

ALLEN & OVERY



The future of the in-house legal function

*An Allen & Overy perspective on the opportunities
and challenges that lie ahead*



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Executive summary

From the birth of the modern law firm until a decade ago, modes of service delivery remained largely unchanged. The market consisted of in-house legal functions, law firms, legal process outsourcing companies, interim resourcing businesses and legal function consulting firms. These players each operated within their self-defined market segment and offered little competition to each other. As a result, the legal market was a seller's market in the sense that the clients – the buyers – had to accept that legal services would be delivered in the rigid and siloed way the providers had always adopted.

Over the last decade the most dynamic players in each of the previously distinct market segments have begun to diversify so as to compete more widely across the market. This competition is evolving the legal world from a seller's to a buyer's market where clients insist on the ability to innovate in service offerings and delivery as a pre-requisite to engaging a legal service provider. But the market is still challenging for clients because no clear leaders have emerged across the broad spectrum of this new world.

Changes that lie ahead

Over the next ten years, the transition from a seller's to a buyer's market will be complete. Instead of picking from a menu of service propositions defined by the sellers, mainly relating to transactions and disputes, clients will, in the future, identify the challenges they face and the suppliers will respond to those challenges.

One of those challenges will be that of self-serve – the legal function empowering business colleagues to act, and transact, without direct lawyer involvement, yet safely within parameters set by the legal function. This will enable business colleagues on their

own to generate, negotiate, amend and conclude contracts. But also to find answers to frequently asked questions using chatbot and logic technologies.

Transactional work will remain core to a legal function's purpose and will evolve into three broad categories. First, a growing proportion of a legal function's business-as-usual flow work will be outsourced to managed service providers using increasingly sophisticated expertise, technology and resourcing models – or platforms. More sophisticated legal functions will adopt those same models to execute that flow work themselves.

Second, for certain types of high volume transaction, clients will continue to engage law firms, but the winning firms will be those who build similar platforms to handle that category of flow work. Finally, there will remain highly complex or time-pressured transactions that do not lend themselves to platforms and which law firms will execute on the current tailored basis, albeit streamlined through technology and alternative resourcing.

Regulatory and market change requiring large-scale, enterprise-wide transformation programmes will continue to consume legal and compliance function time and money. The solutions to these challenges will require a level of subject matter expertise, human resources and technology capabilities that few legal functions will possess. As a result the supplier market will develop end-to-end solutions to fill this gap.

In addition, the best legal functions will spend an increasing proportion of time on risk anticipation as a way of reducing their current high commitment to event remediation (ie managing the fall-out from compliance breaches, misconduct, litigation and arbitration). Technology, in particular, will reshape remediation activities.

Despite all this change, providing wise, business-nuanced advice to internal clients will continue to be a core role of the legal function. The creation of solutions to all the other legal function challenges discussed in this paper will free up time for lawyers to spend on this vital role.

And finally, as the range of tasks and work that is outsourced by legal functions to external suppliers grows, so the functions will become more sophisticated both at procuring those services and at managing them and their conventional law firm relationships.

Catalysts of change

This transformation of the in-house legal function will be brought about by some combination of technology, resourcing and

process. Legal functions are breaking down the tasks that technology can streamline into categories in order to make sense of the bewildering array of legal tech suppliers.

The legal function of the future will have to embrace and plan to exploit the transformational opportunities presented by data. This will require an appreciation of the enabling role that taxonomies and mark-up languages play in effecting a transition from a world of text to a world of data.

Implementing change and innovation on this scale will require a more dedicated and sophisticated capability than most legal functions currently have, so this paper ends with a series of practical steps that can be taken to build innovation capability and embark on the transformation journey.



“Participants in the legal market will have to confront the central challenge: where does my organisation fit into this emerging new world”

A legal tipping point

The legal market is approaching a tipping point. Cost pressures, regulatory overload, the challenges of scale and global reach, advances in technology, diversification of providers and the workplace expectations of a new generation of lawyers entering the profession are combining to present legal market participants with choices that they can no longer defer or avoid.

The opportunities and risks that these forces present for legal market participants – whether they are in an in-house legal function, a law firm, an alternative service provider or elsewhere – should not be underestimated. Those who devise and implement a smart and timely response to these forces will emerge as winners. Those who fail to do so within the timescales that the market imposes will inevitably pay a price.

Gradual evolution, which is the legal market's default response to any form of significant change, is failing to keep up with the rapidly accelerating pace of these developments. Greater agility and more radical thinking is needed. More importantly, participants in the legal market will have to confront the central challenge: where does my organisation fit into this emerging new world and how must it change in order to occupy that role?

In this paper, we address this challenge by describing how the ultimate buyer and the source of most corporate legal market revenues – the in-house legal function – is likely to be configured in ten years' time. We also offer our view on the context for this transformation by charting how the evolution of the market from a seller's to a buyer's market will contribute to this remarkable change.

More practically, this paper offers a tool which in-house legal functions can use to challenge themselves and ask difficult questions about what their role is in their organisation, what structure and operating model they

must adopt to fulfil that role and which suppliers and technologies can accelerate their development into that role.

The future state presented here is not prescriptive. There is no standard operating model or template that can apply to every legal function. The shape of a large legal function will be different from a small one; a tech industry player will be different from a life science one; a global organisation different from a national one.

