



# The impact of the COVID-19 crisis on law departments

EY Law  
June 2020



# Introduction

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This research report is an independent fact-based analysis that provides insights into the impact that the COVID-19 crisis is likely to have on the legal industry with a specific focus on the increasing use of legal managed services.

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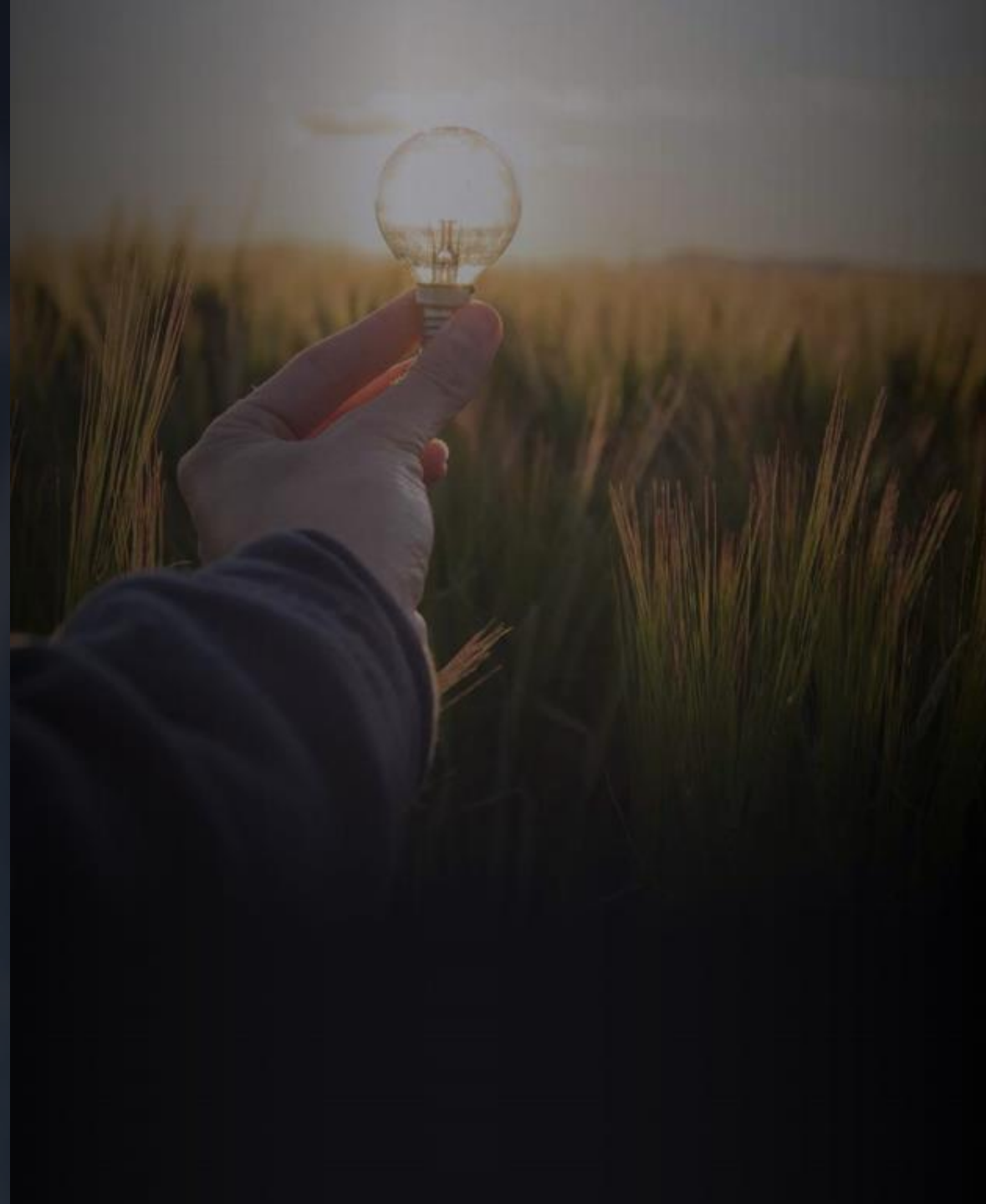
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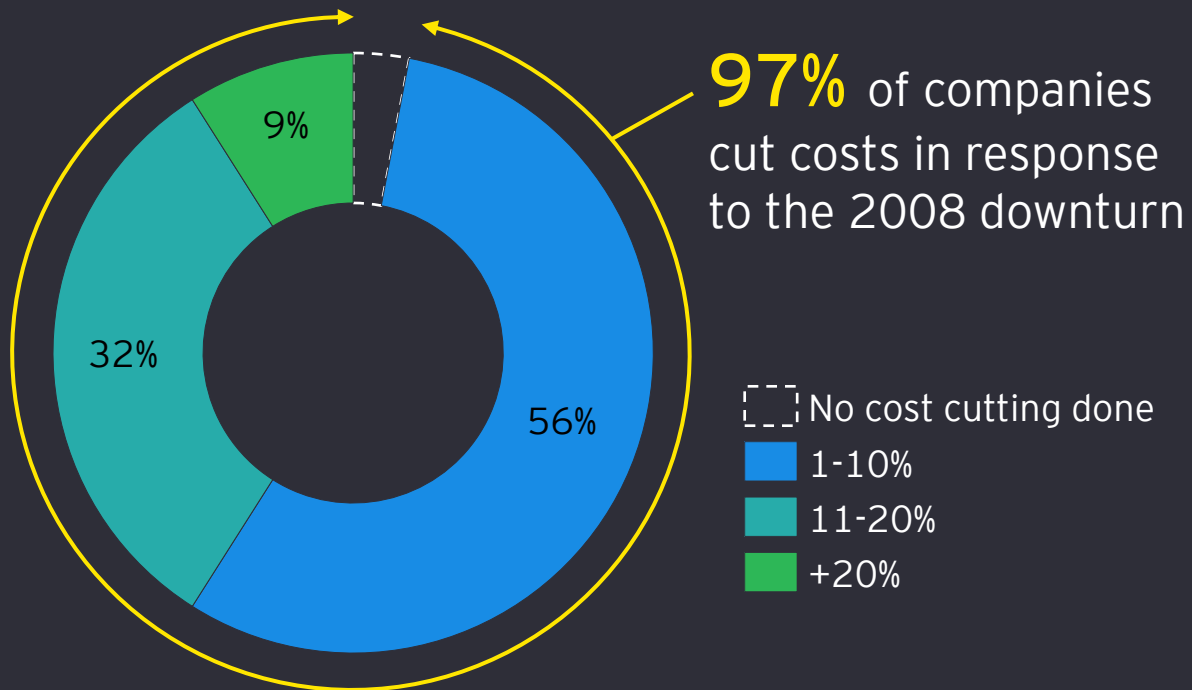
How will the COVID-19 crisis impact corporate law departments?



Corporate response to the 2008 downturn and early reports from the COVID-19 crisis suggest cost cutting will be a focus for large corporations over the next 18 months

## Level of cost cutting during the 2008 Great Financial Crisis

Percentage of total costs cut between September 2008 and January 2010



### Recent news

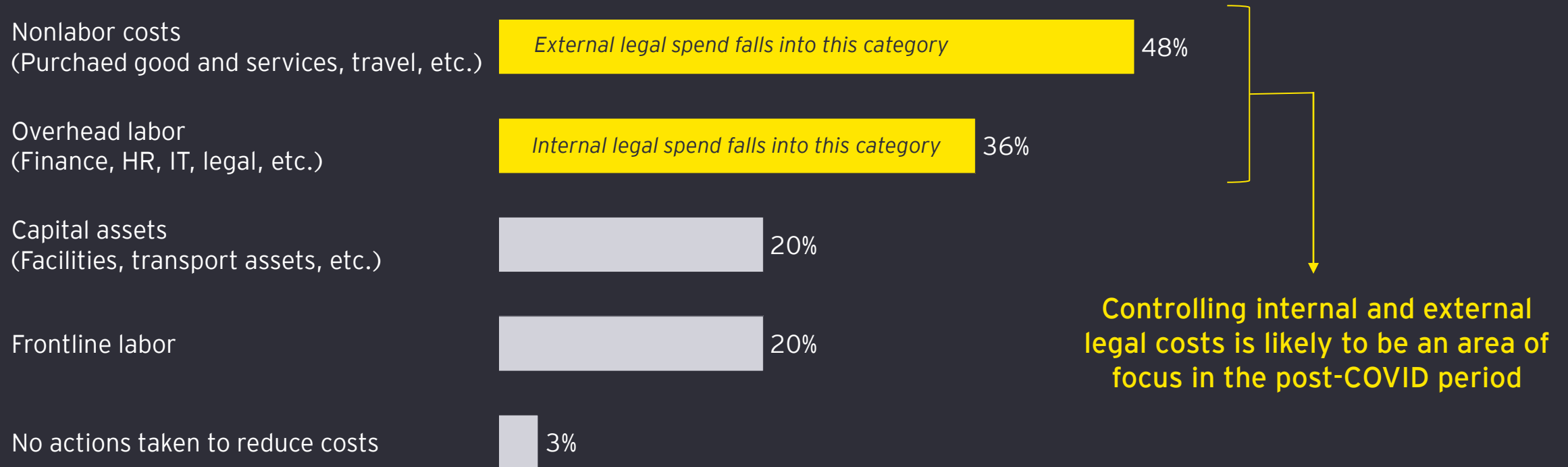
- ▶ **Boeing Company laid off 10% of its workforce (16,000 jobs)**, while GE Aviation cut 25% jobs (13,000 workforce)
- ▶ **Uber Technologies cut 6,700 jobs (23% workforce)** to generate \$1 billion in annual cost savings
- ▶ Financial services spending on IT will fall **5.6% in 2020 to \$502 billion**
- ▶ **3M announced plans to cut costs by \$350million**, focusing on non-labor costs

Source: McKinsey What worked in cost cutting—and what's next, 2010  
Survey size: 300 operations and other senior executives from around the world

Data from 2008 suggests internal and external legal expenses are likely to be under scrutiny as CFOs and CEOs look for cost savings in the post-COVID period

## Actions taken to reduce costs during the 2008 Great Financial Crisis

Percentage of respondents reporting action between September 2008 and January 2010

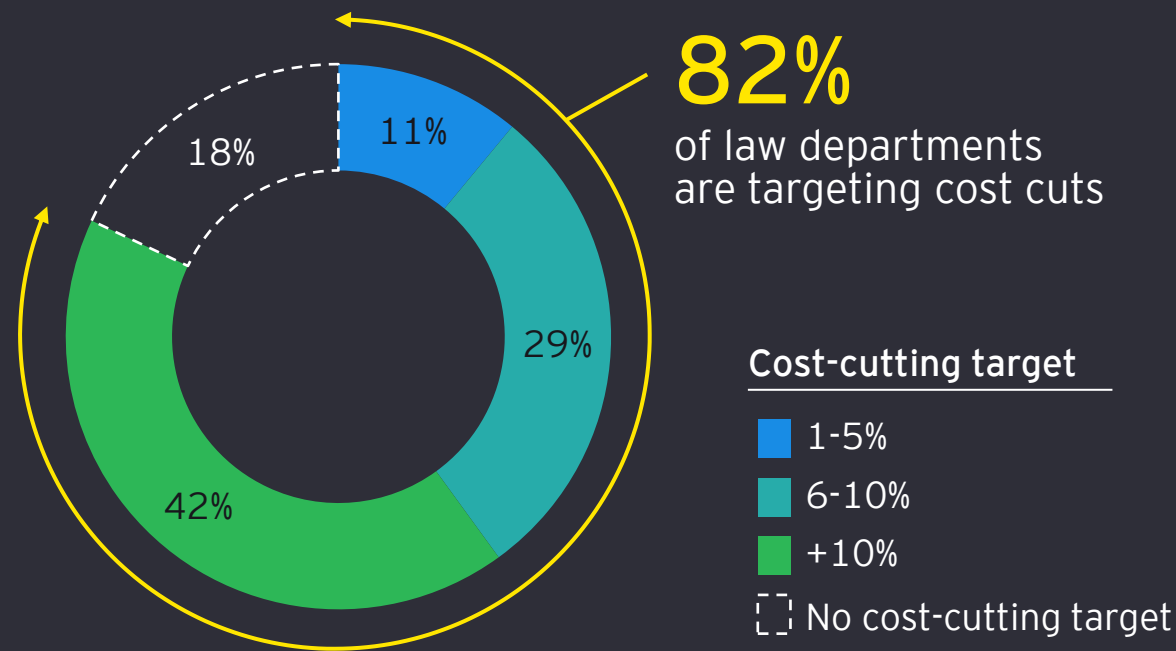


Source: [McKinsey What worked in cost cutting—and what's next](#), 2010  
Survey size: 300 operations and other senior executives from around the world

Scrutiny over legal budgets will strengthen already strong pressures to cut legal costs – requiring law departments to ‘do more with less’

## Law departments' cost-cutting targets prior to the COVID-19 crisis

Percentage of departments by cost-cutting target



How will law departments manage increased pressure to cut costs amid rising work volumes?

