



William  
Henderson

If you are not a lawyer, you may find this next sentence very good news. We are entering a period in human history in which we are going to need fewer lawyers, at least the traditionally trained variety. The world is becoming more interconnected, regulated and complex. Although regulation and complexity have historically been very good for the lawyer business, something very fundamental is changing. Clients are increasingly struggling to pay the bills of artisan lawyers who prefer to craft individual, customised solutions for each transaction and each dispute.

# Losing the law business

In essence, law is facing a productivity imperative. To cope with globalisation, the world needs better, faster, and cheaper legal output. The artisan trained lawyer just can't keep up. To address the productivity imperative – or, more accurately, to turn a profit from this business opportunity – a new generation of legal entrepreneurs has emerged.

Lawyers continue to have a lock on advocacy work and client counselling on legal matters. But an enormous amount of work that leads up to the courthouse door, or the client counselling moment, is increasingly being “disaggregated” into a series of tasks that does not need to be performed by lawyers. Indeed, it may be best performed by computer algorithms. Further, the entire process is amenable to continuous improvement, driving up quality and driving down costs. This is a job that is likely more suitable for a systems engineer, albeit one with legal expertise, than a traditionally trained lawyer.

Although this change may sound radical, it is actually the logical next step in an evolutionary progression that began in the early 20th century as the practicing bar transitioned from generalist solo practitioners to specialised lawyers working together within law firms. Now, as clients search out ways to stretch their legal budgets, specialisation is losing market share to process-driven solutions, akin to how Henry Ford's assembly line methods supplanted craft production.

To illustrate this progression, consider the US legal market at the beginning of the post-War period. At that time, 61 per cent of all lawyers worked as solo practitioners. Not surprisingly, incomes were low. In 1948, the average lawyer in private practice made

\$5,200 per year, which was several hundred dollars less than his government lawyer counterpart. There were private practice lawyers, however, who defied this trend. Less than 2 per cent of US lawyers worked as partners in law firms of nine partners or more, but these “large” firm lawyers made, on average, five times more than their solo practitioner peers.

Why so much more? Because the world was becoming more regulated and complex. And sophisticated, specialised lawyers with deep technical expertise were in short supply. By combining into a firm, lawyers could specialise in new or existing areas of law, handle bigger and more complex matters and otherwise coordinate their efforts to better serve clients. Indeed, the most successful large law firms, such as the New York City firm of Cravath Swaine & Moore, organised themselves so as to optimise the training of junior lawyers in both substantive law and the ability to supervise and delegate (the “Cravath system”). Fittingly, during the 1930s, the press dubbed these firms “law factories”. The best junior lawyers eventually became partner; the rest obtained the benefit of excellent experience and training, thus obtaining jobs with clients or partnerships with other law firms.

For the next several decades, firms with signifi-

cant business clients and a partner-associate training model tended to prosper. As a measure of longevity of the specialist model, among the largest 100 law firms in the US as measured by gross revenues (the AmLaw 100), the average name partner was born in 1895 and died in 1964 – yet the growth has marched on for another half century. The period of greatest financial success has occurred during the last three decades. Between 1978 and 2003, total US legal expenses as a percentage of GDP increased from .4 per cent to 1.8 per cent. From this growing pie, large firm lawyers were getting the biggest slice. By the mid-2000s, the profit share of the average partner in an Am Law 100 firm was over \$1 million per year.

One obvious drag on the legal industry's reluctance to embrace innovation is the financial success enjoyed under the old model. It is hard to convince a group of millionaires that their business model is broken. A second drag is insularity. The US/UK system of lawyering is premised on the idea of independence. In the US, ethics rules prohibit lawyers from splitting fees with non-lawyers. Thus, only lawyers have an equity interest in law firms. In the UK and Australia, in contrast, the ban on fee-splitting has been significantly relaxed, enabling the public listing of law firms and the entry

of name-brand companies, such as Tesco (a super-market retailer), into the consumer legal business.

Ironically, the insularity of the US legal market may have created a more attractive target for capitalists. Among corporate clients, the combination of high law firm profits and low innovation has created discontent among C-suite executives. They ask their general counsel, "why are legal expenses going up faster than other departments? What value are we getting for these higher fees?" The general counsel has no persuasive reply.

