egos, or personalities, which has nothing to do with the issues and priorities of the organization or the legitimate needs and concerns of the Team. These are the times when leadership needs to be exercised and personnel may need to be coached or shifted. It is telling when such destructive conflict involves the same staff member.

The conflict competent organization is one in which positive conflict is appreciated rather than suppressed; managed rather than avoided; and systems are in place to deal with real issues and concerns. Results of conflict management are measured and provided as feed back to the organization. Supervisors, managers and executives are rewarded for dealing well with conflict. Employees are rewarded for engaging in appropriate and positive conflict.

3. Building commitment

"Unless commitment is made, there are only promises and hopes; but no plans."

Peter F. Drucker

In the context of an effective Team, commitment is a function of two characteristics: clarity and buy in. Great Teams make clear and timely decisions and move forward with complete devotion from every member of the Team, even those who voted against the decision. They leave the meetings confident that no one on the Team is quietly harboring doubts about whether to support the actions agreed upon.

Great Teams understand the danger of seeking consensus, and find ways to achieve commitment even when complete agreement on a problem (or solution for that matter) is impossible. They understand that reasonable human beings do not need to get their way in order to support a decision, but only need to know their opinions can be raised, have been heard, and respectfully considered. Great Teams ensure that everyone's ideas are genuinely heard, which then creates the willingness to rally around whatever decision is ultimately made by the team.

Great Teams also pride themselves on being able to unite behind decisions and commit to clear courses of action even when there is little assurance about whether the decision is correct. They understand the old military axiom that “a decision is better than no decision.” They also realize that it is better to make a decision boldly and be wrong, and then change direction with equal boldness, than to waffle interminably and avoid making a decision. In sum, making a mistake is forgivable. What is not forgivable is refusing to make a decision or the refusal to recognize a mistake has been made and take the necessary corrective action.

4. Accountability

"Accountability breeds response-ability."

Stephen R. Covey

Accountability is a buzzword that has lost much of its meaning as it has become overused as terms like empowerment and quality. In the context of teamwork, however, it refers specifically to the willingness of team members to call their peers on performance or behaviors that might impede the effectiveness of the Team.

The absence of accountability is the unwillingness of team members to tolerate the interpersonal discomfort that accompanies calling a peer on inappropriate behaviors and the more general tendency to avoid difficult conversations. Members of great Teams overcome these natural inclinations, opting instead to enter the danger zone with one another. This is where building loyalty and relationships matter as well as the belief that constructive criticism is for the benefit of the team rather than a selfish or egocentric purpose. Accountability also requires strong team leadership.

A mechanism that many effective teams utilize to foster accountability is the development of an agreed upon “Team Charter” that will govern the activities of each team member. Issues that can be addressed in a Team Charter (typically established at the outset of the Team’s mission) includes such items as promises the discussions within the Team remain

confidential and are not published to third parties without the prior consent of the entire Team; each team member is committed to meeting deadlines that might be agreed upon; each member of the team agrees to “listen generously;” each member of the Team is authorized to have a confidential communication with any Team member who is believed to have violated any commitment contained in the Team’s charter; etc.¹¹

5. Results Orientated

"Results! Why, man, I have gotten a lot of results. I know several thousand things that won't work. But, I have not failed. I've just found 10,000 ways that won't work."

Thomas A. Edison

Highly effective teams recognize that all the “soft” aspects of working as a Team are absolutely meaningless unless the team can achieve “hard” results.¹² Results matter and any team that does not achieve results is a failed team regardless of all other positive characteristics they might possess. Every good organization specifies what it plans to achieve in a given period of time and these goals are often more than simply the financial metrics they drive. These drivers make up the majority of the organization’s near-term controllable results.

However, results cannot be separated from a commitment to continuous improvement. If a team does not achieve the hoped for results that does not necessarily mean the team has failed. Edison had it right; it may take thousands of failures to seize upon that which is successful – results and continuous improvement are truly the twin goals.

D. Metrics

“If you don't measure something, you can't change it. The process of leadership is one of painting a vision, then saying how you're going to get there, and then measuring whether you're actually getting there. Otherwise, you risk only talking about great things but not accomplishing them.”