Source: EY Reimagining the Legal Function Survey Data, 2019 (Survey Size = 1,058 Law Departments)

# Increasing pressure to manage legal costs will coincide with rising volumes of work across a broad range of areas

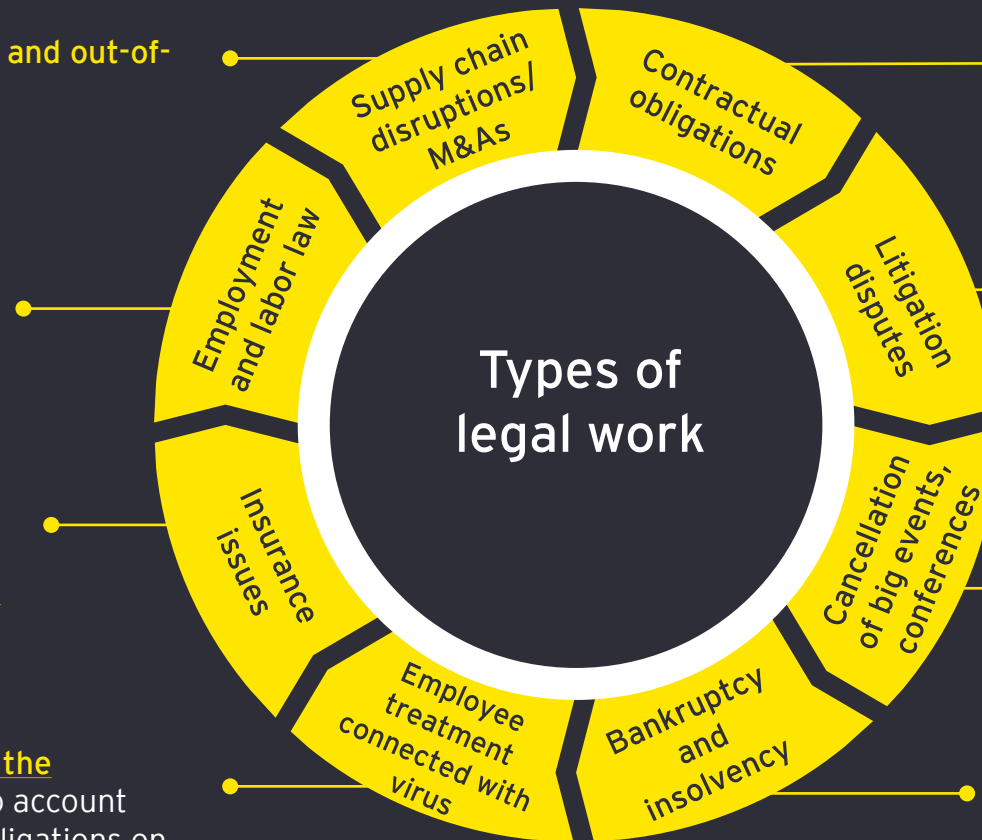
## Legal services expected to witness a rise due to the COVID-19 crisis

Addressing supply chain disruptions and out-of-court debt restructuring

Implications for employers and employees due to the crisis, in cases such as layoffs, pay-cuts and hiring freeze

Allison Chock, Chief Investment Officer-US for Omni Bridgeway, says insurance-related disputes are likely to spike in the near term

Inquiries on 'coronavirus' clauses to the employment policies, which take into account quarantine leave, sick pay and the obligations on employers to protect their workers



Guidance on whether a pandemic allows for contractual obligations to be voided

Litigation disputes concerning whether parties are excused from performance of their contractual obligations during this health crisis. The litigation finance industry is also gearing up for a steady stream of COVID-19-related activity

Cancellation and postponement of major conferences, trade shows and other large events will generate legal work

Falling economy likely to generate much more activity in the bankruptcy and insolvency space. Valeritas, a medical technology company filed for bankruptcy in February 2020 citing supply chain issue exacerbated by the COVID-19 crisis

The fallout from the COVID-19 crisis will impact law departments differently based on the particularities of their business - but most are expected to see an uptick in the volume of work

## Demand outlook for select legal services by practice area and industry

|                           | Travel transport and leisure   | Energy  | Financial services   | Technology media and telecommunications   | Healthcare   | Private equity and funds   | All sectors   |
|---------------------------|--|---|--|---|--|--|---|
| <b>Increase in demand</b> | <ul style="list-style-type: none"> <li>▶ Restructuring</li> <li>▶ Shareholder litigation</li> <li>▶ Supplier disputes</li> </ul> | <ul style="list-style-type: none"> <li>▶ Restructuring</li> <li>▶ Midstream and storage</li> <li>▶ Shareholder litigation</li> <li>▶ Supplier disputes</li> </ul> | <ul style="list-style-type: none"> <li>▶ Government lending programs</li> <li>▶ Dept capital markets</li> <li>▶ Government program compliance</li> </ul> | <ul style="list-style-type: none"> <li>▶ Bankruptcy</li> <li>▶ Restructuring</li> <li>▶ Debt financing</li> <li>▶ IP litigation</li> <li>▶ Labor and employment litigation</li> <li>▶ Force majeure</li> <li>▶ Government investigations</li> <li>▶ Regulatory</li> </ul> | <ul style="list-style-type: none"> <li>▶ Alliances and joint ventures</li> <li>▶ Regulatory</li> </ul> | <ul style="list-style-type: none"> <li>▶ Distressed M&amp;A</li> <li>▶ Mid-market and roll ups</li> <li>▶ Distressed debt</li> </ul> | <ul style="list-style-type: none"> <li>▶ Restructuring and workouts</li> <li>▶ Distressed M&amp;A</li> <li>▶ Labor and employment</li> <li>▶ Corporate tax</li> </ul> |
| <b>Decrease in demand</b> | <ul style="list-style-type: none"> <li>▶ M&amp;A</li> <li>▶ Real estate</li> </ul>   | <ul style="list-style-type: none"> <li>▶ Project finance</li> <li>▶ M&amp;A</li> <li>▶ International arbitration</li> </ul>                                       | <ul style="list-style-type: none"> <li>▶ Equity capital markets</li> <li>▶ Big-ticket M&amp;A</li> </ul>   |   |  | <ul style="list-style-type: none"> <li>▶ Fund formation</li> <li>▶ Big-ticket M&amp;A</li> </ul>                                     | <ul style="list-style-type: none"> <li>▶ Equity capital markets</li> <li>▶ Big-ticket M&amp;A</li> <li>▶ Anti-trust</li> </ul>  |

Source: McKinsey COVID-19: Implications for law firms report, 2020



# In the past, law departments have used two strategies to manage increasing volumes of work

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## Key approaches considered by law departments to perform the excess legal work:

### Law firms

- ▶ Hiring law firms to perform legal work is the default option for many legal departments
- ▶ While law firms' operations are outdated, they are viewed as a 'safe pair of hands' by many in-house counsel

### Insourcing

- ▶ Insourcing has been adopted in recent years by large law departments
- ▶ The popularity of insourcing can be attributed, in part, to the need for increased cost control

# Many law departments will be tempted to use their legacy strategy of relying on law firms to manage increasing workloads

## Law department spending

Share of overall spend



**61%** of overall spend is on external counsel

- ▶ **94%** on law firms
- ▶ **6%** on non-law firm vendors

### The reasons law firms remain the 'default' option for many law departments

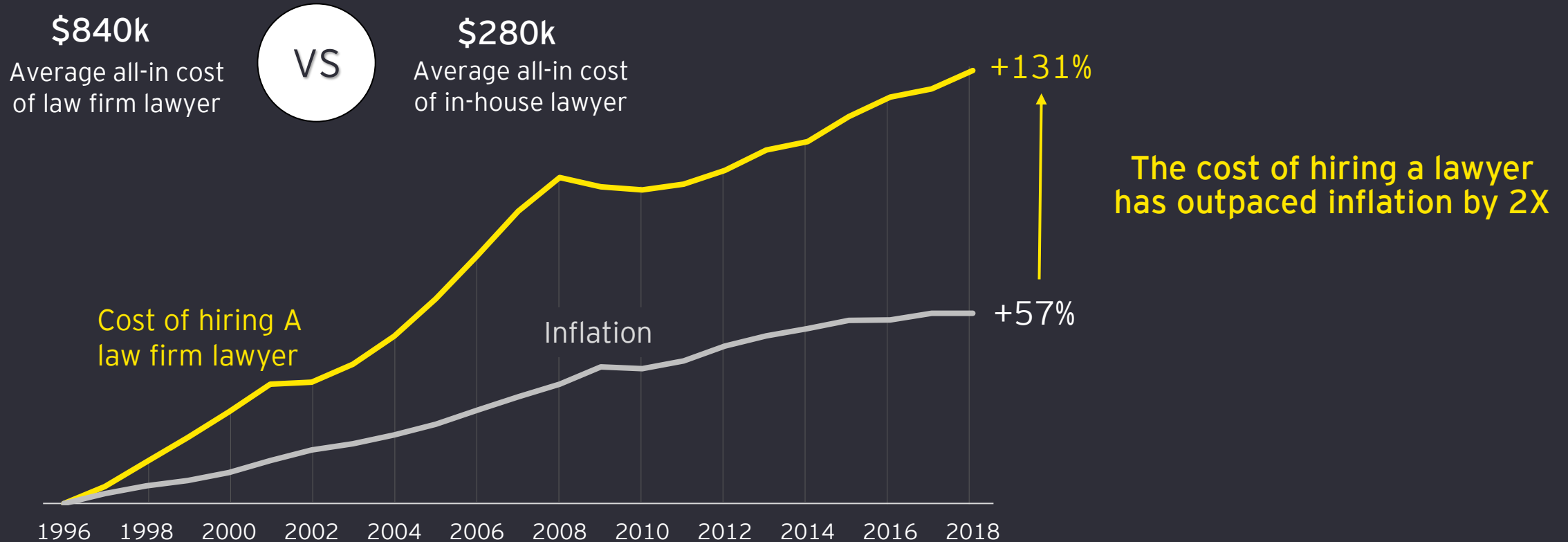
- ▶ **Range of services:** law firms provide a wide range of services, including US legal advice coverage
- ▶ **Trust:** law firms enjoy high level of trust among their clients
- ▶ **Lack of knowledge:** many department leaders are still unaware of the services offered by new providers
- ▶ **Perceived risk:** in times of uncertainty, many department leaders will be hesitant to try new innovative models

Note: Based on US Top 200 Law Firms and US Inflation Rate

Source: Thomson Reuters, Am Law 200, Bureau of Economic Analysis

Relying on law firms to manage increasing workloads will lead to higher and increasing cost - conflicting with law departments' mandate to manage costs more closely

## Growth in the cost of hiring a law firm lawyer



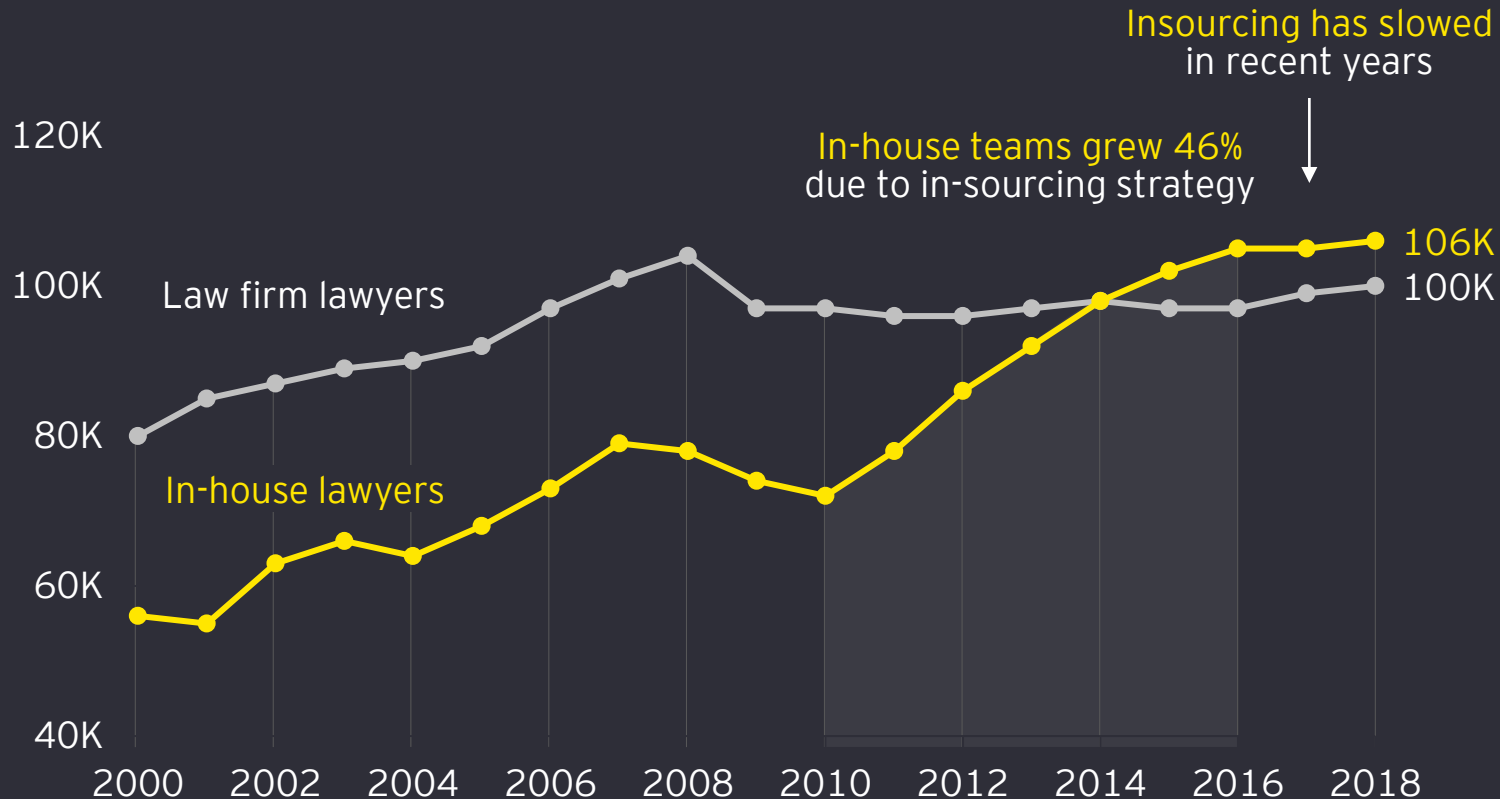
Note: Based on US Top 200 Law Firms and US Inflation Rate