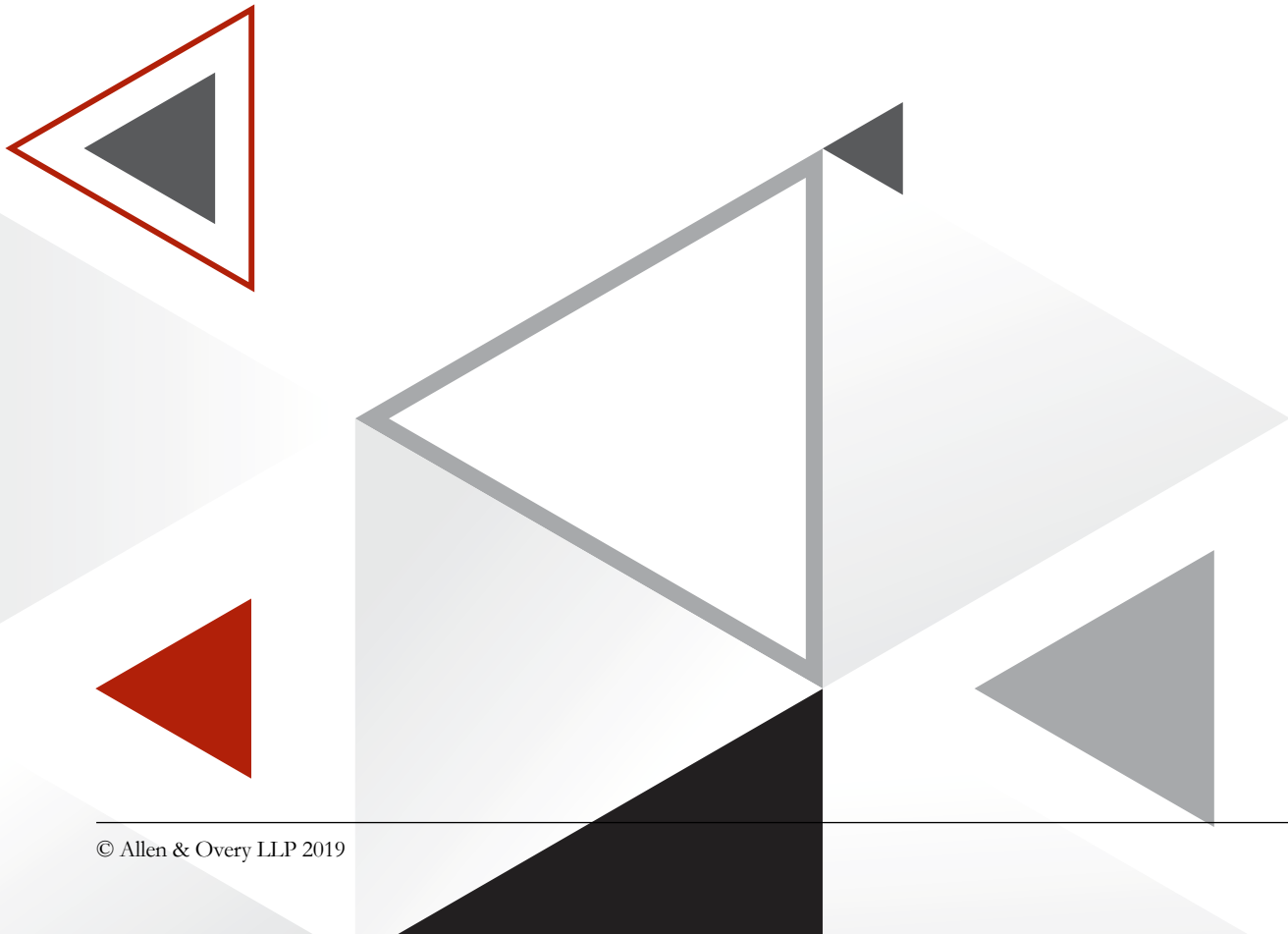
But no matter the size, industry or geography, there is much to be optimistic about as in-house legal functions approach this challenge:

- Anecdotally, some legal functions are already engaged in a wholesale review of their operations and, more broadly, of their fundamental role and purpose within their organisations. This suggests a willingness to treat the challenge as an opportunity – to depart from the market's evolutionary traditions and embark on radical change.
- Legal functions and law firms have in recent decades been astoundingly innovative in the application of legal expertise to client needs. Whole practice areas and markets have developed by adapting established legal principles and creating deal structures, market taxonomies, document conventions and market practices: technology and software licensing, outsourcing, share incentives, derivatives, securitisation and investment funds to name just a few.

More recently, the buzz and effort has shifted from innovation in legal expertise in that sense to how the services that embed that expertise are delivered (ie the use of new technologies and modes of resourcing to reduce cost or improve client experience). This is not a capability that many legal functions or law firms can say is as yet at their core. So the delivery of legal services is at the heart of this paper.

Those who devise and implement a smart and timely response to these forces [of change] will emerge as winners

“A growing proportion of in-house legal functions are becoming more discerning buyers of innovative legal service, and legal technology, providers”



Green shoots – a market in transition

Over the past decade, the legal market has been transitioning – pushed that way by buyer (ie client) pressure to innovate and by the emergence of technologies that can support that innovation. The ultimate source of this pressure has typically been senior management requiring that the legal function, like all other functions, increases efficiency and transparency, cuts cost and improves user experience and access to data. Digital transformation and an innovation mindset are expected of all corporate functions including in-house legal.

The supplier market is undergoing its own parallel transition. The most dynamic of the players in each of the previously distinct legal market segments [See *The past – a seller's market*] recognise that there are realisable commercial opportunities for them outside what they previously accepted as their defined market segments. Moreover, they have begun to recognise that they can pursue those opportunities by exploiting technology and by integrating a wider range of resourcing options and skill sets into their business model.

The supply-side transition is still at an early stage. Almost no organisation can lay claim to having comprehensively entered a different market segment or established itself as a market leader outside its historical market segment.

The past – a seller's market

From the birth of the modern law firm until some ten years ago, modes of delivery remained largely unchanged. The sole tool at the disposal of legal functions and law firms was their lawyers. Most client challenges were solved through some combination of that resource. Legal technology and alternative legal service providers were starting to emerge but as yet had made little impact.

The legal market was a seller's market. Clients had little choice but to accept that legal services would be delivered in the rigid and siloed way the providers had always adopted. The market consisted of several distinct segments:

- **In-house legal functions.** The difference between the work that was performed by the legal function and the work that was properly outsourced to external law firms and other suppliers was well understood. In that sense, the legal function and its external suppliers did not compete with each other.
- **Law firms** (which included the legal arms of the Big Four). Their client proposition was defined by widely understood transaction or dispute types such as M&A, commercial transactions, capital markets, bank lending, litigation, arbitration, not by what challenges the client faced.
- **Legal process outsourcing (LPO) companies.** These providers were mostly located in low-cost jurisdictions. Their entry point into the legal market was to perform high-volume, low-complexity, repeatable review-and-process tasks at the lowest possible cost, using human labour. Perhaps the longest established line of business for these firms was litigation discovery services.
- **Interim resourcing firms.** This branch of the legal market was in its infancy. These firms not only had to confront all the challenges involved in selling a service, but they had to create the very market for that service.
- **Legal function consulting firms.** These organisations advised legal functions and law firms on areas such as strategy, organisational design and supplier procurement. Some provided coaching services.

Each of these five communities operated almost entirely within its own defined market segment. From a client's perspective, this was a relatively easy market to navigate. But it was also an unsatisfactory situation because the solution to any one challenge might involve combining two or more such players. Invariably, it was the client who had to effect that combination, manage it as a coherent project team, and take the risk that it failed.

In-house legal functions have been redrawing the line between what is outsourced and what is performed within the legal function

But the forces of change have begun to break down the traditional market segmentation that prevailed a decade ago, thereby delivering greater power and influence to clients:

– **In-house legal functions** have been redrawing the line between what is outsourced and what is performed within the legal function. This has not led to a consistent model. Some take the view that the legal function should shrink and a greater proportion of their company's legal work should be outsourced to a much wider range of providers than law firms. Others take the view that a greater proportion of work should be performed within the legal function, typically using new technologies and resourcing models, because this approach can be more cost-efficient and strategic, and bring the legal function closer to the business.