Mitt Romney

“You become what you measure.”

Peter Drucker

Establishing the Legal Department’s value to the organization is becoming increasingly important, particularly in an environment where the value of the Legal Department in the organization has been questioned. The manner in which Legal Department management determines those activities that provide “value” to the organization will be driven by two

¹¹ See generally, Connors, Smith, Hickman, *The Oz Principle: Getting Results Through Individual and Organizational Accountability* (Prentice Hall Press, 1994).

¹² Ulrich, Zenger, Smallwood, *Results Based Leadership* (Harvard Business School Press, 1999).

primary considerations: the Legal Department's vision statement (*i.e.*, what it strives to become) and the business objectives of C-suite management.¹³ It is incumbent upon the Legal Department management to identify those metrics that will determine whether the objectives are being met. For example, if the organization has a large portfolio of litigation, one of the goals of the Legal Department and management may be to reduce the cost of litigation by 10% in a specified period of time. There are a number of metrics that can be utilized to determine if this objective is being met:

1. The historical cost of litigation across the organization's portfolio of risk (this can be broken down according to the type of cases such as employment, auto, product liability, breach of contract, *etc.*);
2. The historical life cycle from opening to closing of the litigation across the organization's portfolio of risk;
3. The historical transactional costs (defense costs and indemnifications paid) across the organization's portfolio of risk;
4. Bench marking the litigation costs of other similar organizations;
5. Comparing the above with current activities after the implementation of "cost savings" activities such as:
 - a. Requiring a 15% reduction in the fees paid to outside counsel and/or hiring new outside counsel who will not charge hourly rates in excess of a certain dollar amount;
 - b. Requiring flat fees of 15% less than the average historical cost of cases;
 - c. Reducing the life cycle of the portfolio of risk by requiring immediate ADR in 50% of all cases targeted for early resolution; or,
 - d. Delay the payment of large settlements until 2012.¹⁴

In this overly simplistic example, the Legal Department personnel assigned to the management of litigation would be charged with the mission of reducing the organization's

¹³ See, e.g., *Fulfilling the Promise*, General Counsel Roundtable (2003).

¹⁴ These "suggested" cost reduction solutions to generate metrics to determine whether the Legal Department's goals are being met may be a perfect example of why solutions that are not formulated through the Lean or other process improvement regimens may create more problems than they solve and not deal with the true "root causes" of the problems. See *Fulfilling the Promise*, *supra*. More on the importance of developing "solutions" through Lean and the DMAIC regimen or any number of other process improvement techniques will be discussed below. It also underscores the law of "unintended consequences" when metrics are established that have not been fully thought through. One can anticipate that individuals can always find ways to "job" the metrics. This scenario is a perfect example of an assignment that might be given to a process improvement Team to identify the root causes of the business "problem," formulate solutions, implement the action plan, and monitor to determine if the action plan is achieving the desired results

litigation cost per case by 10% in a given year when compared to the prior year. Periodic reports (i.e., the dreaded “dashboard”) would be generated to determine if that goal is being achieved by the internal personnel charged with achieving this goal. Assuming the goal is achieved at year end the Legal Department would celebrate its success internally and with the management of the organization. If the goal is not achieved, there would be a candid assessment of why and the necessary corrective actions implemented.

Metrics can be an extremely powerful tool in driving desired behavior and Legal Departments use metrics in a multitude of ways. Just a few examples are described below:

No. 1 Practice Title: Legal Department Dashboard

Practice Description: Baxter International’s Legal Department asks its attorneys to submit ideas for areas in which the legal department creates value, such as cost savings achieved by the department or revenues produced as a result of legal service. The general counsel reviews and edits the submissions before compiling them into a final report the general counsel uses as a discussion piece in meetings with the CEO.

Key Insight: Precise reporting of legal department value is not necessary, a good estimate is adequate, to establish a sense of where the department produces value and where new opportunities for value creation might lie.