Source: Thomson Reuters, Am Law 200, Bureau of Economic Analysis

# Insourcing - a strategy law departments have embraced over the past decade - offers a solution to high law firm costs, although it comes with other challenges

## Growth in US lawyers

Number of in-house lawyers vs. law firm lawyers



## Insourcing trends

- ▶ Law departments realized they could reap significant cost savings by insourcing work previously performed by law firms
- ▶ Many law departments are now the size of large law firms, housing hundreds or even thousands of lawyers
- ▶ Some of the initial cost savings have been eroded due to increasing salaries and the need for mid-career lawyers to manage junior staff
- ▶ In-sourcing has also significantly increased the volume of work law departments manage

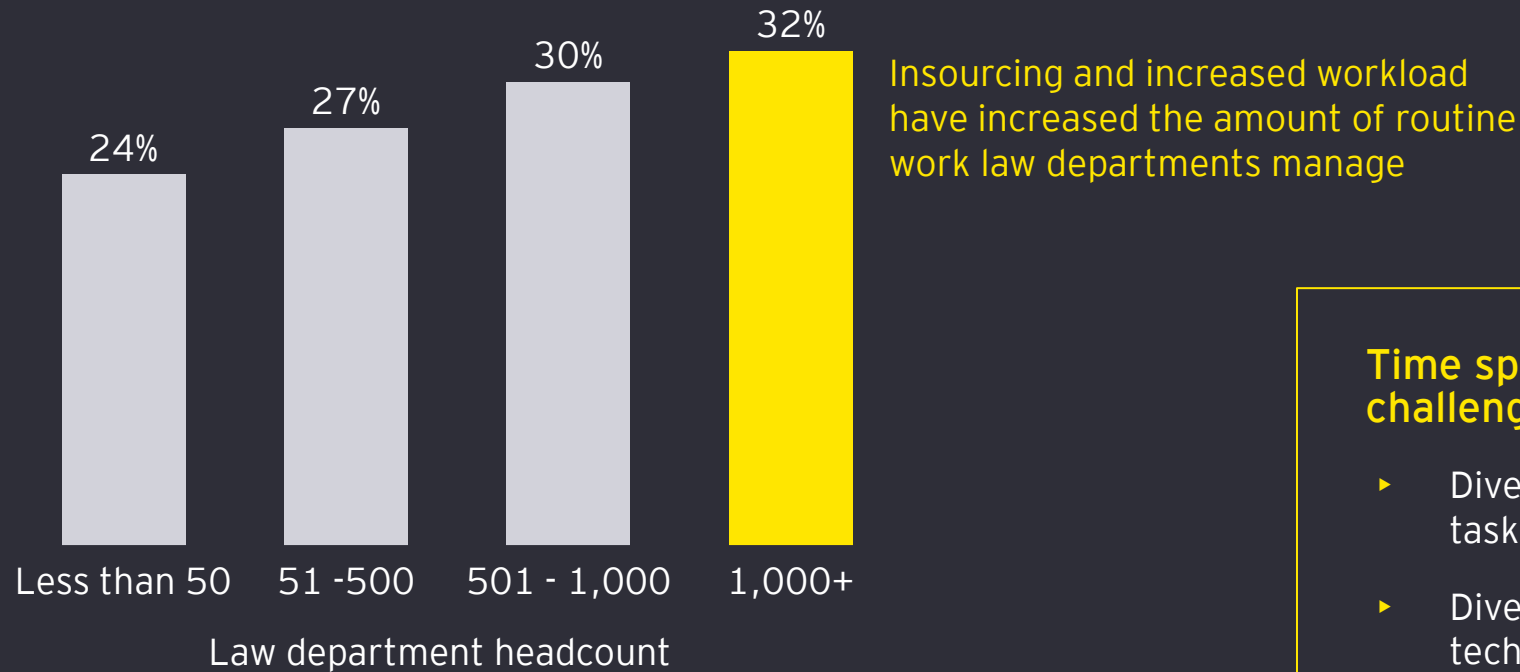
Source: The Rise (and Fall?) of In-House Counsel, Hugh Simons, The American Lawyer, 2018



One outcome of the insourcing trend is an increase in the volume of routine low-value work performed by in-house counsel

## Time spent doing routine tasks

*Weighted average time spent by law department headcount*



### Time spent doing routine tasks creates challenges for law departments:

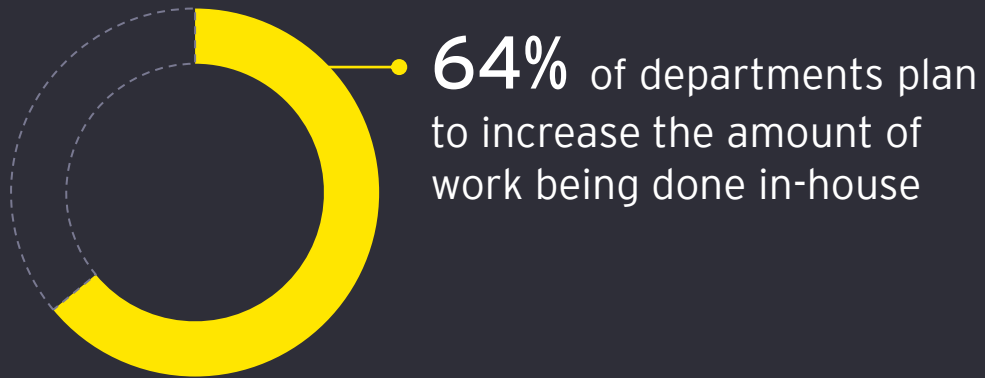
- ▶ Diverts energy and resources away from the tasks which matter most - complex risks
- ▶ Diverts resources away from investments in technology and building new capabilities
- ▶ Lowers morale and hurts recruitment and retention

Source: EY Reimagining the Legal Function Survey Data, 2019 (Survey Size = 1,058 Law Departments)

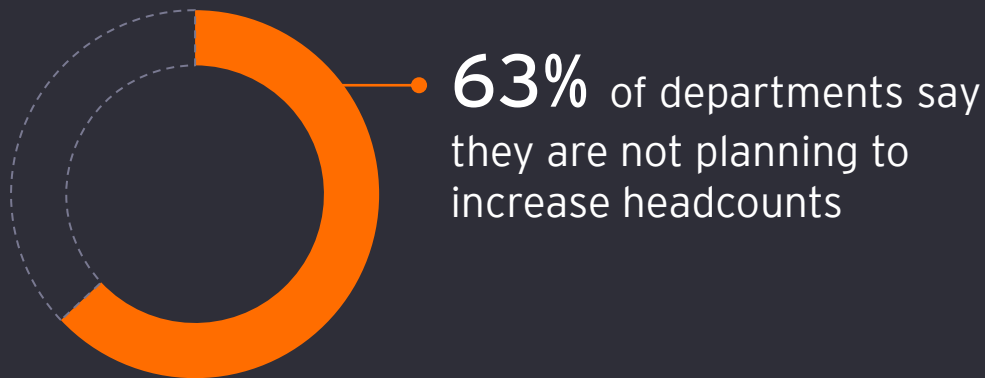
# The challenges with insourcing have caused many companies to rethink their strategy – many are now hesitant to add more headcount

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## Law departments' conflicting opinions on how work should be managed is likely to come to a head in the aftermath of the COVID-19 crisis



**64%** of departments plan to increase the amount of work being done in-house



**63%** of departments say they are not planning to increase headcounts

### How will law departments manage rising volumes of work?

The high – and rising – cost of engaging law firms has led many law departments to in-source work. This strategy is at odds with the desire to keep headcounts low. Rising volumes of work due to the COVID-19 crisis will force law departments to embrace a new approach to service delivery.

Source: Legal Executive Institute Report 2020

# Challenges with traditional strategies for managing increasing volumes and cost cutting will force some law departments to embrace new strategies

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## Non-law firm vendors

- ▶ The use of non-law firm service providers and managed services has been increasing in recent years.
- ▶ Early results suggest the use of legal managed services provides significant benefits that go beyond cost control.

## Internal optimization

- ▶ Leading law departments have already put significant effort into optimizing external counsel costs over the past several years and are now turning inward - focusing on optimizing internal resources and functions.
- ▶ Law departments are focused on improving functional effectiveness and overall efficiency.

# Summary: COVID-19 crisis is likely to have significant impacts on internal law department operations and sourcing strategies

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## Key insights

1

**Cost pressures:** The economic fallout from the COVID-19 crisis is likely to increase pressure on law departments to manage costs more closely

2

**Increased volume of work:** The volume of work law departments will have to manage is likely to increase

3

Law departments previous strategies for managing increasing volumes of work, **law firms and insourcing**, are likely to create more challenges than solutions

4

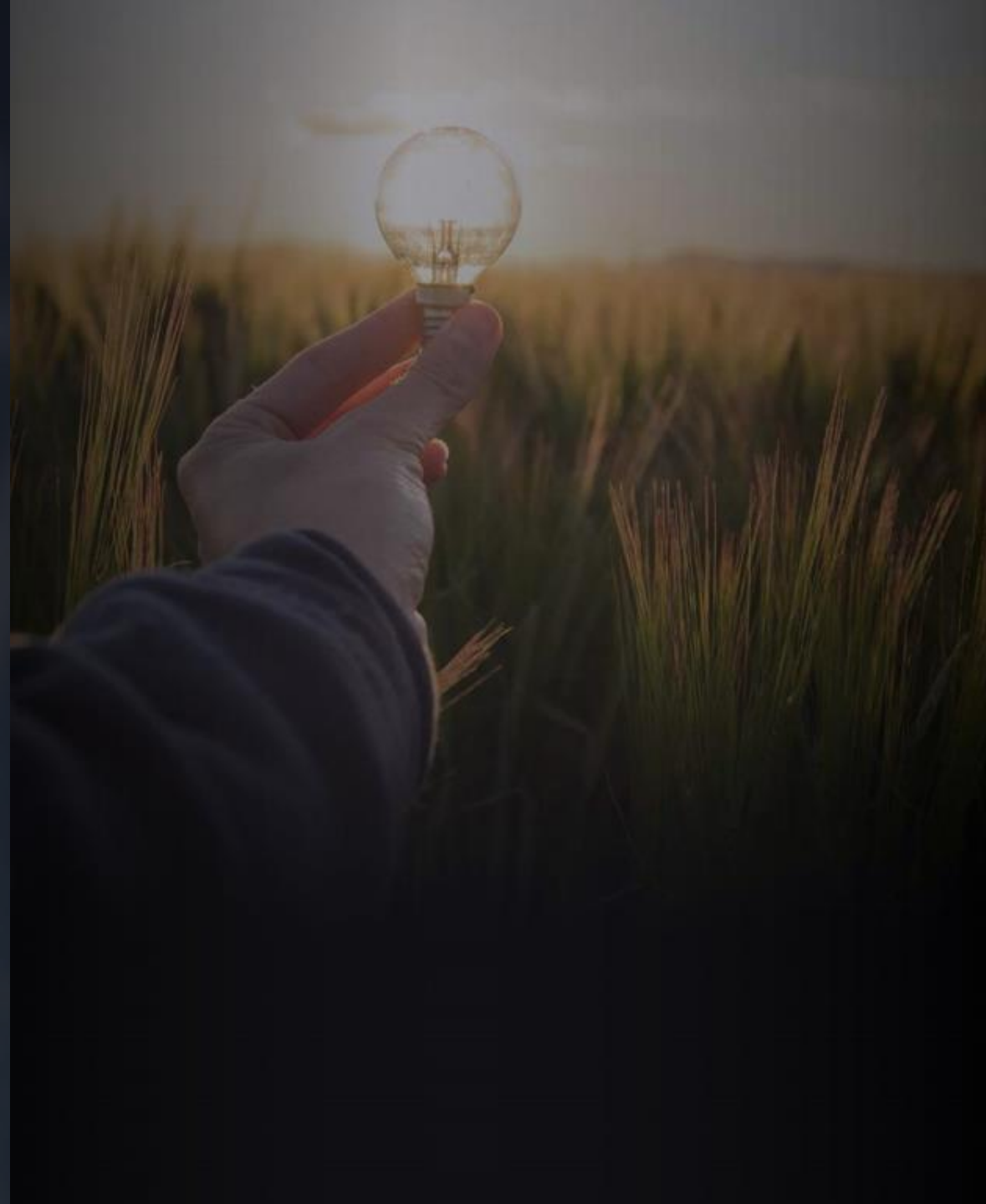
**Non-law firms vendors:** Law departments are likely to increase their usage of non-law firm providers and legal managed services