Whichever approach is taken, a growing proportion of in-house legal functions are becoming more discerning buyers of innovative legal service, and legal technology, providers. Some are configuring themselves also to be the originators of that innovation by hiring a chief operating officer, an innovation leader, legal tech experts, data scientists, knowledge managers, process engineers or project managers.

– **Some law firms** – a relatively small number – have diversified their resourcing models. They have built their own in-house, lower cost, LPO-style centres and their own project management, interim resourcing and business consulting solutions, alongside their traditional law firm expertise and resourcing model.

They are actively seeking out and adopting legal technology applications that streamline the conventional work and delivery methods they employ on client engagements. This innovation is also enabling them to extend the range of services they offer to clients, either by moving into areas previously unoccupied by law firms (such as business or legal function consulting or mass document review) or by creating services and solutions that previously were not practicable (for example, the implementation of mass repapering exercises in response to regulatory change).

– **The Big Four accounting firms** target areas in the legal market that align well with their wider capabilities. So their traditional strengths still form the core of their growth: tax litigation, employment, corporate structuring and entity management, data privacy and mid-market M&A.

They have all shown a growing interest in the new legal market that is emerging as capabilities which they have, but which are not part of their law firm arms, such as their forensic accounting (with its presence in e-discovery) and financial regulatory practices, find themselves competing with law firms. However, they remain dominated by their audit, tax and consulting arms.

- A new breed of **alternative legal service provider** has emerged, offering different combinations of resourcing and technology to develop solutions to client challenges. The LPO firms and the interim resourcing firms that were established before substantive legal market change started are gradually moving into this space. In addition, new companies are being created specifically to target the client challenges to which this approach lends itself.

For this category of provider, which is often well capitalised through private equity funding and with its roots in process, efficiency and technology enablement, the recurring income available through managed services is an attractive feature of the market.

- **Business or regulatory consulting firms.**

The market for business advice to in-house legal functions has become much more diverse. In addition to legal function strategy, design and transformation, it also includes procurement, legal and compliance risk management, legal technology adoption, regulatory change management, regulatory strategy and the application of products and services developed outside the legal sector to address governance, conduct and culture and operational risk. Although the small number of generalist legal consulting firms that were established more than a decade ago would cover many of these areas, the market is now deeper, with greater specialisation.

The legal market that is emerging out of this transitioning dynamic makes life both easier and more difficult for buyers of legal services.

It makes life easier because the legal world is moving from a seller's to a buyer's market. There are now law firms and other providers actively streamlining their everyday work through technology and alternative resourcing. This means that clients will no longer tolerate suppliers that refuse to innovate in the way they deliver their core services. Beyond those core services, it is now possible to find a single external provider – or perhaps a joint venture of two or more – that can create a tailored solution for a client's particular challenge, which integrates a range of legal expertise, resourcing skillsets and technologies. Previously, a client would have had to pull together and manage a range of siloed suppliers to achieve that tailored outcome. Or they would have had to outsource the challenge to one of those siloed suppliers.

However, the transitioning dynamic also makes life more difficult for buyers. No leaders have so far emerged that are clearly recognised by the market as pre-eminent across all the challenges clients face in adopting this way of working, both in their core services and in creating tailored client solutions to new challenges.

Buyers must choose from a wide range of providers which in turn are likely to approach the challenge from very different backgrounds (law firms, Big Four firms, alternative legal service providers, consulting firms). Although many may claim expertise in this way of working, only a few can demonstrate a track record of delivery because many of the client challenges are being tackled by the market for the first time. For all these reasons, supplier selection is challenging.

“The pressure on in-house legal functions to reduce cost and enhance quality and speed to market will make them ever more imaginative about how to empower their business colleagues to act without the constant presence or intervention of in-house lawyers”

The future – a buyer’s market

Over the next decade, these trends will evolve the legal market from one shaped by the supply side – clients picking from a menu of service propositions defined by the sellers, most of them relating to transactions and disputes – to one shaped by the buy side – clients identifying the challenges they face and the suppliers responding to those challenges.

While this is happening, a cadre of leading suppliers will emerge with the skills and,

increasingly, the track record to address all or a wide range of these challenges.

Time will reveal the extent to which those leaders will be drawn primarily from law firms as they diversify beyond their conventional resourcing, technology and business models, or whether they will fail to transition to this new world, leaving a vacuum for the Big Four or the more agile alternative legal service providers to occupy.

The client challenges will evolve into the following areas:

Self-serve work

The pressure on in-house legal functions to serve their business, reduce cost and enhance quality and speed to market will make them ever more imaginative about how to empower their business colleagues (ie internal clients) to act and transact without requiring the constant presence or intervention of in-house lawyers, while at the same time operating within parameters that are set by the legal function and therefore ensure that the business is not put at risk.

This trend will see the legal function devote considerable time to creating and constantly maintaining contracting processes. They will template a wide range of counterparty documentation which standardises not only their organisation’s opening position in a contractual negotiation, but also the ‘playbook’ of fall-back and negotiated provisions they are prepared to accept¹. They will adopt technology platforms that allow

them to embed those ‘Legal approved’ templates and playbooks into document automation processes and capture the content of those documents as data.

Business colleagues who follow those processes will be able to generate, negotiate, amend and sign contracts on the platforms without intervention by the legal function. And the contract data captured in that process will facilitate post-signing contract monitoring and performance, risk management and opportunity identification. But the templates, the processes and therefore the outcomes will have been designed, quality assured and kept up-to-date by the legal function so that the contracting process will be occurring within a ‘safe space’ and accepted risk parameters.

This trend to ‘self-serve’ will not be confined to the contracting process. Chatbot and logic technologies will allow the internal clients that the in-house legal function supports to find

1. The potential role of industry collaboration and trade associations in developing ‘industry approved’ playbooks is discussed in ‘Flow transactions (out of the ordinary)’ on page 16.

answers to frequently asked questions with a consistent user experience on laptops, tablets and mobile phones, increasingly without having to track down and engage personally with the in-house legal function expert.

Already today, logic, or decision tree, technologies are being used to identify frequently asked questions and allow internal clients to obtain the answers to those questions by providing the underlying facts through a series of pre-programmed diagnostic questions behind which the legal function can embed logic to produce automated answers.

But the chatbot technology that allows an internal client to pose a free-form question in natural language and receive a natural language answer is still relatively immature. In the legal sphere, those applications that exist today tend to rely on written questions, but orally posed questions is a natural and feasible extension. It is realistic, for example, to think that chatbots could be used widely to

triage incoming legal support requests and direct them to the correct person within the in-house legal function – or to the policy document or contract template that contains the answer. This is, after all, the customer experience we have become used to when we call a retail customer support line. At least one large in-house legal function has already adopted this approach on a limited basis.