No. 2 Practice Title: Advertising Review Dashboard

Practice Description: As part of the company’s Six Sigma efforts, the Vanguard Group of Investment Companies legal department uses dashboard metrics that tie into Vanguard’s corporate dashboard to measure the department’s performance in areas such as accuracy, timeliness, efficiency, and client satisfaction.

Key Insight: Legal departments should tailor their dashboards to the audiences they strive to inform, but should provide links between even the most granular data (such as practice area operational metrics) and the company’s overarching strategic objectives.

No. 3 Practice Title: Outside Counsel and Litigation Management Assessment

Practice Description: In an effort to control outside counsel costs and litigation-related expenses, NCR Corporation undertakes a litigation management project that follows Six Sigma process improvement methodology. Using client interviews and data from client satisfaction surveys, the Six Sigma team identifies what clients deem a successful litigation management process. Next, the team defines litigation management defects – correctable errors in the process. As a result of its tracking efforts NCR significantly lowers the number of self-identified defects in the litigation management process.

Key Insight: Systematic measurement serves as both an effective diagnostic tool and a gauge of an initiative’s success. Without such measurement, the root cause of

inefficiencies may remain unidentified and the success of efficiency initiatives will remain unclear.

E. Process Improvement

“Check up each week on the progress you are making. Ask yourself what mistakes you have made, what improvement, what lessons you have learned for the future.”

Dale Carnegie

“Quality is improved through three processes: a quality-improvement process, corrective-action process, and a customer-complaint resolution process. These processes involve everyone. Every person in the company gets the big picture.”

Stephen Covey

“Today you may make progress. Every step may be fruitful. Yet there will stretch out before you an ever-lengthening, ever-ascending, ever-improving path. You know you will never get to the end of the journey.”

Winston Churchill

Process improvement and project management (as more fully discussed below) are two distinct and potential tools to enhance the effectiveness of Legal Departments in serving the needs of their clients and their organizations. There can be confusion as to the meaning of these two different tools:

Process Improvement is a tool that assists the organization to identify how a certain task can be carried out in the “best” way to achieve:

- Maximum efficiency
- An avoidance of duplication and redundancies
- Minimize re-work
- Maintain quality control and provide excellent quality of work and service
- High probability of success of outcomes
- Predictability

Project Management is a role and set of skills that ensures that for a particular engagement the organization:

- Employs whatever “best practices” that have been developed
- Effectively harnesses the power of the work Team
- Actively manages, schedules and staffs the project to obtain the desired deliverable throughout the life of the engagement

Project Management is the tool to ensure the “deliverable” is provided on time and maximizes the utilization of resources to achieve the deliverable. It is possible for excellent project management is saddled with ineffective or unsatisfactory processes. All the effective project management skills in the world will not transform an ineffective process into an effective process. Thus, the growth in emphasis on legal process improvement over the past decade.

Business has utilized any number of process improvement practices over the years and it is rare to find any business organization that does not incorporate some or all of these processes into the fiber of the organization. How can the widget be made better, less expensively, and more efficiently are just some of the questions the widget manufacturer asks itself every day. While not all process improvement techniques can easily be translated to the Legal Department, the Legal Department cannot afford to ignore the question of how can its processes and procedures improve to better meet the needs of its clients. Tools that have proven very effective for Legal Departments are Lean, Six Sigma and the Theory of Constraints.

In the Law Firm and Legal Department setting, the Lean process often utilizes the Six Sigma analytical tools embodied in DMAIC (**d**efine, **m**easure, **a**nalyze, **i**mprove and **c**ontrol). The DMAIC process is proven and can be taught and learned throughout the entire Legal Department and Law Firm.¹⁵

For example, the development of a contract with a key supplier might follow the process improvement steps outlined below:

Define – what are the specific problems and challenges and why do they need to be addressed – the business case for change should be identified and quantified:

- What are the legitimate expectations this supplier must meet and maintain for the enterprise to adequately meet the needs of its customers; how have these expectations not been met in the past; what is the likelihood of the expectations being met in the future if there is no change, and is there a “performance gap” with our customers attributable to the performance of the supplier?
- What are the problems this supplier can create for the organization if it fails to perform to our expectations or fails to perform in a timely manner; in what specific manner has there been a failure to meet expectations in the past?
- Is there “waste” in the processes with this supplier and the way in which the business interfaces with the supplier and, if so, will the elimination of this waste result in any benefits such as more favorable pricing?
- Have we timely identified the true “root causes” of performance issues early in the process and, if not, what performance issues have been ignored and for how long and at what cost to the organizations?
- Does the supplier perceive itself as a true team member in the goal of meeting the expectations of our customers and, if not, why not?