5

**Internal optimization:** Law departments are likely to put significant effort into internal optimization



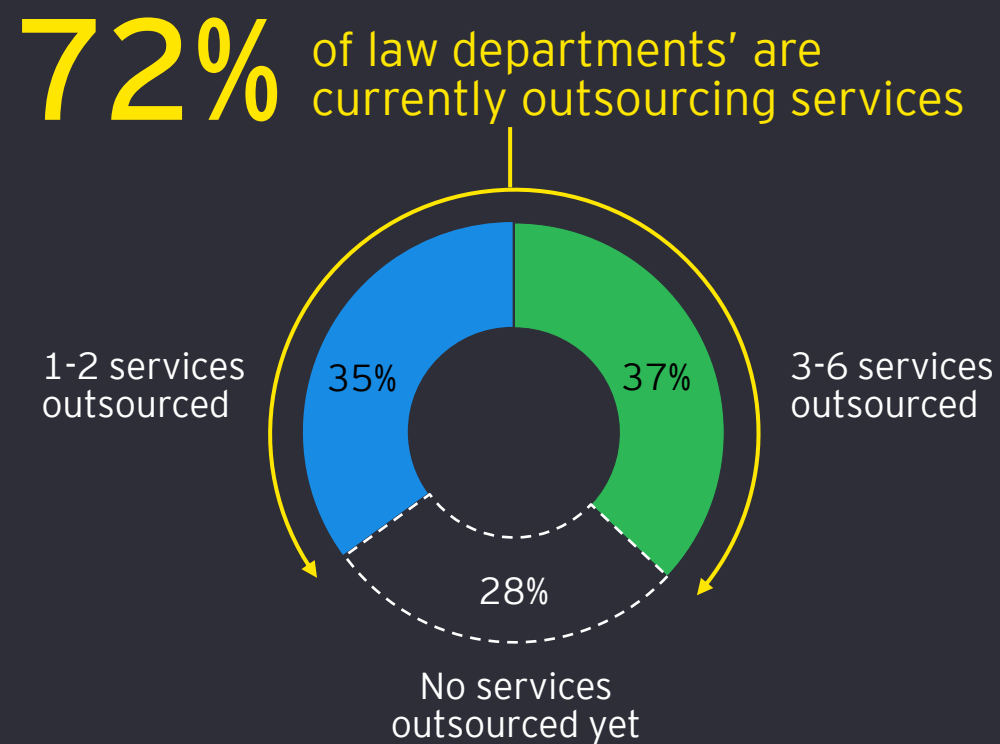
# The rising use of legal managed services



# Increasing the use of non-law firm providers offers law departments a third way which could resolve some of the challenges they face

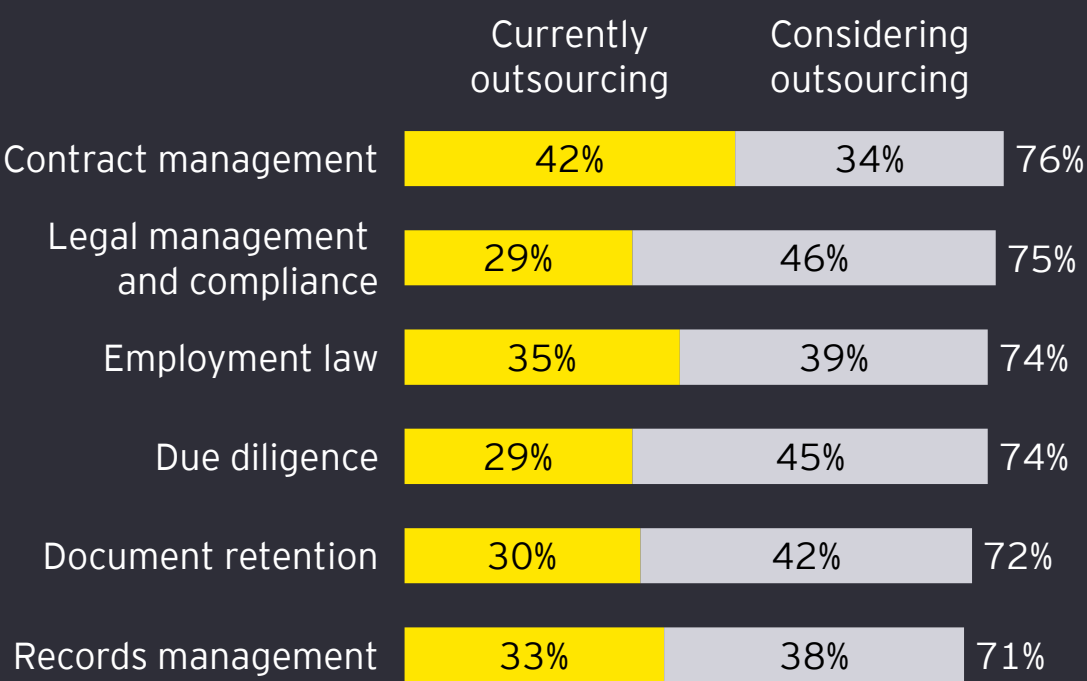
## Law departments' use of outsourcing

Percentage of law departments by number of services outsourced



## Status of outsourcing by service

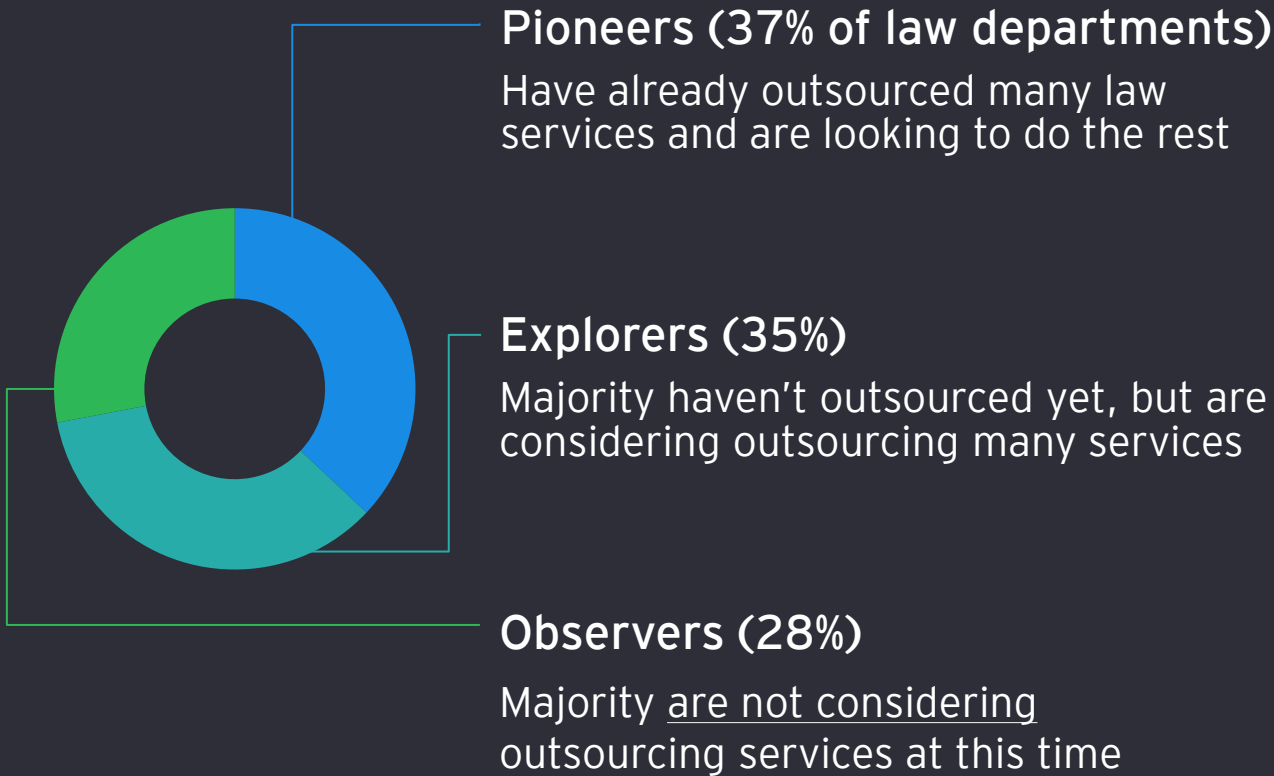
Percentage of law departments by service



Source: EY Reimagining the Legal Function Survey Data, 2019 (Survey Size = 1,058 Law Departments)

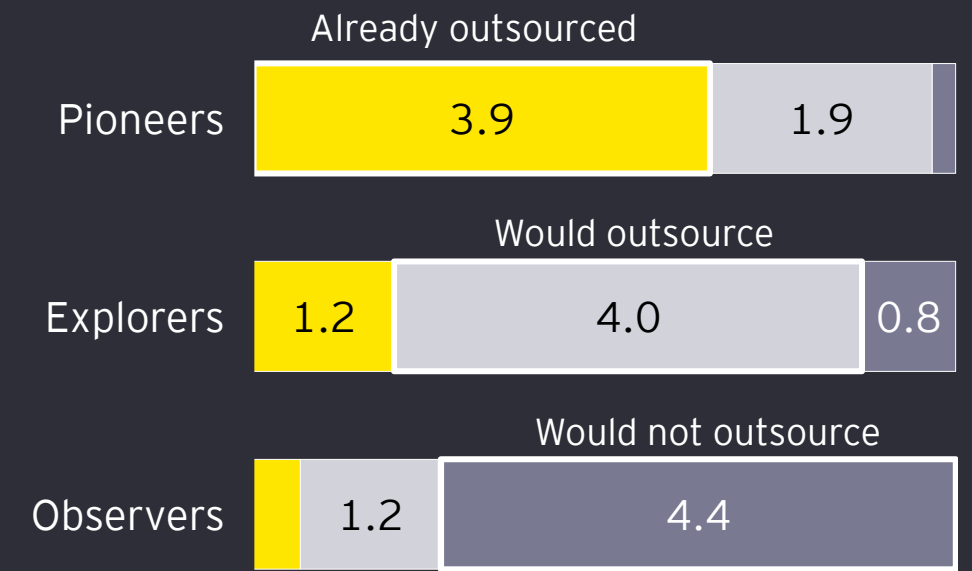
Over the past decade a group of pioneering law departments have embraced outsourcing to legal managed services providers

Law departments by outsourcing strategy



Average number of law services outsourced

The 6 services assessed are contract management, legal management and compliance, employment law, due diligence, document retention and records management.

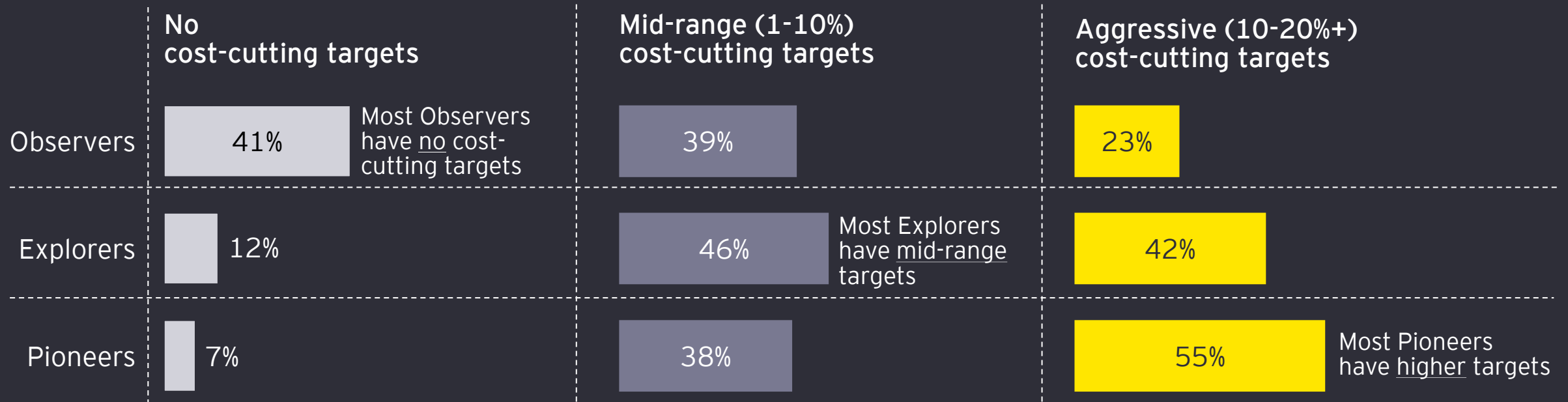


Source: EY Reimagining the Legal Function Survey Data, 2019 (Survey Size = 1,058 Law Departments)