Perhaps the best example of new entrepreneurs serving corporate clients is the large number of vendors working in eDiscovery and document review. The explosion in digital data over the last 10 to 15 years has made it untenable to continue using expensive law firm associates for an exhaustive manual review.

Initially the work went to registry services, which assembled large crews of temporary low wage "contract" lawyers for large document review projects. After building a sufficient data infrastructure and security controls, the work flow has gradually expanded to legal process outsourcers (LPOs) in places like India, where a fraction of the wages paid to US contract attorneys could attract highly motivated and able Indian lawyers. Having achieved sufficient success and scale, the best LPOs are now turning to process engineering, combining this highly motivated and able labour with superior technology and workflow design.

More recently, new vendors have emerged who specialise in "predictive coding". In a case that considered acceptable methods of conducting electronic discovery, a federal judge in New York City reviewed studies comparing the cost and accuracy of computer-based machine algorithms (predictive coding) with manual human review. Finding that the predictive coding was at least as accurate as manual methods and reduced the number of documents for human review by a factor of 50, the judge ruled that predictive coding was judicially reasonable in many cases involving large numbers of documents.

Although many large US law firms may perceive document review as "commodity" legal work not worthy of their efforts, the new legal vendors getting into this space are remarkably well capitalised. For example, one of the larger suppliers of contract attorneys is Robert Half, which has 26 locations through the US and Canada. Its corporate parent, Robert Half International, is publicly traded on the New York Stock Exchange (RHI). Another company in the contract attorney space is Special Counsel, which has 36 US offices. Special Counsel is a subsidiary of Adecco Group, which is listed on

the SIX Swiss Stock Exchange (ADEN).

In the LPO space, Pangea3, which opened in 2004 with \$1.5 million in venture capital, was sold in 2010 to Thomson Reuters (NYSE symbol TRI) for an amount reported to be in the \$35M to \$40M range. The original management team was kept intact, as the company has been growing between 40 per cent and 60 per cent every year since its founding. The company now employs over 850 lawyers, mostly in India. Because of its emphasis on process improvement, Pangea 3 and other high-end LPOs are obtaining a competitive advantage beyond mere wages. Thus LPOs have become a much more attractive option for Indian law graduates. Another competitor is Huron Consulting Group (NASDAQ symbol HURN), which recently announced a new document review facility in Gurgaon (a booming suburb of Delhi), bringing its total global document review workforce to 1,500 in 17 offices worldwide. Since 2007, Huron Consulting Group's annual revenues have nearly doubled, growing from \$315 million to \$606 million.

The major players in the predictive coding space are also well capitalised. One of the leaders is Reconnind, a privately held company with \$15 million in revenues in 2011 and approximately 100 employees in facilities in California, London, Germany and Australia. Similarly, Kroll Ontrack, which started in the hard disk recovery business nearly 30 years ago, has information management services that include predictive coding as part of its broader eDiscovery services. Kroll Ontrack is owned by Kroll, Inc., which was recently acquired by Altegrity, an information conglomerate owned by Providence Equity Partners. Providence Equity is a global private equity firm with over \$27 billion under management.

Since 2008, revenues in large US-based law firms have been relatively flat. A recent article in *Managing Partner* magazine acknowledged that law firms are losing market share to the LPOs – which broadly includes all the companies mentioned above – as general counsel are increasingly contracting with LPOs directly. The savings are perceived to be in the 50 per cent range with no diminution in quality. According to the article, the LPO business is estimated to be a \$1 billion per year industry that will double in size over the next two to three years.

Unlike traditional lawyers, the competitive advantage enjoyed by these new entrants is that they have learned how to learn. If law is like other industries, these companies will move up the value chain and find new ways to satisfy the needs of large corporate legal departments. Law is not just for lawyers anymore. This genie is permanently out of its bottle.

**William Henderson**  
Principal, Lawyer Metrics, LLC

Professor of Law, Indiana University Maurer School of Law, United States  
| T: +1 (812) 856-1788 | E: wihender@indiana.edu  
| W: The Legal Whiteboard - <http://lawprofessors.typepad.com/legalwhiteboard/>

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