¹⁵ Richard Hurford Dispute Resolution Services, P.C. has developed materials that describe various process improvement tools more thoroughly.

- Have we managed conflict with this supplier successfully and, if not, why?

Measure – measure the current performance of the process, what are metrics and data that support the definition of the problem and challenges:

- What have been the greatest causes of conflicts and disputes in the past; which have been the most costly to the organization (in terms of time, money, and quality)?
- Can the costs, time and money be quantified?
- Can “waste” in processes be quantified and measured?
- Will metrics and data permit the identification of the root causes of the conflicts, problems, and challenges?

Analyze – analyze the opportunities to reduce waste or variation in performance and ask what are the data driven solutions that are required:

- What contractual provisions will best meet the organization’s needs?
- What process improvements can be implemented?
- What insurance coverages are needed?
- Who should best bear the risk for problems that can be anticipated?
- What conflict resolution processes will be helpful in identifying the “root causes” of issues as early as possible and undertaking the most effective corrective actions?
- How can we best measure quality?
- What reporting milestones are necessary?
- What contractual provisions will be key to the supplier?

Improve – improve the contract by identifying provisions that will improve the process and implement solutions:

- Craft the agreement and protocols that will strategically address the issues that have been defined and measured.

Control – control the process by implementing methods to ensure the intended improvements are achieved and measure and evaluate whether the solutions are working or could be improved upon:

- Measure whether the objectives are being met during the course of performance of the contract and, if not, identify those improvements in the process and contract terms that can and should be made.
- Undertake a retrospective evaluation (i.e., a “balanced score card”) to determine if the organizational goals have been met.

This approach is strategic and will clearly meet the needs of the organization far better than a “form” contract. Obviously, such efforts are not necessary for every contract entered into

by the organization. However, if your organization is dependent upon key suppliers, such an approach (carried out by the appropriate work teams) has resulted in significant benefits to a multitude of organizations. In essence, contracts of this nature create a *de facto* Team with the supplier.

The issue is not whether there can be effective process improvements within the Legal Department; the real issue is how to prioritize the processes that can benefit from a Lean Sigma analysis. Once there is a commitment to improve processes the potential may prove daunting as to how many processes can benefit from a Lean Sigma analysis; the chore that lies ahead is akin to how the mouse will eat the elephant – “one bite at a time.”

F. Methodologies for Evaluating Risk

“People who don't take risks generally make about two big mistakes a year. People who do know how to take risks generally make about two big mistakes a year.”

Peter Drucker

“First weigh the considerations, then take the risks.”

Helmuth von Moltke

“Take calculated risks. That is quite different from being rash.”

George S. Patton

The underlying premise of risk management is that every business entity exists to provide value to its stakeholders. The typical “stakeholders” of publicly held companies are its shareholders, employees, suppliers and customers. In evaluating risk and opportunities, it rarely is feasible to advance the interests of all stakeholders equally. Some decisions will advance the interests of some stakeholders to a greater degree than others. However, it is typically important to balance the interests of all stakeholders over the long term and not call upon any subset of stakeholders to constantly sacrifice to advance the interests of others.

As all entities face uncertainty, the challenge for the Legal Department in working with management is to determine how much and what kind of uncertainty to accept as the organization strives to grow stakeholder value. Organizations fully understand that uncertainty can present both risks and opportunities with the potential to erode or enhance value. The development of SWOT analyses, and similar analytical tools, provide businesses with a disciplined framework in assessing certain business risks and opportunities. In this same manner, risk management principles provide the organization with another tool to deal effectively with uncertainty and associated risk and the opportunity to enhance the capacity to build value for stakeholders.