# Pioneers face bigger cost-cutting targets than Explorers or Observers

## Cost-cutting targets by law department type

Targets over the next 24 months



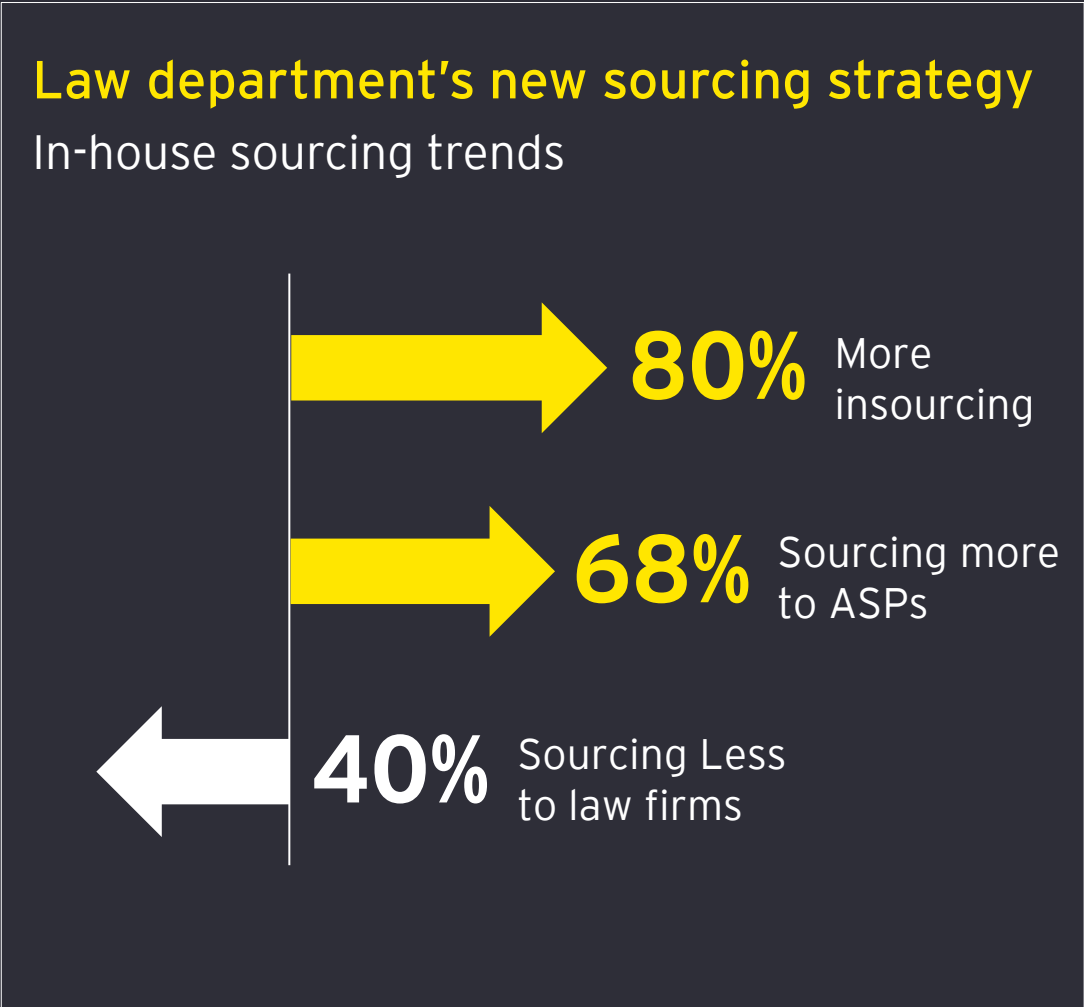
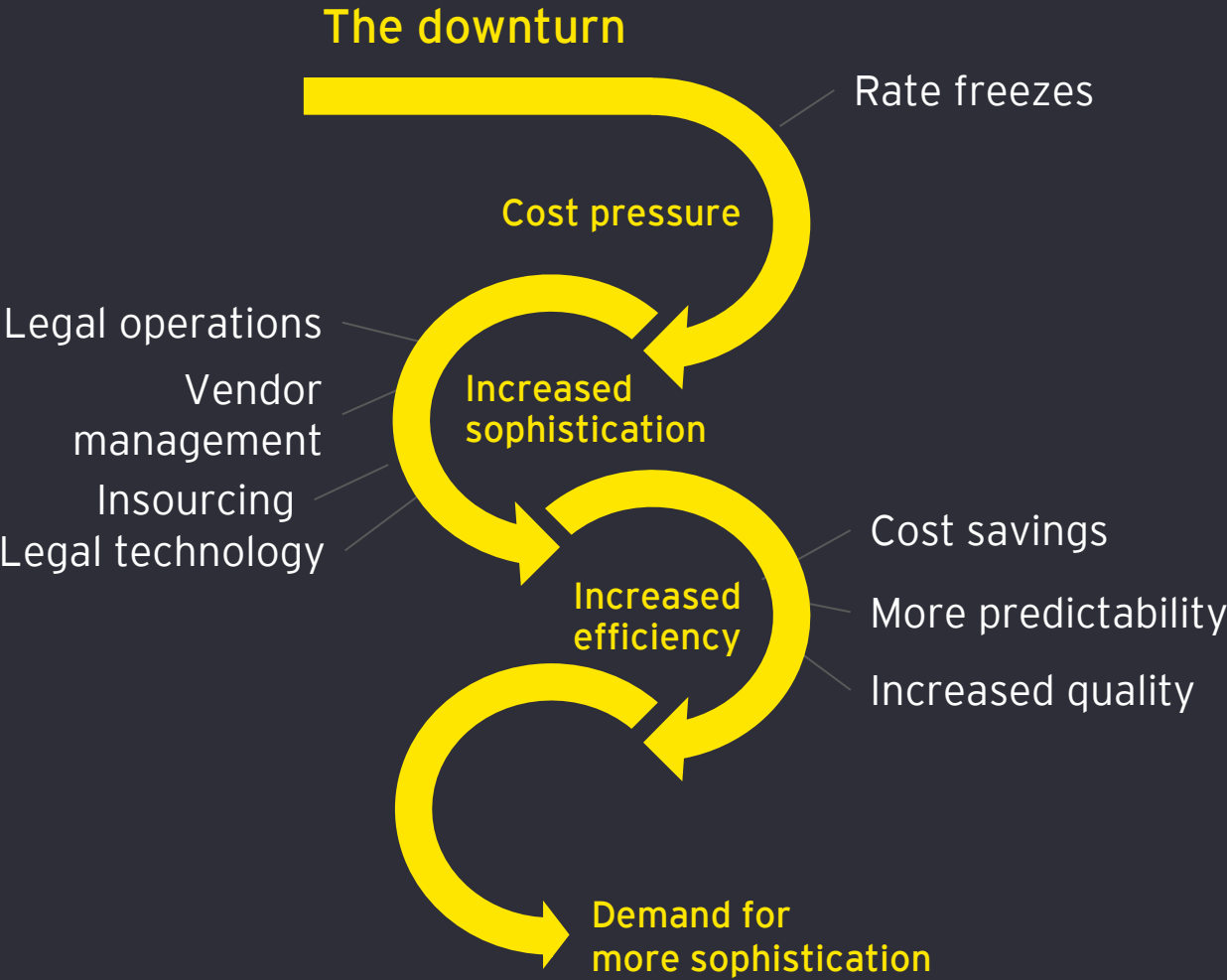
Source: EY Reimagining the Legal Function Survey Data, 2019 (Survey Size = 1,058 Law Departments)

Why do Pioneers - who use alternative legal service providers (ALSPs) and legal managed services (LMSs) most - have more aggressive cost-cutting targets?

- Hypothesis 1: Cost-cutting targets are driving their decision to outsource
- Hypothesis 2: Prior use of these entities is driving greater confidence in cost cutting



While cost cutting has been a major focus for law departments since the downturn, the strategies leading departments are using to cut costs have evolved significantly

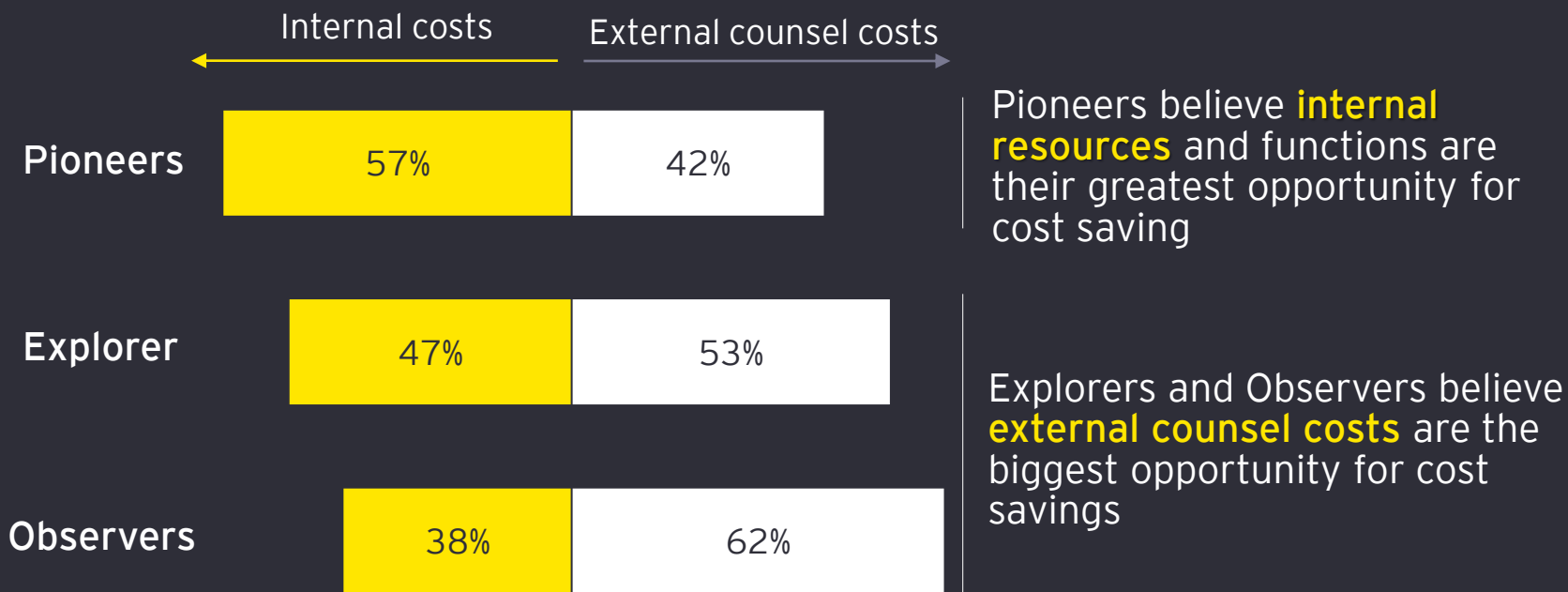


Source: Build or Buy The Evolution of Law Department Sourcing, ALM Intelligence, 2017

# Pioneers believe internal optimization is their biggest opportunity for cost savings

## Cost-cutting focus

Percent of law departments by area of cost-cutting focus



### Why are Pioneers focusing on internal cost savings?

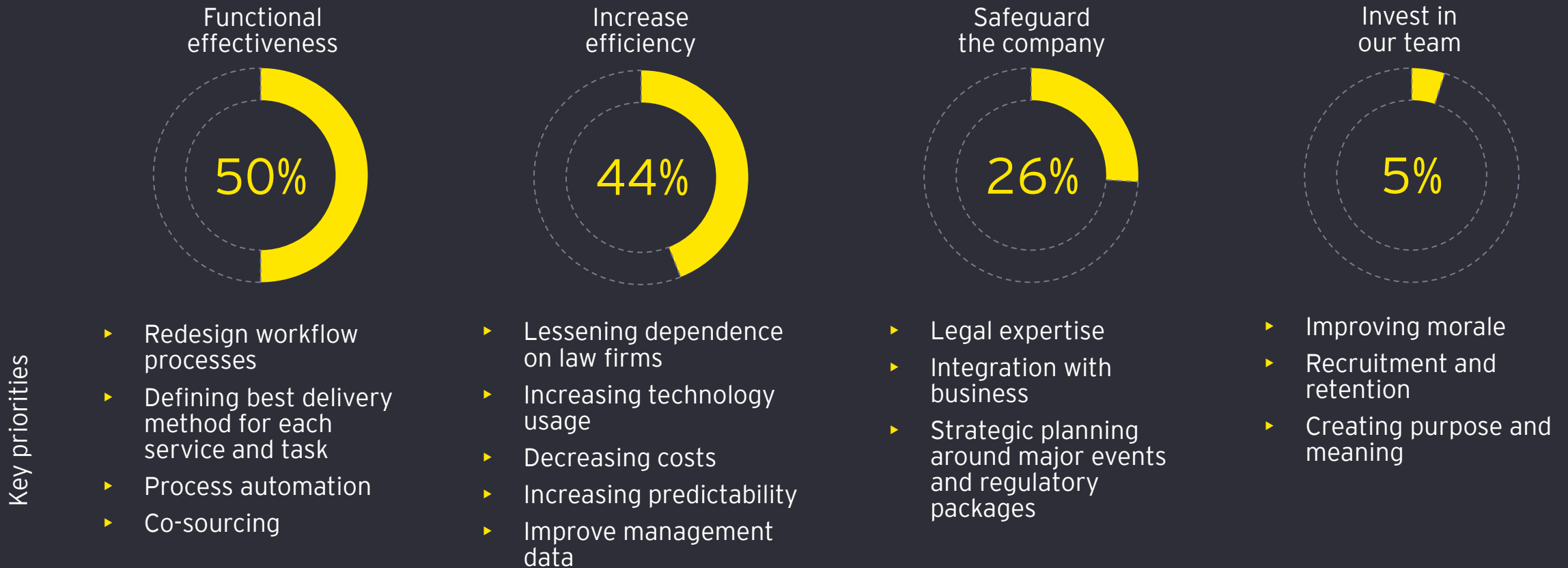
Pioneers have already put significant effort into optimizing external counsel costs over the past several years and are now turning inward - focusing on optimizing internal resources and functions.