Self-serve can have the additional benefit of identifying within an organisation the unit that is willing to fund a legal technology build. If self-serve is presented as the key to increasing profit, whether through increasing speed to market or reducing deal costs, then the business function that benefits will often be willing to fund the cost. By contrast, if a technology build makes the legal function more efficient or reduces corporate risk, the link to the bottom line is more tenuous and budget can be harder to find.

Flow transactions (business as usual)

In the past, most legal functions have drawn a more or less clearly defined line between those commercial transactions that are ‘business as usual’ and those that are ‘out of the ordinary’ (ie, time-pressured or high complexity or where the legal costs are borne by a customer or other third party).

The business-as-usual deals tend to be executed in-house. Sometimes, they are outsourced to external alternative legal service providers to execute on behalf of the organisation under a managed service arrangement. But the organisation may still hire external law firms to execute the out-of-the-ordinary deals.

In the future, that line will blur and a higher proportion of an in-house legal function’s work will be outsourced to managed service providers. This will occur because, as relevant technologies mature, more – and more sophisticated – suppliers will offer compelling managed services to legal functions by ‘platformising’ the work.

These services will be based around the smart use of technology platforms to remove as much human intervention as possible, the smart use of different types of resourcing to reduce the cost of that human intervention and the smart use of process to make that human intervention efficient.

In-house legal functions are already exploring this branch of outsourcing more ambitiously. There are one or two isolated examples of outsourcing almost an entire legal function (eg, DXC to United Lex). More commonly,

the outsourcing is of specific parts of the work of the legal function, typically where deal volumes are high, speed to market is important and the deal terms and processes can be standardised. General examples include the review, negotiation and signing of incoming non-disclosure agreements or the drafting and negotiation of vendor procurement contracts. In the financial markets, specific examples include the execution of transactions involving over-the-counter derivatives, structured financial products and medium-term note programmes.

The most sophisticated legal functions sometimes ‘insource’ or ‘near-shore’ these areas of their work, rather than outsourcing it. In other words, they adopt the same technology, resourcing and process techniques as independent managed service providers, but establish and control the facilities themselves, generally in a lower cost jurisdiction or region than their normal offices.

As managed service providers become more sophisticated, their commercial proposition to in-house legal functions will become more compelling. What legal function would not opt for lower cost, faster speed to market, ability to scale resources up and down as business volumes require, higher quality and consistency across a distributed global organisation and better data? However, the up-front investment in business process engineering, template drafting and system design and build will require the underlying challenge to be at scale.

Flow transactions (out of the ordinary)

The same technology, resourcing and process techniques that will allow managed service providers to capture part of the traditional 'flow' work of in-house legal functions, will also be adopted in, and transform, the 'flow' work for which clients engage law firms.

Area of law firm work, where there is a high volume of transactions adopting similar documentation and process, will be transformed. The same commercial logic that will motivate the client to use managed services for in-house flow work will apply to law firm flow work. Examples in the financial markets might include mainstream corporate lending, real estate finance, leveraged finance, asset finance, vanilla corporate debt instruments and securitisation. The logic will also prove compelling in areas outside the financial markets, for example, high-volume M&A work for lower-value deals and for private equity deals.

The obvious *victims* of this conversion of 'tailored' deals into 'flow' deals will be law firms. The essence of this way of working will be to consolidate all of an organisation's deal flow of a certain kind on to a single technology platform which adopts standardised documentation and processes. So deals will take less lawyer time to execute and the per deal fees will reduce, potentially radically.

It is less clear who will be the most likely *winner*. Law firms could be. They are certainly fully incentivised to embrace this 'platformisation' of their deal flow. There is the positive incentive: by establishing the platform for a client, the law firm will create the possibility of handling all the deal flow of a certain type for that client, whereas previously the client may have shared that work among two or more law firms on its panel. And there is the negative incentive: unless it creates the platform, the law firm may lose out on all or most of that deal flow.

However, to win that role, the law firm will have to demonstrate that it has the expertise and track record to create a technology platform,

to engineer efficient processes, to recast deal documentation and to develop insightful data. Those law firms that do not develop these skillsets within their own organisation will reach the point where joint venturing with an alternative legal service provider to integrate those skills into a joint proposition will be the only way into this market.

Since these are not conventional law firm skillsets, law firms may not be agile enough to exploit this opportunity and the Big Four and alternative legal service providers may emerge the winners. As these suppliers move up the expertise and value curve, handling what was formerly in-house executed deal flow, they will acquire the expertise to tackle ever more complex areas. That may be by developing their own legal expertise or by joint venturing with independent law firms. Either way, they will be targeting these deal platforms.

But client organisations may be reluctant to put all their deal flow of a certain type through a single legal provider (whether that is a law firm or an alternative legal service provider). They may equally be reluctant to bear, even indirectly and over time through per deal fees, the entire investment cost of creating the platform. This suggests that the natural provider of any such platform, and therefore the winner, may well be an independent utility, perhaps sponsored by an industry collaboration or association, where the investment cost can be shared among various industry participants.

This outcome is all the more likely because an influential industry association is uniquely well placed to push the standardisation of processes and documents (not just opening position documents but also the playbook of fall-back and negotiated provisions). FIDIC, the international standards organisation for the engineering and construction industry, and ISDA, the International Swaps and Derivatives Association, are strikingly successful examples – the more so since each established its market documentation standard decades ago.

Tailored transactions

Although some of the transactions which corporates and financial institutions have traditionally engaged external law firms to execute in a tailored way will become flow work that is executed over platforms in this way, other types of transaction – which might include high-value or ‘bet-the-company’ M&A work, or deals involving highly customised contractual arrangements – will not lend themselves to these approaches. Law firms will continue to be engaged to execute these on a tailored basis.

That does not mean that these transactions will continue to be executed by the law firms without regard to the advances in technology, resourcing and process which will be blanketing the rest of the market. The law firms that clients engage on these transactions will

be the firms that can demonstrate they are adopting technology, lower cost resourcing and process to execute all those parts of the deal that lend themselves to that approach.

These then will form the main pillar of work for traditional ‘transaction law firms’ that do not extend their services into the other areas outlined in this paper. It will represent a diminishing portion of legal market spend. It is likely this type of ‘high-end’ work will sustain a reducing number of specialist boutique law firms and a reducing number of full-service law firms for which tailored transactions are one part of a larger portfolio of work that includes, for example, platform-based flow work. The other firms that currently operate in this space will lose out.

Large-scale change and compliance programmes

The wave of regulatory and market change that started with the global financial crisis, and then continued in response to other 21st century phenomena such as the digital and data revolutions, has forced large-scale change programmes on to the agenda of in-house legal and compliance functions.

They are charged with managing their organisation's response to such global, cross-border compliance and implementation challenges as Brexit, anti-money laundering, IRS 35 and data privacy rules such as GDPR and, in the financial industry, MiFID, initial and variation margin for derivatives and IBOR transition.