The “value” of an organization is maximized when management sets strategy and objectives to strike an optimal balance between growth, its return goals and related risks. Only then will the organization efficiently, effectively and selectively deploy its resources in pursuit of the entity’s objectives. As such, the essential elements of risk management encompass:

- *Aligning risk appetite and strategy* – Management considers the entity’s risk appetite in evaluating strategic alternatives, setting related objectives, and developing mechanisms to manage related risks. To be effective, the business counselor must be keenly aware of the entity’s business strategy that will permit the counselor to formulate credible frameworks to seize upon opportunities and minimize acceptable risks.
- *Enhancing risk response decisions* – Risk management provides the rigor to identify and select among alternative risk response. The role of the Legal Department is to assist management in identifying these fundamental options. There are only four essential methods a company employs to deal with known risks: avoid the risk; employ methods and techniques to reduce risk that positively add to the company’s cost-benefit analysis; sharing the risk, either with third parties or through insurance mechanisms; or accept the risk. It is incumbent upon the business counselor to understand the risk tolerance of the organization, assist in the identification of the risks, quantify the known risks, and assist in the development of potential risk minimization strategies.
- *Reducing operational surprises and losses* – Entities that gain an enhanced capability to identify potential events and establish responses will reduce “surprises” and associated costs or losses. In any business undertaking the goal of the business counselor is to anticipate and evaluate a whole range of risks so there are “no surprises” and unanticipated losses. In this context, the relatively malignant phrase “it’s a business decision and not a legal decision” has absolutely no place in the lexicon of the Legal Department
- *Identifying and managing multiple and cross-enterprise risks* – Every enterprise faces a myriad of risks affecting different parts of the organization. Risk management facilitates the effective, integrated responses to the interrelated impacts and integrated responses to risk.
- *Seizing opportunities* – By considering a full range of potential events, management is positioned to identify and proactively realize opportunities.
- *Improving deployment of capital* – Obtaining robust risk information allows management to assess effectively overall capital needs and enhance capital allocation.

Risk management is a critical tool for the Legal Department’s arsenal that assists an entity to maximize stakeholder value while avoiding or minimizing the multiple pitfalls and surprises along the way.

Systematic risk management principles are being embraced by a whole host of organizations. For example, the U.S. Department of Defense summarizes the four basic principles of risk management that it follows as:

1. Accept risk when the benefits outweigh the costs;
2. Accept no unnecessary risk;
3. Anticipate and manage risk by planning; and

4. Make risk decisions at the right level.¹⁶

One of our greatest “value added propositions” of a Legal Department is to assist its clients in making these strategic decisions through a disciplined analytical analysis.

In today’s mercurial global economy, companies are responding to new and unforeseen risks with the incentive to view the opportunities often underlying those risks that, if strategically exploited, can lead to significant competitive advantages. To exploit those opportunities, business leaders must develop a greater appetite for strategic risk taking that improves business performance both financially and operationally.

“Risk is really a potential cost on capital,” says Professor Neil A. Doherty, Chairman of the Insurance and Risk Management Department at the Wharton School of Business.¹⁷ “So you can think of managing risk as really the other side of the coin from managing capital.” Doherty contends that a sophisticated approach to risk management can increase a company’s value 3 to 5 percent. Not a bad “value added” proposition for the Legal Department to make.

Narrow approaches to risk management hamper an organization’s ability to monitor critical risk interdependencies. This leaves an organization less prepared to discern the bigger, smarter risk they should take in an increasingly volatile business environment.