Note: For simplicity, the response "Other" which accounted for <2% of responses was omitted  
Source: EY Reimagining the Legal Function Survey Data, 2019 (Survey Size = 1,058 Law Departments)

# Improving functional effectiveness and overall efficiency are at the top of law departments' internal optimization priorities

## Current strategic priorities for corporate law departments

Percentage of departments reporting priority as important



Source: Legal Executive Institute Report 2020

Over the past decade law departments have made progress on internal optimization but more work remains to be done

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## Areas of focus for leading law departments over the past decade

- ▶ Insourcing
- ▶ Reducing the number of suppliers
- ▶ Negotiating rate freezes / slower rate increases
- ▶ Increasing the use of alternative fee agreements (AFAs)
- ▶ Increasing use of non-law firm vendors

Law department  
initiatives focused on  
**reducing external spend**

- ▶ Investing in law department operations
- ▶ Legal technology implementations
- ▶ Improving systems (e-billing, matter management, etc.)
- ▶ Work flow redesigns

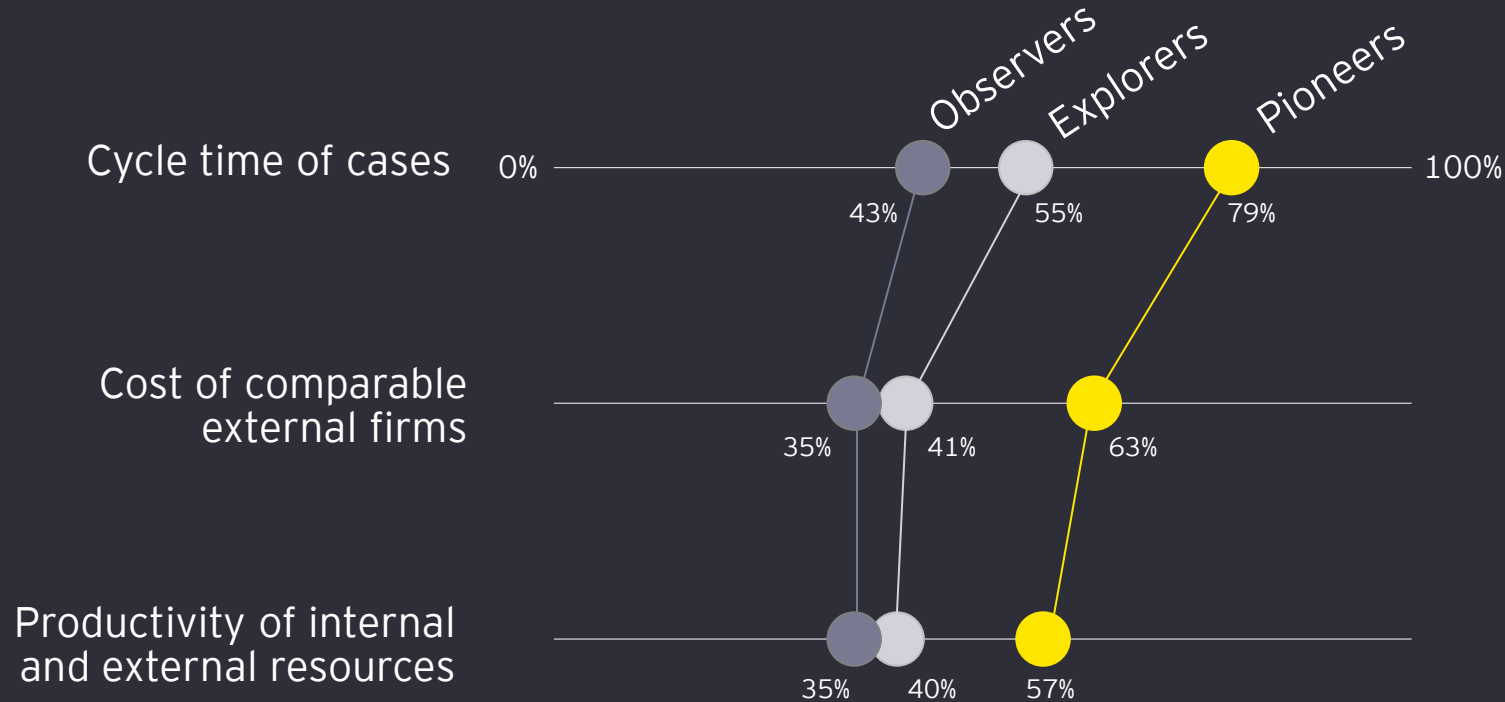
Law department  
initiatives focused on  
**improving internal operations**



# Pioneers' investments in new systems have given them better access to vital information necessary to manage their departments

## Law departments' access to detailed and timely information

Percent of law departments that are **very confident** in their data in the following areas



**Pioneers report having better access to a broad range of management information**

### Why do Pioneers have better access to management information?

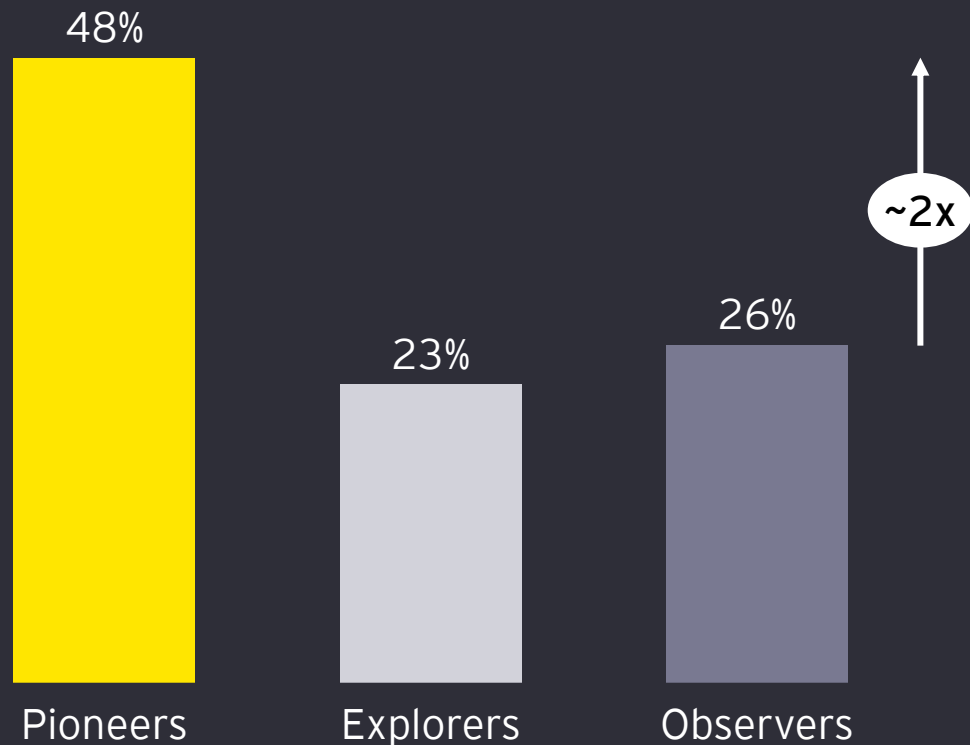
Many leading law departments have spent significant effort over the past decade upgrading their systems and processes (examples: matter management system, e-billing, etc.).

Source: EY Reimagining the Legal Function Survey Data, 2019 (Survey Size = 1,058 Law Departments)

Access to better quality information has allowed Pioneers to clearly define what work their department should and should not be doing

## Law departments' confidence that they understand what work they should not do

*Percent of law departments which report being very confident*



- ▶ Pioneers are about **twice as likely** to know what tasks their department should and should not do
- ▶ Pioneers are also about **twice as likely** to have identified which tasks should be self-serviced by the business

Source: EY Reimagining the Legal Function Survey Data, 2019 (Survey Size = 1,058 Law Departments)

## Summary: The forces pushing Pioneer law departments to outsource are clear

① Pioneers are **under significant pressure to cut costs**

② Spent significant effort **optimizing external counsel costs**

- ▶ AFAs, rate freezes
- ▶ Panel consolidation
- ▶ Revised guidelines

③ Pioneers have **turned toward optimizing internal resources and functions**

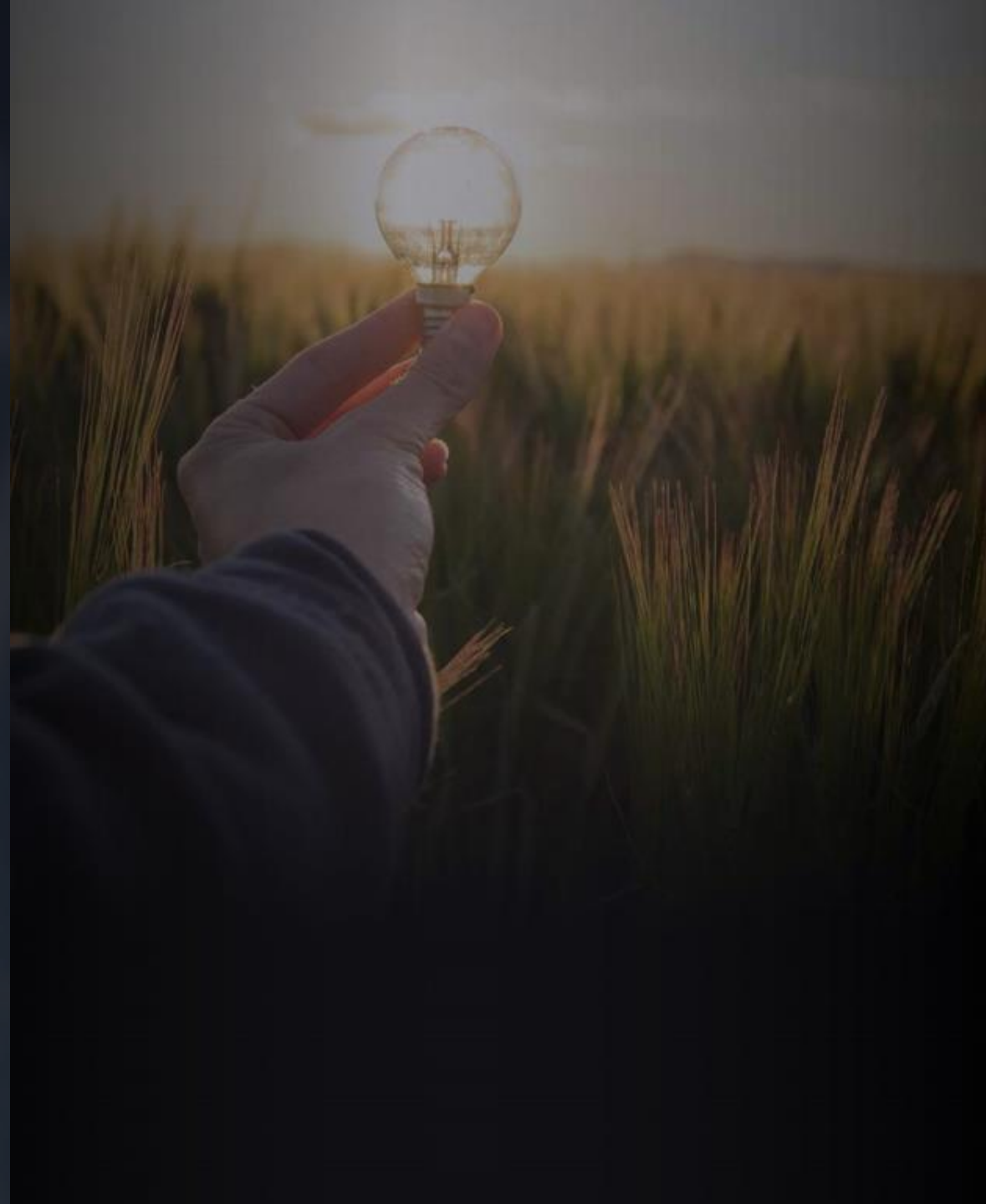
④ **Upgraded systems and processes** to improve the quality of management information

- ▶ Matter management
- ▶ Workflow
- ▶ Knowledge management

⑤ Pioneers have the information needed to **define what work their department should and should not do**

⑥ **Pioneers have embraced sourcing to legal managed service providers** as a strategy to cut costs, improve efficiency and focus their department on the most important tasks

# The benefits of legal managed services



# What are the potential benefits of outsourcing to legal managed services providers?

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## Outsourcing to legal managed services providers offers law departments the potential to:

- ▶ Reduce cost
- ▶ Increase efficiency
- ▶ Shift focus to most important tasks
- ▶ Shift operations to defined and continuously monitored processes

## These “first round” benefits could lead to “second round” impacts such as:

- ▶ Improved management information and data on processes
- ▶ Improved ability to manage complex risks
- ▶ Improvements in talent morale and recruitment and retention
- ▶ Ability to shift investment dollars toward building new capabilities

Source: EY Reimagining the Legal Function Survey Data, 2019 (Survey Size = 1,058 Law Departments)

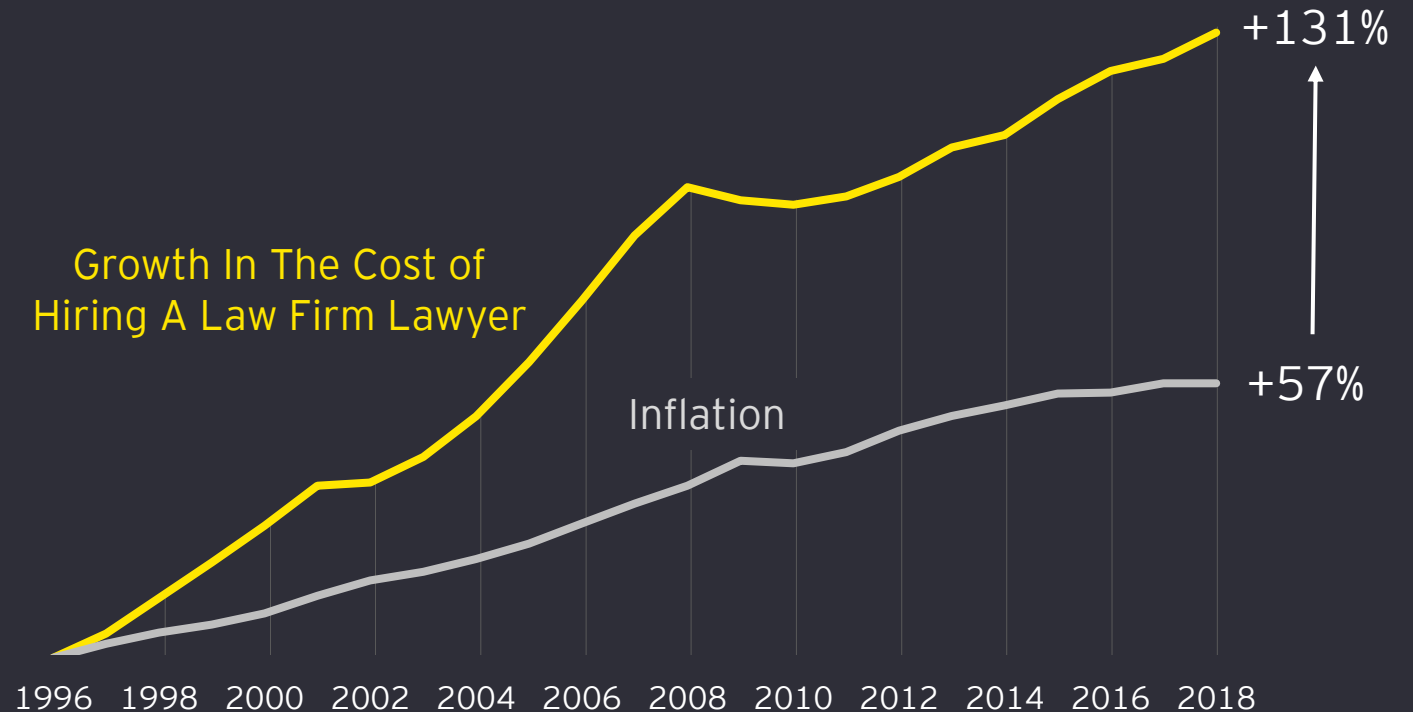
One of the key benefits of sourcing to LMS is that it offers law departments the ability to decrease reliance on law firms – and gain better cost control

Law firm costs account for...