These challenges are likely to remain a significant part of a legal or compliance function's area of responsibility as the long-term consequences emerge of the global phenomena that gave birth to them.

The solutions to these challenges will require experience of some or all of the following resources and capabilities:

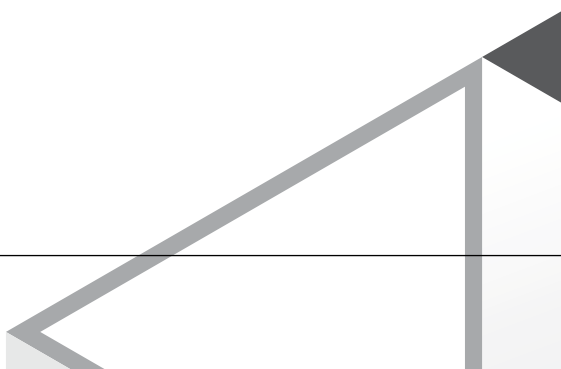
- identifying, extracting and uploading to technology platforms data and documents from management information systems;
- applying artificial intelligence to review and extract data from those documents;
- querying, organising and sharing data;
- deploying workflow and logic systems to automate the process of analysing that data, developing insights and producing outputs

(whether they take the form of a report, a regulatory filing, an instruction to a person to complete a task or a draft agreement);

- outreach to counterparties to negotiate and sign agreements;
- deploying potentially large numbers of lawyers – and non-lawyers – to complete the tasks that still cannot be performed by technology; and
- feeding back into management information systems the vastly enhanced data that will result from these processes.

Almost no client organisation has the internal expertise, human resources and technology skills to fashion their own response to these challenges, especially while maintaining already lean day-to-day operations.

As the occurrence of these challenges has multiplied and the technology to tackle them has improved, so the provider market has matured. Increasingly, global client organisations are able to buy an end-to-end solution from a single provider, or joint venture of providers, that takes most of the challenge off the shoulders of the organisation and delivers a regulation-compliant outcome. The large-scale 'repapering' challenges presented by Brexit, derivative margin requirements and IBOR transition are good examples requiring contract parties to amend or re-document existing contracts with high volumes of counterparties to ensure a regulation-compliant outcome.



Risk anticipation

Instead of spending disproportionate time on event remediation, whether defending the business following a compliance breach or from adverse litigation or arbitration claims, or pursuing such claims against others whose actions have adversely and wrongly affected the business, the emphasis will move to legal risk anticipation and prevention.

The smart businesses will recognise that the true cost to them of remediation, which includes the legal and related costs, the fines, the financial damages awards, the reputational and brand damage and the opportunity cost of 'unproductive' management time, far exceeds the cost of risk anticipation.

Legal functions will position themselves to drive initiatives that embed, at the heart of their organisations, governance, culture and corporate purpose, conduct and operational risk controls and smart responses to regulatory change and policy.

Legal risk anticipation is not a responsibility that many in-house legal functions currently embrace, but the legal function, which has ethical and professional duties and responsibilities at its core, is best placed of all corporate functions to be the guardian of this initiative.

Nevertheless, in highly regulated industries such as financial services this role – particularly for conduct risk – has often been taken on by a separate compliance function, in part because of scepticism on the part of regulators as to whether the legal function can deliver organisation-wide compliance at scale. The rising tide of regulatory oversight and enforcement has also resulted in the

compliance function receiving a multiple of the funding made available to the legal function. It therefore remains to be seen the extent to which the risk anticipation function in regulated sectors will reside in legal vs compliance.

Some highly regulated industries are already harnessing technology to support these initiatives and to make compliance across their global organisation feasible.

The largest participants in these sectors deploy technology to assist with horizon scanning and regulatory lifecycle management. They monitor regulatory change across multiple countries; allocate internal accountability for their organisation's response to any change; introduce work flow and process to ensure compliance or reduce risk; establish monitoring technologies to identify anomalous or non-compliant conduct in real time; and train their staff using smart online tools.

Participants that are not among the largest in the regulated sectors, or are not in such highly regulated sectors, will need to find ways of harnessing technology to tackle these challenges.

But even the largest corporate organisations currently struggle to anticipate regulatory change on the far policy horizon such as identifying changes in public sentiment that herald a shift in the focus of regulatory supervisors tasked with prioritising enforcement activity across a wide range of law and regulation. Technology will support this activity.

As legislation and regulation is 'digitised', aspects of risk anticipation will become less cumbersome. At a basic level, digitisation will

allow technology to detect regulatory change, trigger alerts and generate action points and risk information.

At a more sophisticated level, today's experiments in 'machine executable regulation' will build compliance into an organisation's business processes. By enabling the regulations, the information required by regulation to be reported and the business processes by which that information is generated to be expressed as open source code, regulators and technology providers will empower companies to transact in a way that is automatically reg-compliant, and without the need for extensive intervention of humans

and spreadsheets to manipulate information resulting from one process so that it is fit to be reported for another purpose.

Using these approaches, the best legal functions will spend an increasing proportion of their time on risk anticipation and a reducing proportion of their time on event remediation. They will be able to demonstrate with data over time how their efforts at risk anticipation have reduced the cost to their organisation of event remediation. They will also be much better placed to provide strategic advice to senior management on their organisation's regulatory and legal risk profile.

Event remediation

However good in-house legal and compliance functions become at risk anticipation, in-house legal will always have to devote effort to damage limitation and event remediation, which typically may include defending their business following a compliance breach, or other misconduct, or from adverse litigation or arbitration claims, or pursuing such claims against counterparties or third parties whose actions have adversely and wrongly affected their business.

And this, in turn, will continue to be a major source of work for law firms. But technology, in particular, will reshape how certain types of litigation are conducted:

- the second generation of AI-driven applications will make more feasible the management, review and bundling of mountains of written and oral evidence (eDiscovery) so as to identify and organise with greater precision and speed the critical pieces of evidence, thereby reducing the need for humans to labour at this task;
- in those litigation cases requiring the production, routinely in standardised form or in high volumes, of submissions, replies or

similar documents, technology will be used to streamline the production, extract data from public sources and so on; and

- AI-driven technologies will take over much of the work related to searching for case precedent and, for smaller, high volume claims, potentially for predicting dispute outcomes.

But these activities relate to larger-scale, business-to-business event remediation challenges. Many organisations have high volumes of lower value claims which are triaged and sometimes dealt with by the legal function – for example employee claims, personal injury claims in industrial businesses or 'slip-and-trip' or 'crash-and-bang' claims in retail businesses.

Logic systems are already automating the decision making process for whether to defend or settle such claims. The user answers a multiple choice questionnaire that elicits the essence of the facts and the logic embedded in the software behind those answers automates the thought process the lawyer undertakes to make that decision based on those facts.

