Subprime – Legal Serivce Providers

Part II – The First Step In Reducing Litigation Cost: Widen Focus To The Portfolio With A Litigation Scorecard!

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Management requires measurement. Managing litigation cost starts with knowing what a corporation spends on its litigation portfolio. Most corporations do not measure the total cost of litigation. (See *Fortune 500: The Total Cost Of Litigation Estimated At One-Third Profits, The Metropolitan Corporate Counsel* February 2008, p. 28) The cost of defending cases is expensed annually to the law department. Liability cost – settlements and judgments – are expensed in the quarter incurred to the business unit giving rise to the dispute. The litigation portfolio cannot be managed effectively without total cost accounting.

Focus On The Portfolio

Focusing on individual cases – scrutinizing each tree without looking at the forest – does not provide a gauge of overall results. Any individual case can be an outlier. Each case will have its own facts. Only by looking at results on a portfolio basis over time can a corporation measure the success of its litigation management.

Corporations must begin measuring aggregate data over time. eLawForum's *Litigation Scorecard*™ focuses on the metrics that demonstrate portfolio performance (the key performance indicators, or "KPIs"). The Scorecard provides objective benchmarks to compensate lawyers – inside and outside – for reducing litigation cost.

The Board of Directors Compensation Committee sets top management compensation, including the general counsel or "Chief Legal Officer." The Committee's *raison d'être* is to create the right incentives, tying compensation to objective metrics within the direct control of the executive. A CEO may earn a bonus based on exceeding a bottom-line earnings benchmark or top-line revenue growth expectations. The CFO is usually rewarded for reducing cost. General corporate metrics are indirectly related to CLO performance. CLO compensation should be tied to the metrics under his/her control – the cost of the litigation portfolio. The KPIs give the compensation committee the metrics required to incentivize the CLO to attack this cost.

Every dollar saved drops straight to the bottom line. The opportunity is great: eLawForum estimates that the Fortune 500 spends the equivalent to one-third of profits on litigation. Subprime litigation can only increase this cost.

The CLO can use the Scorecard to focus the law department on saving money. Tying law department compensation to measurable results is the best way to improve portfolio performance.

When the law department hires outside lawyers to defend cases, it should not lose sight of what the corporation is paying for. The CLO's goal is to retain outside counsel to resolve the litigation portfolio at the lowest total cost. This goal is unattainable when most cases are placed on slow-burn, paying for discovery and motion practice for more than two years, and then settling at a premium on the eve of trial. Paying outside counsel by the hour rewards inefficiency. Fixed fees on individual cases usually result either in a windfall for outside counsel – or renegotiation for a higher fixed fee!

The most cost-effective approach is to compensate outside counsel for resolving a portfolio of cases. A combination of fixed fees and results sharing provides outside counsel with an incentive to reduce the overall cost of the portfolio. The fixed fee shifts defense cost risk to outside counsel. Results sharing shifts a portion of liability cost risk to outside counsel, and should account for at least half of total compensation. A portfolio approach spreads the risk for outside counsel of both fixed fees and liability cost outliers over many cases. Compensating outside counsel over a portfolio places the focus on overall results and rewards cost-efficiency. To re-

Chart 1: Total Cost Accounting *($000s)*

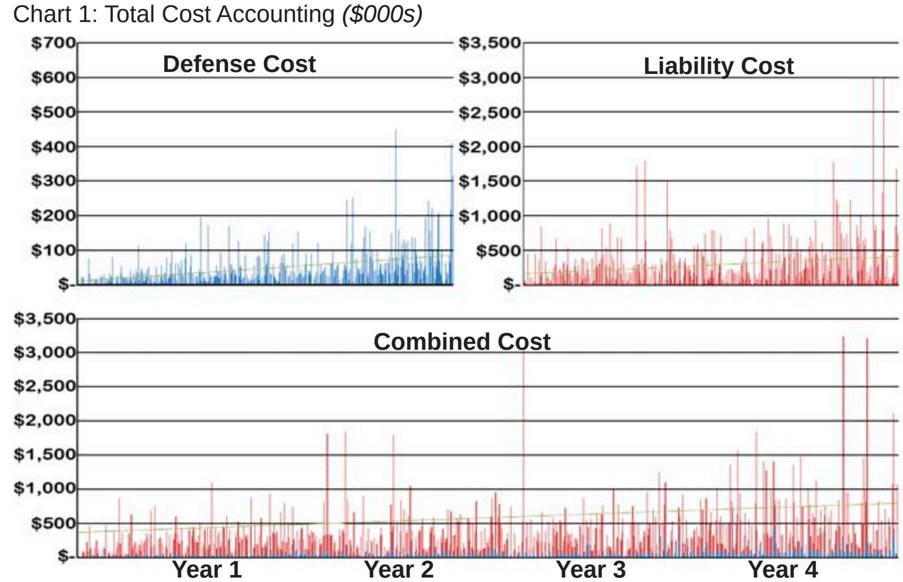
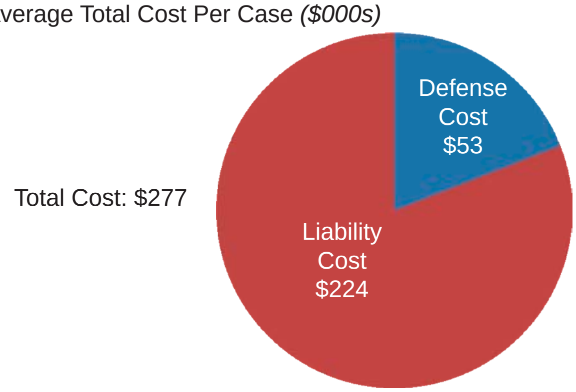