While more companies recognize the importance of systematically linking risk and reward, a gap between awareness and action persists. Ninety-two percent of recently surveyed CEOs agreed that information about risk is important or critical to long term success, but only 23 percent believed they had comprehensive information about the risks to their businesses.¹⁸

Regardless of the size of its clients, the Legal Department operates in an interconnected world and must deploy a strategic approach to managing both performance and risk. As such, those who manage operations and risk should pose numerous questions to ensure the strategic objectives of the Company are being met.

| Questions for Managers of Operations | Questions for Managers of Risk |
|--|--|
| Have I identified the risks that pose threats to business objectives? | Have I aligned the Company’s risk profile with the performance objectives based on corporate strategy? |
| Have I identified the types of risks that reveal opportunities for improved performance? | Am I using non-financial as well as financial information to build the Company’s risk profile? |
| Do I fully appreciate the Company’s appetite and tolerance for risk? | Am I adequately assessing how risk events can potentially affect business strategy? |
| Do I have access to information that could help anticipate events posing risks to | Have I identified the smart risks that create opportunities for success? |

¹⁶ Navy Safety Center ORM, <http://www.safetycenter.navy.mil/orm/index.asp>.

¹⁷ Wharton School, “Leveraging Risk Management,” Knowledge@Wharton, March 1, 2006.

¹⁸ PricewaterhouseCoopers, 12th Annual Global CEO Survey, January 2009.

| | |
|---|---|
| performance? | |
| Do I work closely with risk managers to tie performance management with risk management? | Do I interact frequently with operations managers to ensure that risks are well integrated with operational management goals? |
| Am I clear on the reliability of the performance metrics used to gauge progress toward business objectives? | Am I continually monitoring risks to the performance indicators used to gauge progress toward business objectives? |

The fundamental intellectual framework to engage in an effective risk management process involves:

1. **Establishing Context:** This includes an understanding of the current conditions in which the organization operates on an internal, external and risk management context.
2. **Identifying Risks:** This includes the documentation of the material threats to the organization’s achievement of its objectives and the opportunities the organization may exploit for competitive advantage.
3. **Analyzing/Quantifying Risks:** This includes the calibration and, if possible, creation of probability distributions of outcomes for each material risk.
4. **Integrating Risks:** This includes the aggregation of all risk distributions, reflecting correlations and portfolio effects, and the formulation of the results in terms of impact on the organization’s key performance metrics.
5. **Assessing/Prioritizing Risks:** This includes the determination of the contribution of each risk to the aggregate risk profile, and appropriate prioritization.
6. **Treating/Exploiting Risks:** This includes the development of strategies for controlling and exploiting the various risks.
7. **Monitoring and Reviewing:** This includes the continual measurement and monitoring of the risk environment and the performance of the risk management strategies.

In fact, this analytical framework is the similar to the model that has been adopted by the Department of the Navy in its Operational Risk Management Manual (attached as Exhibit 1). The crux of Operational Risk Management to the Department of the Navy is described in terms that resonate with the goals of a Legal Department’s clients:

Risk is inherent in war and is involved in every mission. Risk is also related to gain; normally greater potential gain requires greater risk. Our naval tradition is built upon principles of seizing the initiative and taking decisive action. The goal of ORM [Organizational Risk Management] is not to eliminate risk, but to manage the risk so that the mission can be accomplished with the minimum amount of loss.

The Bank of Scotland has developed a Risk Management Process into its business planning as described in the attached flow chart. See Exhibit 2. Virtually every organization has developed a de jure or de facto process in evaluating and assessing risk and its associated opportunities. It would be beneficial for the Legal Department, and certainly “value added,” to

become familiar with these risk management principles and utilize this framework in counseling the Department's clients.

In sum, "risk management" is here to stay and effective Legal Department personnel need to be aware of its basic tenets and analytical tools. The more these tools are used, the better in house counsel will become in effectively counseling their clients and being "value added." However, the risk management endeavor must be real and not merely lip service.

It is well known that over the past decade, and especially over the past few years, a number of the world's most widely respected companies have collapsed. Analysts have cited equally well-known reasons for these collapses. The usual suspects include: nonviable business models, greed, incompetent (and overpaid) management, a lax regulatory environment, inappropriate governmental objectives that drove risky business decisions, faulty internal risk management analyses, and a belief that the organization could accept excessive risks as the organization would not be "allowed" to fail.