Counselling

This is the self-image of many lawyers, whether practising in-house or in a law firm: that they deliver wise, business-nuanced advice to their clients. In reality, it makes up a much smaller proportion of the work of the average lawyer than most lawyers like to think. But this role will remain.

As legal functions create mechanisms for routine and repeat queries to be dealt with on a self-serve basis, by outsourcing or offshoring flow transactions through managed service arrangements and by anticipating risk better and ensuring there are fewer situations

requiring event remediation, so they will be able to increase the proportion of their time that they spend on counselling. This will cover the less common internal requests for support that require judgment and do not lend themselves to automation techniques.

It is this kind of lawyering which is welcomed by a legal function's internal client base and which enhances the reputation of the function. It will also improve the working lives of the lawyers who will be less consumed by repetitive and routine tasks.

Managing external providers

As in-house legal functions increase the range of tasks and work that is outsourced, they will become more sophisticated at procuring those services and in how they manage them and their conventional law firm relationships.

This will be made easier because both managed service providers and law firms will price more often on an output basis than a chargeable hour, or input, basis. The advent of supplier management technology will result in all suppliers reporting against quantitative metrics. eAuctions of work packages may become more prevalent, despite their uneven adoption and success to date.

Moreover, as engagement feedback and client listening programmes become more digitised,

even qualitative or subjective measures such as client satisfaction will increasingly be captured through quantitative approaches. This will introduce transparency and comparability into supplier relationship management.

At present, the absence of industry standards, and therefore the plethora of different approaches among law firms, technology suppliers and in-house legal functions is holding back these developments. But benefits like these will be adopted more widely and more quickly if industry standards are agreed for such issues as data to be fed into e-billing platforms, reporting metrics from legal service providers to clients and client information security audit requirements of provider technology.

“Today the market for both technology applications and resourcing is fragmented. Each offers a bewildering and growing range of providers”

Foundations of the future

It will be apparent from this paper that the transformation of the legal services market which we are on the brink of experiencing will be brought about, in each case, by some combination of technology, resourcing and process.

Yet today the market for both technology applications and resourcing is fragmented. Each offers a bewildering and growing range of providers. There are no clear market leaders capable of tackling most legal function

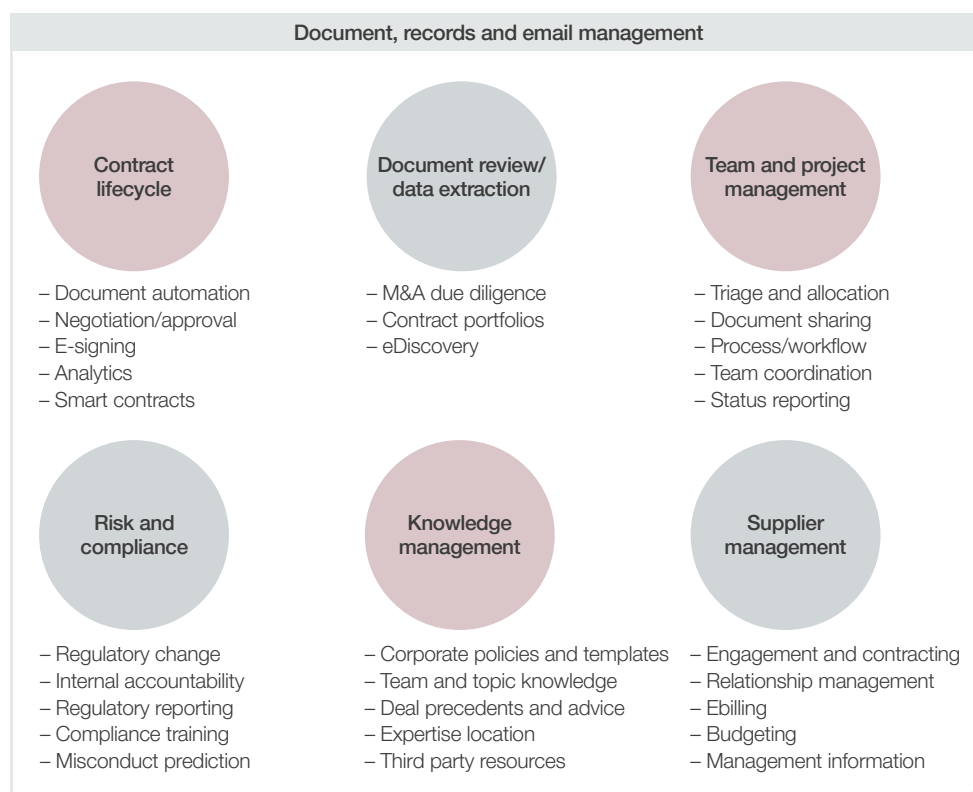
challenges. Each supplier has its niche target area or area of expertise. In the jargon of the legal tech industry, the market mainly offers 'point solutions', each of which tackles a very particular task or pain point. The consequence is that any in-house legal function trying to create an overall solution to a challenge will have to integrate several technologies and source a range of human skillsets – and then forge them into a technology platform and team capable of overcoming the challenge.

There are certain key building blocks that need to be put in place to equip an in-house legal function to tackle the challenge:

Technology

Our experience in Fuse, Allen & Overy's tech innovation space, is that the tasks which technology can help in-house legal functions perform fall into the categories summarised below.

Most tasks in a legal function can be streamlined through technology



Technology also offers the in-house legal function the strategic opportunity to align itself more closely with the business it serves

This is a task-centric way of looking at what a legal function does, rather than the challenge-centric approach presented earlier in this paper. For example, in order to build a platform that can handle one challenge, eg a certain kind of flow transaction, an organisation will most likely have to integrate multiple technology applications from the contract lifecycle, document review / data extraction and team and project management categories above – and perhaps also knowledge management.

The difficulty for an in-house legal function is that, in order to transition to the legal function of the future outlined above, it will need the flow transaction platform to handle many different types of transaction and it will need other technology platforms (for example, to triage, allocate and monitor matters coming into the legal function). There is, however, currently no single technology provider (such as, for example, SAP or Oracle in the enterprise technology field) whose platform can meet most of the needs of most legal functions, without reinventing the wheel in each organisation.

As things stand, the choices available to an in-house legal function are to:

- wait until one or more technology suppliers emerge with one or more platforms that can be deployed ‘out of the box’ to streamline many of the tasks;
- identify one or more suppliers that can, in return for service fees, build or configure the necessary platforms to the particular needs of that organisation, host, maintain and update the platforms and their content and either allow the organisation to operate it themselves (ie software-as-a-service (SaaS)), or operate it as a service provider so as to deliver an outcome to the organisation using the platform (ie a managed service);
- build or configure its own platform(s), integrating multiple technology applications where necessary; or
- use generic (ie not legal specific) software already licensed by the organisation.