**50% - 80%**

of the law department's total budget

## The cost of hiring a lawyer has outpaced inflation by 2X

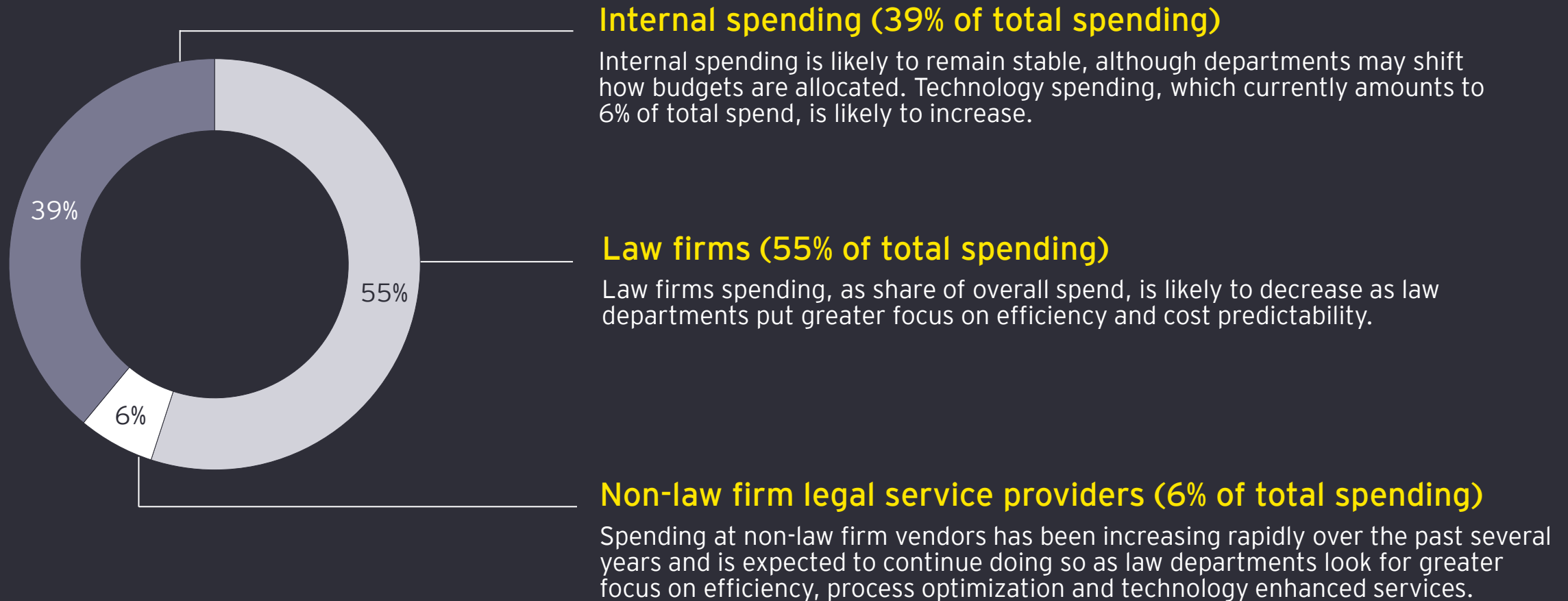


Note: Based on US Top 200 Law Firms and US Inflation Rate  
Source: Am Law 200 , Bureau of Economic Analysis

# There is still significant room for change in most law departments' sourcing mix

## Average corporate law department spending

Share of total legal spend



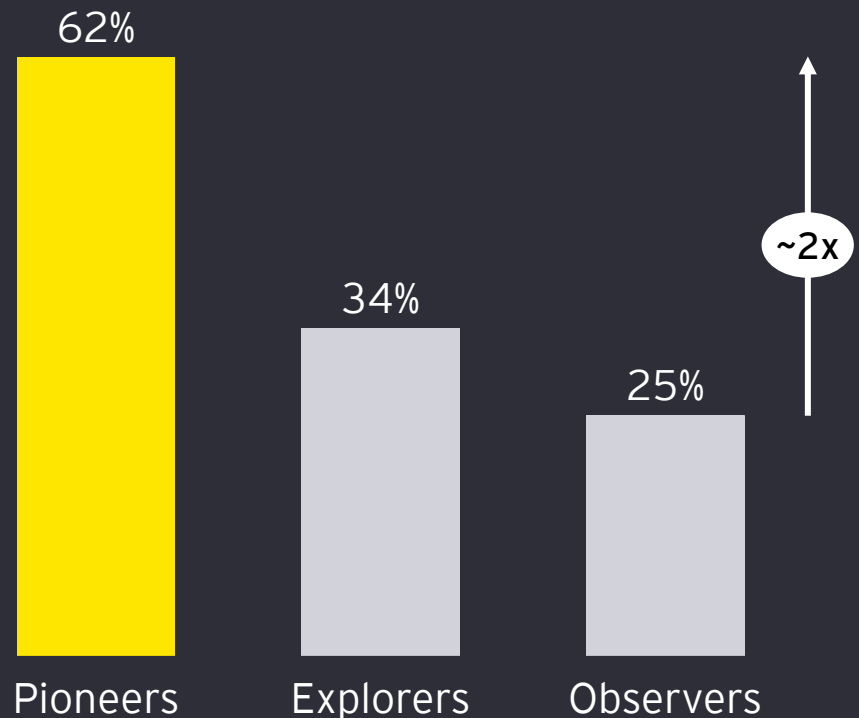
Source: ACC CLO Survey 2020



Pioneers are more confident in their ability to manage third-party costs – a key piece of the puzzle in increasing overall efficiency

## Law departments that have cost-effective arrangements with third-party providers

Percent of law departments which report being *very confident* in their arrangements with third-party providers



### Why do third-party cost arrangements matter?

Law firms and alternative service providers typically account for 50-80% of a law departments' budget.

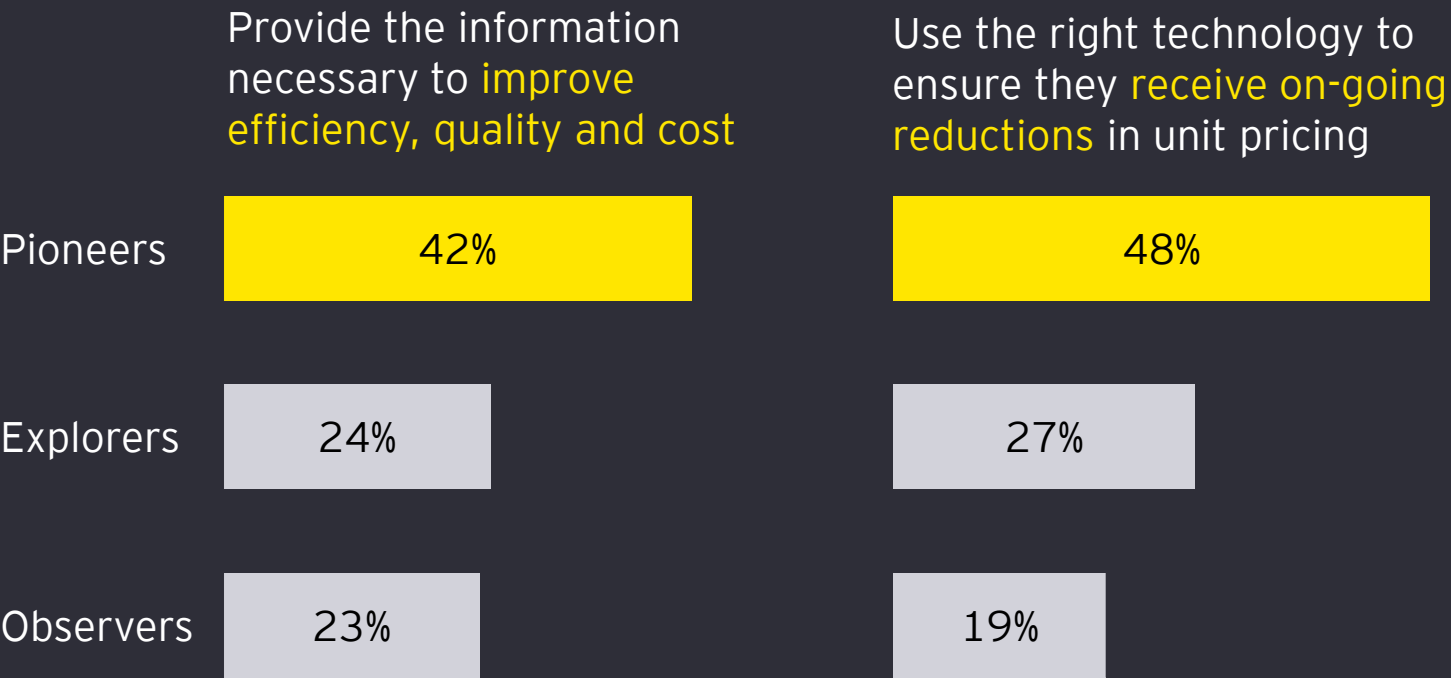
Outsourcing arrangements reduce cost, allowing Pioneers to increase the overall efficiency of their departments.

Source: EY Reimagining the Legal Function Survey Data, 2019 (Survey Size = 1,058 Law Departments)

# Pioneers also feel more confident in their ability to continue increasing efficiency in the future

## Law departments who are very confident that their vendors...

Percent of law departments



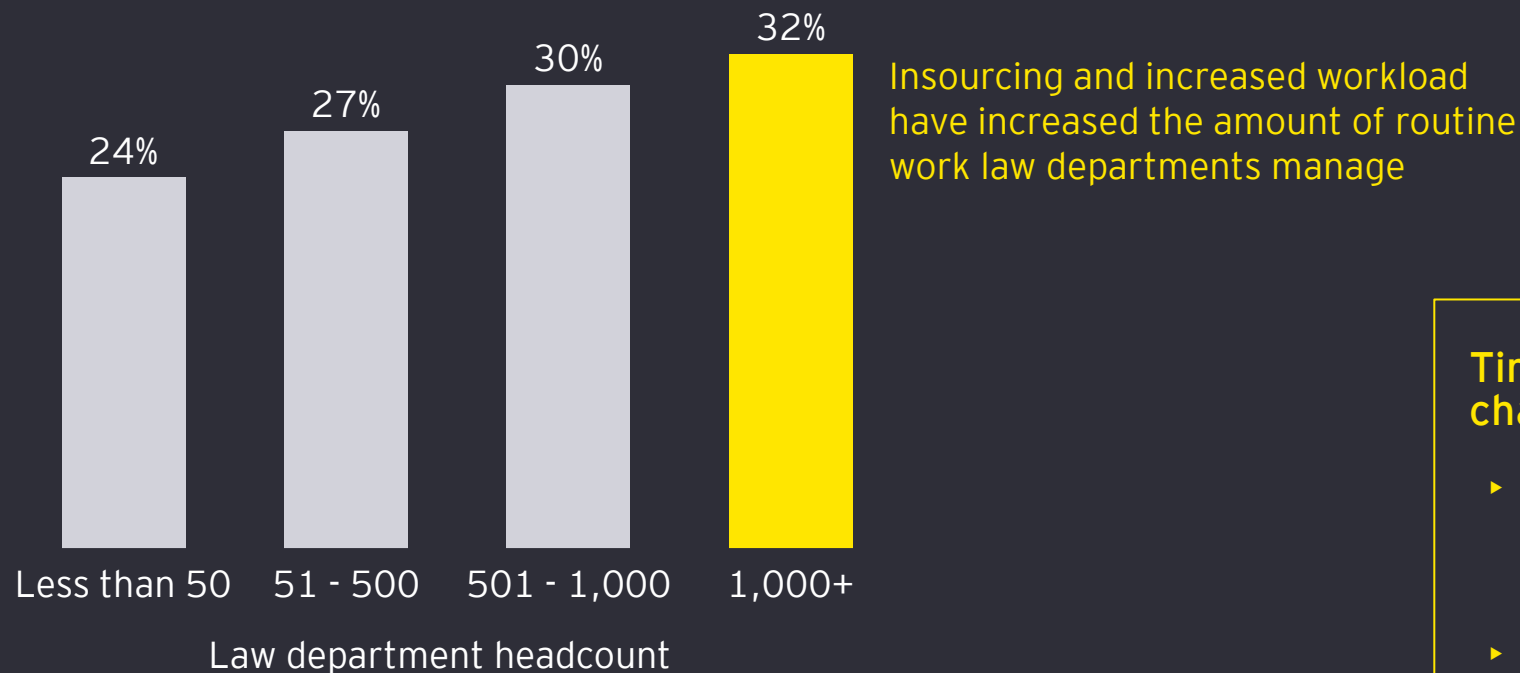
Outsourcing provides Pioneers with greater access to information and technology, allowing them to continue increasing efficiency in the future.