That faulty risk management could be a major (though not sole) cause for these failures may seem incomprehensible. The troubled American International Group, for example, was a leader in risk management and even maintained a risk management subsidiary. Its former CEO, Maurice R. "Hank" Greenburg, boasted AIG had "the best risk management [department] in the damn industry." Bears Stearns touted its "best-in-class processes in analyzing and managing...risk"; even the *New York Times* cited the company's "carefully honed reputation for sound risk management." Fannie Mae, the Federal National Mortgage Association, took great pride in its "excellent credit culture and risk-management capabilities," and Lehman Brothers Holdings leaders claimed a "culture of risk management at every level of the firm."

All these companies, and others with comparable risk management "cultures," apparently performed quite dismally. In fact, the risk management culture at these companies was seriously flawed as was the risk management approach they pursued. The literature quite appropriately indicates that the failures in risk management experienced by these companies can be grouped in five different ways:

1. Failure to use appropriate metrics;
2. Mis-measurement of known risks;
3. Failure to acknowledge known risks;
4. Failure in communicating risks to top management; and
5. Failure in monitoring and managing the risks.

F. Project Management

"Operations keep the lights on, strategy provides a light at the end of the tunnel, but project management is the train engine that moves the organization forward."

Joy Gumz

“Project management” is taught in business school; architects do it; it is ingrained in engineers; it is fundamental for most front line managers; but don’t seriously utter the term to attorneys, whether in house counsel or outside counsel. All too often (although increasingly occurring with less frequency) a lawsuit is filed, an acquisition is being contemplated, a contract needs to be negotiated and drafted and outside counsel is called and provided the “assignment.” To be sure, counsel may be given billing guidelines (which may or may not be followed by outside counsel depending upon the consequences), advised of reporting requirements (that may often vary from in house counsel to in house counsel within the organization depending upon their individual preferences) and outside counsel is off and running. The typical supporting rationale for this process is usually something along the following lines: “I have worked with outside counsel on a number of projects and outside counsel is conscientious, really smart, and professional. If there are any problems outside counsel will give me a call.” This is not project management. Certainly, the “root cause” of the multiple problems this type of “project management” may give rise to will not be solved by simply requiring a 10% reduction in the fees charged by outside counsel. Such a “solution” will not address those behaviors by Legal Department personnel and outside counsel that must change.¹⁹

In assigning a lawsuit to outside counsel, for example, the Legal Department should at least consider the utilization of any number of effective and critical project management principles.²⁰

- a. Identifying a responsible project manager (outside counsel) and a project sponsor (typically a member of the Legal Department);
- b. Establishing “ground rules” that set expectations and govern the conduct of all members of the litigation Team (typically more robust than simple billing guidelines);
- c. Identifying the agreed upon goals and objectives of the Team (ensuring alignment exists with all the members of the project Team) and the responsibilities of each member of the Team in achieving those goals and objectives (i.e, what legal activities will be undertaken by partners, associates, and paralegals etc.);
- d. Evaluating the likely risks or impediments in achieving the agreed upon goals and objectives and evaluating methodologies and activities to reduce those risks;
- e. Agreement on a budget and establishing the understanding it is the project manager’s (i.e., outside counsel) to manage the Team’s resources to effectively meet the budget (regardless of whether a flat fee or other alternative billing arrangements are entered into);
- f. Agreement on the time line for the project;

¹⁹ Burke and Barton, *Partnering Between Inside & Outside Counsel: Best Practice* (Glasser Legalworks, 1996).

²⁰ Simple “checklists” are a form of project management and can be a very powerful tool. See Gwande, *The Checklist Manifesto: How to Get Things Right* (Henry Holt and Company, 2009).

- g. Sets forth a conflict management and dispute resolution strategy should there be a disagreement between the member of the Team; and
- h. At the conclusion of the project the Project Sponsor and the Project Manager undertake an assessment of the results of the project and the generation of “lessons learned.” This step is critically important for an effective continuous improvement process.