The ‘wait for an out-of-the-box solution’ approach is attractive because it is likely to be the least costly and risky approach, but a solution of that kind which can meet most needs of most legal functions may not emerge for five to ten years.

There are encouraging signs that technology providers are now pursuing or actively exploring this market, but in the short to medium term (say, three years), any platform will be a ‘minimum viable product’, covering only some of a legal function’s needs. The build out to a fully formed platform will take place over a period of several years after that. So this approach may expose the legal function to criticism within its organisation for not tackling the challenge of digital transformation which other parts of the organisation are tackling.

Both the SaaS and managed service approaches potentially offer the advantage that in-house legal functions typically find it very difficult to access budget and resource to license or build technology. An organisation’s technology stack is not something the legal function controls. The legal function is often not a priority of the IT department and the internal corporate governance around technology licensing or building is hard to navigate.

By contrast, all legal functions routinely pay fees to law firms and other service providers, so the idea of accessing technology through a browser as a service in return for a fee can be attractive.

On the other hand, many organisations, particularly those with large, business critical technology departments, will approach this issue with an assumption that they will want to build or configure their own solution(s). This is an approach requiring deep technology and change skills.

The default expectation of those outside the legal function (for example, an organisation’s IT department) will often be that the organisation already licenses numerous generic applications that serve other functions and that can therefore be configured to suit the needs of

Legal. On the face of it, this makes perfect sense since those applications are already installed and paid for. The experience of many legal functions, however, is that those applications can be hard to adapt to the special needs of the legal function with the result, if they are 'clunky' or not intuitive for lawyers, that they are not adopted and fail to achieve impact.

Whichever approach is adopted, in the fragmented and dynamic world of legal marketplace technology it is important for an organisation to insulate itself as far as possible from dependency on any one technology provider and from the delays involved in adapting an organisation's technology stack to changed circumstances (see *There are certain principles to follow in 'future-proofing' a legal function's technology*). A tech company which today appears to offer a leading technology could easily be eclipsed by better technology tomorrow, or it could change the direction of its technology development. The company could even undergo a financial setback.

Technology also offers the in-house legal function the strategic opportunity to align itself more closely with the business it serves. Although processes and controls undertaken by other functions within a business such as sales, finance and risk are increasingly integrated one with another, often by technology, it is rare for the processes performed by the legal function (for example, the critical role it plays in contracting) to be included in that integration. As a result, even when the legal function is valued and highly regarded by its internal client base, it is often not viewed as a partner in the business but as a separate function. Its contribution to business success is less visible and this affects the willingness of the business to grant funding and access to resources for innovation. Technology offers in-house legal functions the opportunity to become business partners through the integration of legally important processes with other business critical processes.

There are certain principles to follow in 'future-proofing' a legal function's technology

- Where established, global technology leaders, with high and scaled levels of engineering capability can be used, give serious consideration to using them even if they are relatively new in prioritising the legal market. Their long track record and scale makes it more likely that they will be there continuously developing their capability tomorrow.
- Build systems to be interoperable, in other words with APIs (application programming interfaces) which allow them to integrate with and 'talk' to other applications easily. It is likely that any one solution or platform will involve several technology applications. If it makes sense to change any one of those to another application, the easier it is to unplug the old one and plug in the new one, the better. In that sense, think of technology platforms as app stores.
- Keep your data and your documents in a 'data lake' separate from your technology applications so that unplugging one application does not result in a loss of data or documents and, on plugging in another, you can easily give it access to the existing data and documents.
- Find a way of hosting appropriate applications in the cloud. This is a complex topic and one on which many organisations have strong views, for example related to information security. However, the cloud offers many benefits, not least the ability to buy SaaS where the burden of ensuring the technology is always available and always operating off the most recently enhanced version rests with the provider, not with the organisation's IT department. In a world where storing and processing extremely high volumes of data is becoming commonplace, the cloud offers the ability to scale storage and processing capability up and down to meet unexpected or short term business needs without incurring the delays implicit in buying, installing and integrating additional servers and other hardware.

Adherence to these principles will also help with the deployment in a cost-effective and agile way of new technology solutions that not only cut across different business lines and product types, but are also capable of operating together with legacy systems that can take years to retire.

Data

The legal market, both law firm and in-house legal function, has been slow to seize the opportunity created by capturing, analysing, manipulating and deriving insight from data and documents. While other industries and other functions within a corporation are forging ahead with this endeavour, legal market participants in general remain frozen in the headlights.

The digital transformation of in-house legal functions can be harnessed so as to crack this challenge. The use of workflow, collaboration

and automation technologies is often thought of as having the fortunate side-effect of creating useful data. Over time, the data will come to be seen as the primary benefit of technology adoption because the data captured through digital transformation will make it feasible to manage legal risk on a data-driven basis, rather than on the basis of tacit knowledge and intuition. The workflow, collaboration and automation will seem like a useful side-effect of the data generation.

Types of data and documents that the in-house legal function must be able to store, manage and analyse

- **Information about what the legal function is doing:** what matters are being worked on, by whom, at what unit cost and what spare capacity remains, all broken down by category, geography and business line; what stage each matter has reached; how much effort is being expended on the matter and so on. This in turn will assist in determining the cost of an internal legal service at the point of request, ensuring transparency of the resource being committed and demonstrating which internal clients are benefiting from the legal function and what value is being delivered.
- **Comprehensive management information about the relationship between an organisation and its legal service providers:** this will allow the legal function to assess the outcomes being delivered by its external providers and the related cost, to compare one provider with another and to budget future costs on a data-driven basis, rather than a ‘finger in the air’.
- **All the contracts and other transaction documents that pertain to the organisation:** This should not be stored solely as words in a PDF or Microsoft Word document. It should be organised and stored in data format so that it is possible to search, retrieve, organise, analyse and share, both at

a portfolio level and at the individual contract level, granular information about what contractual commitments an organisation has concluded, with which counterparties and on what terms. This digitisation of an organisation’s contract portfolio will create the foundations for the automation of post-signing activities: monitoring contractual risk and performance by the counterparties, processing of the organisation’s own performance obligations and meeting reporting and other regulatory obligations associated with the contract.

- **Legal risk management data:** based on metrics, taxonomies and tolerance levels agreed for the relevant business that allow the legal function to plan resource more strategically and facilitate risk reporting in line with the expectations of the wider organisation and the regulators.

The in-house legal function of the future will need to find ways of storing all these types of data and documents in a central repository – a data lake – that complies with company security and privacy standards. All technology applications will have to have easy access to this data repository and each application must be able to draw seamlessly those data and documents it needs to accomplish a particular task, without huge integration or interface

challenges and without disrupting other applications which wish to access the same data or documents.