Source: EY Reimagining the Legal Function Survey Data, 2019 (Survey Size = 1,058 Law Departments)

Another potential benefit of sourcing to LMS is its ability to reduce the volume of routine tasks – a key challenge for many departments

## Time spent doing routine tasks

*Weighted average time spent by law department headcount*



### Time spent doing routine tasks creates challenges for law departments:

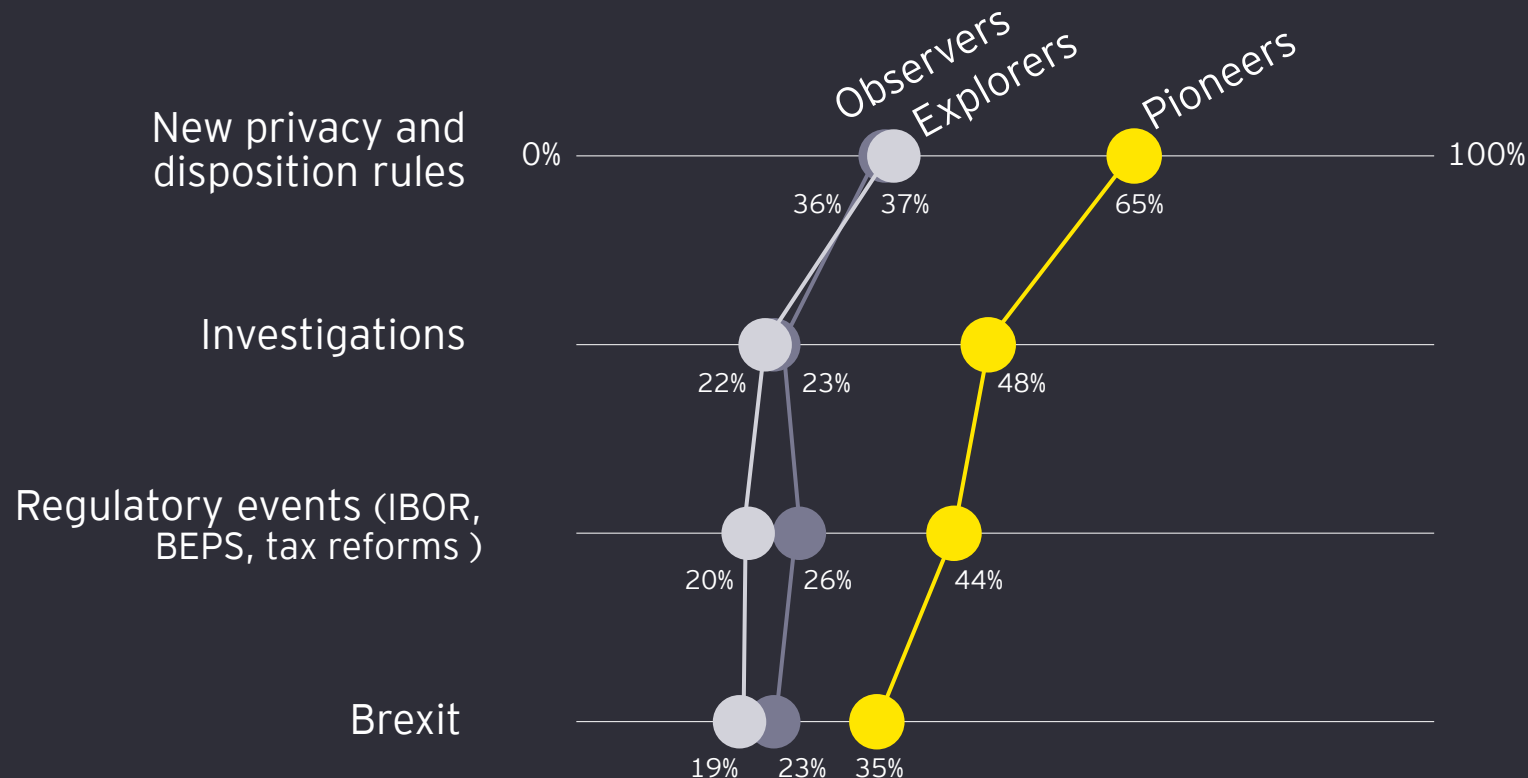
- ▶ Diverts energy and resources away from the tasks which matter most – complex risks
- ▶ Diverts resources away from investments in technology and building new capabilities
- ▶ Lowers morale and hurts recruitment and retention

Source: EY Reimagining the Legal Function Survey Data, 2019 (Survey Size = 1,058 Law Departments)

# Sourcing routine tasks to LMS has allowed Pioneers to focus on the issues that matter most

## Law departments' confidence in their readiness plans

Percent of law departments reporting they are **very confident** in their readiness in the following areas:



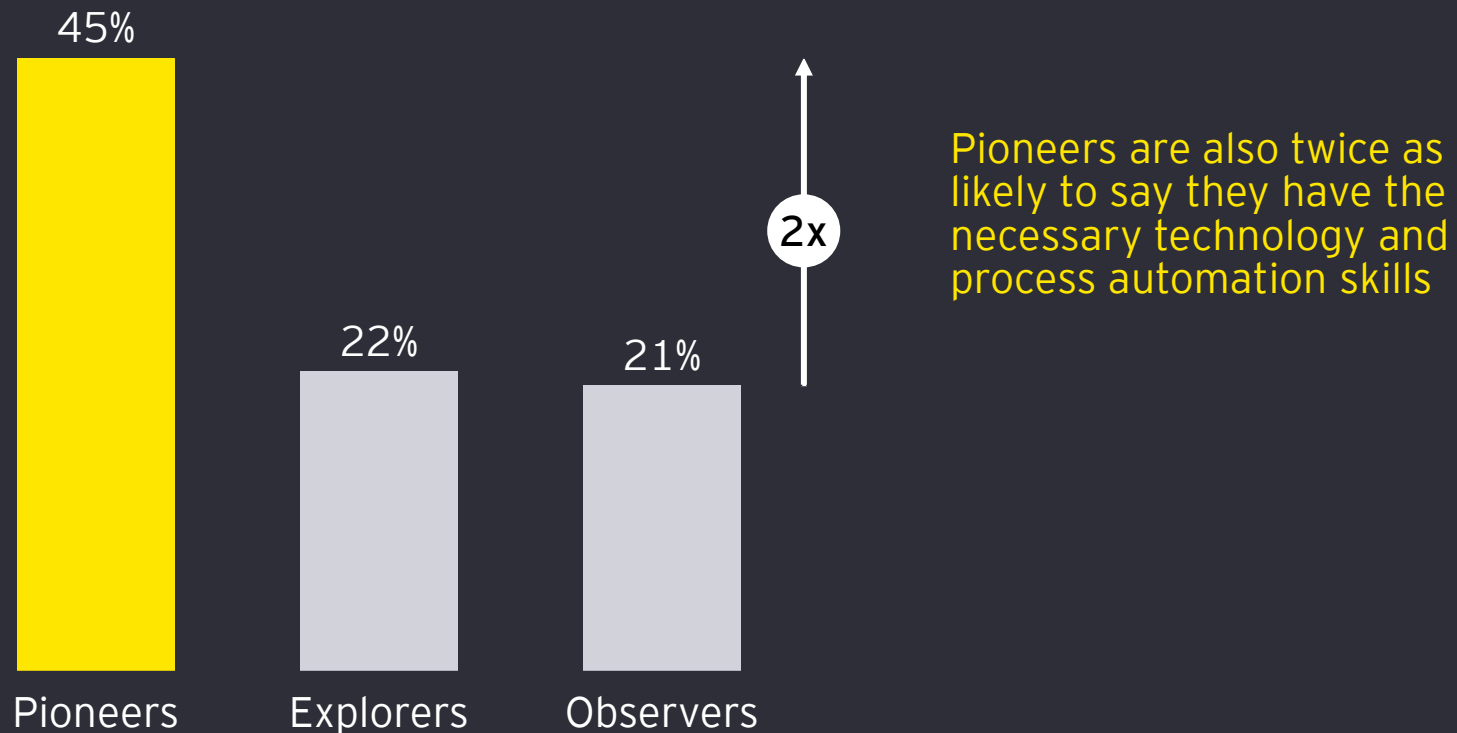
Pioneers are more confident about managing the complex risks facing their corporations.

Source: EY Reimagining the Legal Function Survey Data, 2019 (Survey Size = 1,058 Law Departments)

# Sourcing to LMS has also allowed Pioneers to invest in building new capabilities

## Law departments which believe they have the appropriate non-legal competencies

Percent of law departments which are *very confident*



### Why are Pioneers more confident about their non-legal skills?

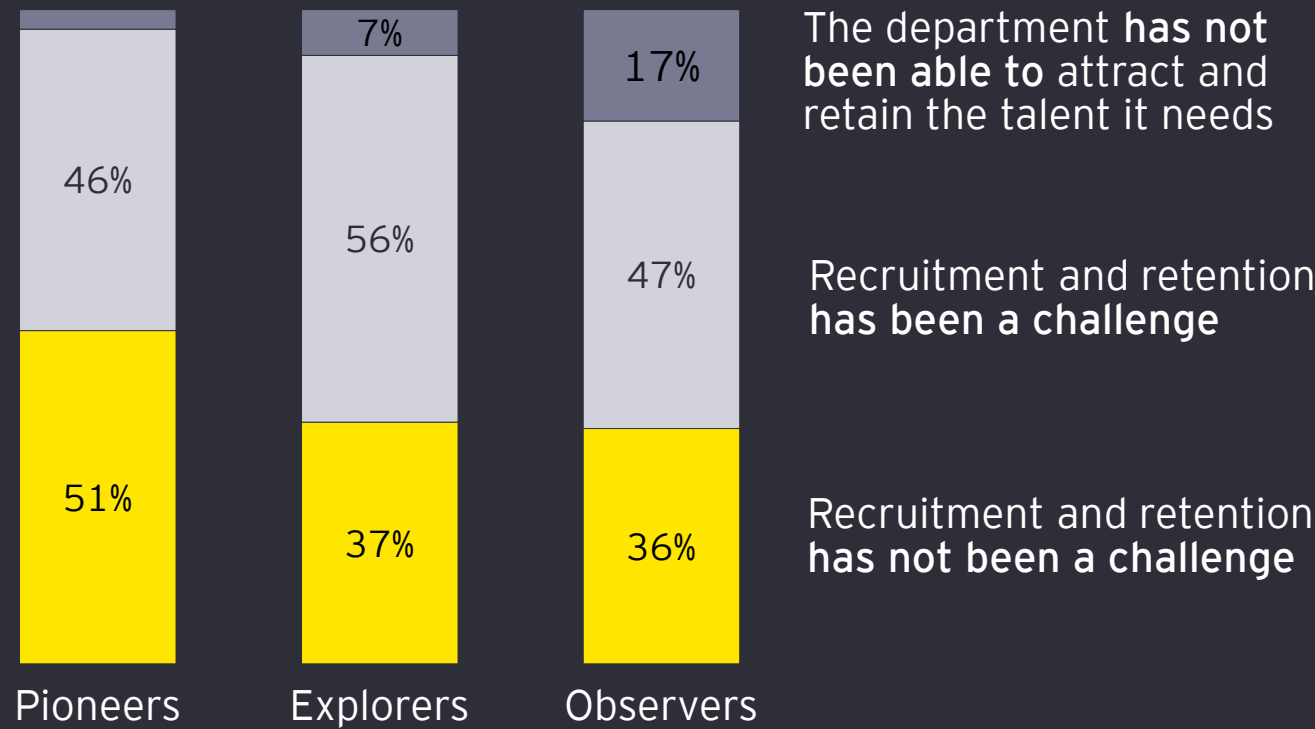
Pioneers' use of LMS has freed up time and resources, allowing the department to identify and invest in the skills it needs to manage the department and tackle its most important tasks.

Source: EY Reimagining the Legal Function Survey Data, 2019 (Survey Size = 1,058 Law Departments)

# Pioneers are also better able to attract and retain talent

## Law departments' ability to attract and retain talent

Percent of law departments



**Why are Pioneers struggling less with recruitment and retention?**

Pioneers' use of LMS has allowed them to focus their in-house counsel on higher value tasks, improving morale and recruitment efforts

Source: EY Reimagining the Legal Function Survey Data, 2019 (Survey Size = 1,058 Law Departments)

# Summary: Law departments that outsource to legal managed services providers are enjoying a broad range of benefits

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## Pioneers are....

- 1 More **cost effective** today
- 2 More **confident about improving efficiency** in the future
- 3 More **confident in their ability to respond to geopolitical and regulatory changes**
- 4 More **confident they have built the right set of capabilities** within their department
- 5 **Better able to attract and retain talent**

Source: EY Reimagining the Legal Function Survey Data, 2019 (Survey Size = 1,058 Law Departments)



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