While most Companies formulate billing guidelines for outside counsel, those guidelines are all too often a partial listing of the “ground rules” to govern the conduct of the litigation Team and fail to incorporate other critical project management principles. An example of a potential project management charter for litigation is attached as Exhibit 3.²¹

The importance of these ground rules can be underscored by one action step that is typically contemplated by outside counsel in most lawsuits, the filing of a Motion for Summary Judgment. If there is alignment between all the members of the litigation Team, there will be an analysis of the “cost-benefit” in the filing of the Motion. There are a number of typical “benefits” that might be realized in a case:

- a. Because of the Judge and the facts there is a high likelihood the Motion will be granted that will permit the avoidance of significant future transactional costs;
- b. There is a significant settlement event that is upcoming and having such a Motion pending will likely have a positive impact on the plaintiff’s settlement demand even if the ultimate likelihood of success of the Motion being granted is not high; and,
- c. There are significant ancillary Motions that will be heard by the Court and it is important to educate the Court as to certain aspects of plaintiff’s case even though there is not a high likelihood of success the Motion for Summary Judgment will be granted.

If, in the hypothetical case, these or other valid reasons do not exist for the filing of the Motion for Summary Judgment, it is the role of the Project Sponsor to seriously question the “cost” of incurring \$20,000.00 or more in the filing of such a Motion. If the cost benefit issue is not raised by outside counsel, it may also call into question the “alignment” of the Project Sponsor (Legal Department personnel) and the Project Manager (outside counsel) as to the goals and objectives of the litigation. Is the Project Manager, either wittingly or unwittingly, motivated to generate otherwise avoidable legal fees than appropriate? Moreover, even if one of the three listed goals exists, the cost-benefit ratio will vary in each of the circumstances in the preparation of the Motion. If there is not a significant likelihood the Motion will be granted, but it is believed the Motion will have a significant impact on the plaintiff’s settlement position, the budget that would be allocated to prepare and file the Motion will likely be much different than

²¹ This is only one example of a potential project management plan for litigation. It is obviously the role of outside counsel to conform to the Legal Department’s processes and not *vice versa*. The attachment is merely a starting point for consideration by the Legal Department as to the scope of project management principles that might be considered.

if there was a realistic likelihood the Motion will be granted. This is where the “stick man” and Rembrandt analogy comes into play. See note 2, *supra*. Even in the scenario of there being a high likelihood of the Motion being granted, does there become a diminishing return in the effort by outside counsel to have the Motion “perfect” as the Motion goes through the re-work and re-edit cycle. Will incurring the potentially significant re-work and re-edit costs add to the likelihood the Motion will be granted in any significant way and at what point is the return *de minimum*? Of course, this analysis will be quite different in a “bet the company case” and a case where the exposure to the Company is minimal. The decision making quality on this and other litigation issues will be maximized only if there is alignment on the goals and objectives of the litigation. A project management plan, established at the outset of the litigation, significantly enhances the existence of such alignment.

Project Management, to effectively confront this one issue, as well as all the numerous other tactical decisions that are made during the course of litigation, is critical. Rare is the assignment that should be given to outside counsel without a project management plan in place. Of course, the sophistication of the project management plan can vary with the nature of the assignment, but a project management plan is critical to ensure there is alignment among all members of the work Team.

G. Conclusion

“Hell! There are no rules around here! We’re trying to accomplish something.”

Thomas Alva Edison

Having no rules may be the best “rule” for some organizations. The complexity and environment in which Legal Departments exist, does not permit the luxury of an absence of processes. While there are no facile bright line rules that ensure “success” for the Legal Department to meet the challenges it faces, there are processes that may enable the Legal Department to find its solutions on the road to achieving its vision.

As Legal Departments are asking outside counsel to become more effective and efficient, there are greater pressures on Legal Departments by management to become more effective and efficient. In fact, it is somewhat surprising the legal profession has been so immune to these pressures for so long. One of the greatest problems confronted, however, is what does it mean for a Legal Department to become more effective and efficient and what does an effective and efficient Legal Department look like. That answer will vary from Legal Department to Legal Department. There are no quick fixes, silver bullets, or one size fits all solutions to the myriad and varied challenges facing Legal Departments today and tomorrow. The suggested processes, which require leadership, discipline and commitment, are only potential tools to assist a Legal Department to achieve its vision and adapt to the particular needs and objectives of its clients.