Chart 2: Average Total Cost Per Case *($000s)*



ward results, the CLO must have an actuarial projection of the cost of the portfolio. By aligning incentives on a portfolio basis, eLawForum consistently obtains fixed fees less than 50% of projected defense cost, based on law firm estimates of liability cost reductions of 20% or more. (For details on the law firm risk transfer, see *The Metropolitan Corporate Counsel* April 2008)

The Litigation Scorecard

Historic defense and liability cost must be collected for each case in each practice area over a number of years. Defense cost includes all outside counsel fees and expenses. Liability cost covers payouts to plaintiffs. Combining defense and liability cost gives the total cost per case. The total cost of a portfolio is the sum of the total cost of each case. *[See Chart 1.]*

The first KPI, Average Total Cost Per Case, is calculated for each practice area. In the example shown in Chart 2, on a portfolio of 1,500 product liability cases, a corporation spent an Average Total Cost Per Case of $277,000 – paying $224,000 to plaintiffs and $53,000 for defense. The second KPI, Case Count, is the number of new cases a corporation faces each year. Analyzing trends over several years, a corporation can project the volume of cases it is likely to defend in the future. *[See Chart 3.]*

Subprime cases, like any new wave of litigation, create a higher risk environment which requires judgment in projecting future requirements. Constructing a portfolio of subprime cases can substantially reduce total litigation cost.

With the KPIs, a corporation can make an actuarial projection of the total cost of each practice area portfolio for the next three to five years. In our example, the Scorecard forecasts $500 million total cost for a 1,500-case product liability portfolio. *[See Chart 4.]*

The Scorecard provides the first effective tool to align incentives and manage total cost by measuring and rewarding results.

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Chart 3: Case Count

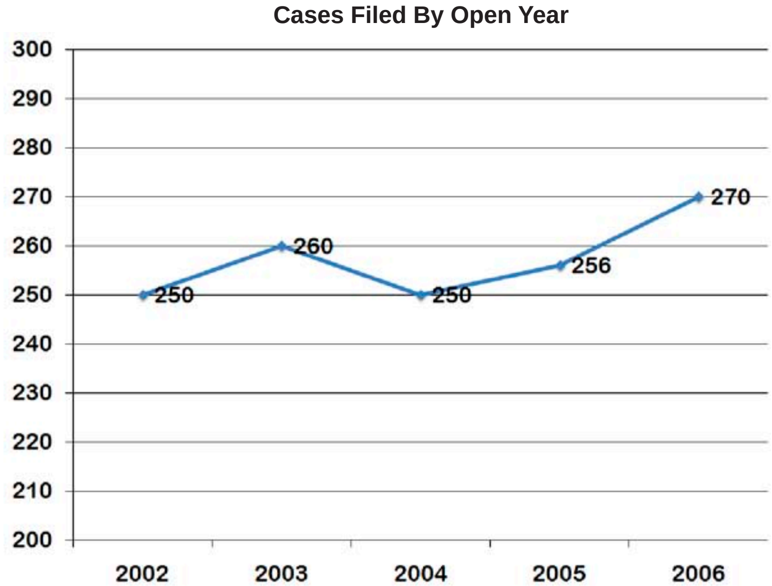
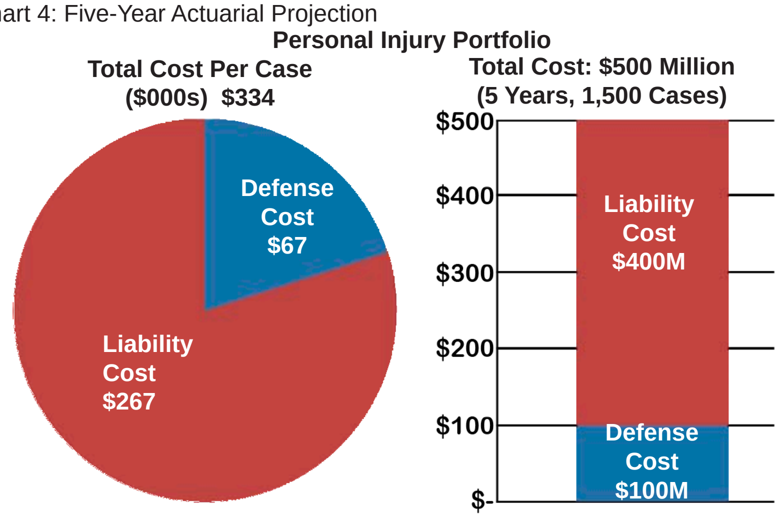


Chart 4: Five-Year Actuarial Projection



Please email the author at jhenry@elawforum.com with questions about this article.