For most commercial organisations, contracts with customers and counterparties are the legal foundation on which most revenue streams are built. As the natural guardians of an organisation's contract portfolio, the legal function of the future can put itself in a position where it is generating valuable commercial insight, as well as legal and risk insight, by manipulating the contract data it has at its fingertips. This might, for example, draw correlations between the most profitable revenue sources in their organisation and the presence or absence of certain contractual terms. Insights like this will empower legal functions to become valued contributors to their organisations' bottom line.

Transitioning from a world of text to a world of data and text requires an organisation to have available to it a clearly understood language or taxonomy that allows it to classify text as data – to allocate all text that has the same meaning or contains the same type of information to the same descriptor.

To take a very simple example, there are numerous ways in which an agreement can express the principle that the governing law of the agreement is English. An agreed taxonomy

might tag all such clauses as "Gov law – English". Similarly, there are numerous ways in which an agreement might express the principle that the agreement can be terminated if the Borrower's credit rating with Moody's falls below BBB. An agreed taxonomy might tag all such clauses as "Termination Event – Borrower – Moody's downgrade – <BBB".

Such a language or taxonomy is necessary at the enterprise level. But it makes no sense for each enterprise to incur the cost of developing its own. Far better for the enterprise simply to adopt a standard that is open source. This has the added advantage that the contents of documents can then be shared as data between counterparties to the contract and more widely, allowing efficiencies, for example, in how they reconcile the terms of agreements they have concluded with each other and how they perform those terms, confident that they both have the same understanding of what the terms are. Nor is it wise for an enterprise's technology systems to become dependent on a taxonomy that is proprietary to a third party, lest the creator abuses that dependency.

Given that every business organisation in the world is challenged to know in any degree of detail what the terms of its contractual commitments are, it is surprising that such a taxonomy covering most of the contents of legal documents does not yet exist.

Data captured through digital transformation will make it feasible to manage legal risk on a data-driven basis, rather than on the basis of tacit knowledge and intuition

“Although some legal functions are moving fast to catch up, most today are not configured to tackle the change and innovation challenge in a sophisticated way”

Building innovation capability

Faced with all the challenges outlined in this paper, the way forward for the corporate legal function is exciting, but can be daunting. Where to start? How to engage with the challenges?

Although some legal functions are moving fast to catch up, most today are not configured to tackle the change and innovation challenge in a sophisticated way (and incidentally the same can be said of most law firms). Law firms and legal departments alike lack the expertise to enable them to analyse, at the necessary level of detail, the work they do and, within each

work area, the tasks they perform, and to re-engineer their processes in the way necessary to become the legal function of the future. They lack the familiarity with the technology market necessary to be discerning buyers of technology with a coherent master plan and management capacity to implement change. In-house legal functions are expert at selecting and managing law firms, but often they are not familiar enough with the world of technology and alternative legal service providers to make the right selections.

Below is a checklist to help the in-house legal function approach the challenge of change and innovation:

Build internal knowledge about the full range of legal service providers and legal tech available and how other organisations are transforming their legal function. The field is bewildering and knowledge is key.

Develop a vision for how you want to position the legal function within your organisation: trusted counsel, business partner, risk and reputation guardian, deal executor, first-line response to routine questions or self-serve enabler and ultimate responder? Where are the overlaps and handoffs with Compliance, Risk, HR, Government Relations, Corporate Secretarial and other functions? This will shape your course.

Communicate the opportunity which change offers to all stakeholders (colleagues in the legal function, key internal clients, senior management). Generate enthusiasm. This will help overcome inertia, whether caused by conservatism, entrenched habits, concerns about the future or scepticism as to whether the in-house legal function can deliver on a vision.

Build change skills so that you can undertake a digitally enabled change programme. Do you need to appoint a COO, an innovation leader, legal tech experts, data scientists, knowledge managers, process engineers, project managers? Do you need a change, or management, consultant on a project basis to help develop a plan? Lawyers already in the legal function may take too long to retool into these roles.

Understand your organisation's skillsets outside Legal. The necessary skills need not all be housed in the legal function. Understand your organisation's strengths in the change arena and establish the willingness of those outside your department with the relevant skills to support the legal function in any transition, perhaps most importantly the IT department. This can have the upside of fostering connectivity with the wider organisation.

Understand your organisation's technology estate since that is already installed and paid for. Which applications may be useful to the legal function? If you can accomplish 75% of a task quickly and without material cost, that may be better than 100% sometime in the future, funded by the legal function. Establish which legal function challenges are generic and can be solved using existing enterprise technology and which are specific to Legal and require tailored solutions.

Create an in-house task and service catalogue. Understand at a granular level how your lawyers spend their time, where their pain points and inefficiencies are and where the internal client experience can be improved. Develop a catalogue of services provided by the legal function. Conduct an audit. Perhaps use questionnaires or interviews. Would time recording over a fixed period help?

Using that data, build a map of your organisation's legal needs and the legal function's response. Which do you wish the legal function to execute and, just as importantly, not to execute? Which do you wish to send out to external providers? Where can technology intervene? Perhaps use this paper as a way of testing ideas and priorities.

Prioritise your technology needs. Are there foundational technologies such as a document, or legal department work, management system that you must have to enable change, or a contract lifecycle platform because contracts make up a high proportion of the work of your legal function?

Develop an implementation plan. At one extreme, this is a target operating model for the legal function with a target technology stack, organisational chart and staffing/skills plan, phased in over a period, with milestones, priorities, a benefits or return on investment analysis, accountabilities and some idea of budget. But for most organisations that is a counsel of perfection. There is value simply in identifying your legal function's top five pain points and working to solve them. This exploratory approach will build confidence and knowledge and may point the way forward.

Identify sources of funding and personnel to implement any plan. Do other, perhaps revenue generating, parts of your organisation benefit sufficiently from your plans to be willing to fund any part of the transition? If not, what is your business case and who do you sell it to? Those primarily charged with implementing the plan need to be accountable and therefore freed from other commitments.

Create lower cost resource. Much innovation starts with unbundling transactions or projects into their component tasks. Does your organisation need its own service centre in a lower cost location to handle high-volume or routine tasks? Or do you prefer to outsource those tasks to external managed service providers?

Revisit your plan continuously. Your organisation and its needs will change. The technology and supplier market will change too.

The road ahead

Cost pressures, competition, regulatory overload and other 'push' factors have, for many years, been nudging legal market participants to change. The market has, until recently, been able to adapt incrementally to those pressures.

Now the pressure to change has been compounded and made more urgent by even stronger 'pull' factors that are forcing market participants to contemplate transformational change. Advances in technology now make feasible the things that were not previously possible, the increased range and sophistication of the offerings of legal service providers, and the different career and workplace expectations of the talent joining the legal profession are among the most compelling of these 'pull' factors.

Our expectation is that most in-house legal functions – along with most law firms and alternative legal service providers – will, over the next ten years, have to respond to these pressures in ways that they will consider radical. The change is likely to take place over a number of years, but tackling it soon will allow time for evolution and mistakes.





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Fuse

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