



Under the Magnifying Glass: Emerging Challenges Facing In-House Counsel as the Trusted Advisor

Vendor Management
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Vendor Management

Today's Topics:

1. Increased emphasis on Risk Management generally
2. Risk Management in the context of Vendor Management
3. Vendor Management in the context of managing outside counsel

Increased Emphasis on Risk Management Generally

- Topic has received increased attention recently
 - Particularly in the case of Cyber Security



Increased Emphasis on Risk Management Generally

- Process For Developing Risk Management Framework
 - Risk appetite statement
 - Risk appetite is the amount of risk, on a broad level, an organization is willing to accept in pursuit of value
 - A risk appetite statement is a formal board approved statement of how much risk the entity is willing to accept

Increased Emphasis on Risk Management Generally

The Board of Directors Role in Risk Management

- Define and Organize Risks
 - Operational Risk
 - Compliance Risk
 - Reputation Risk
 - Strategic Risk
 - Financial Risk
- Assign Rules and Responsibilities
 - Board of Directors
 - Senior Management Team
 - Finance, Compliance and Legal Teams
 - Division Leaders

Increased Emphasis on Risk Management Generally

The Board of Directors Role in Risk Management

- Implement Programs
 - Risk assessments should be conducted periodically to ensure applicable risks are identified and measured timely. Risk assessments will likely be done on specific categories of risk and assessment criteria will include monetary and non-monetary considerations as well as qualitative factors
 - Assessed risks should be quantified through measurable metrics
 - Formalized internal control programs, including periodic testing and monitoring for effectiveness mitigate inherent risks
 - Insurance and other methods may be used to transfer some remaining risks
 - Remaining risks are then monitored and reported upon periodically. The level of reporting depends upon the risk and the recipient's responsibility

Increased Emphasis on Risk Management Generally

The Board of Directors Role in Risk Management

- Establish Ownership & Accountability
 - Provide oversight and establish risk governance through policy
 - Set the tone for risk culture
 - Approve risk appetite statement a risk framework
 - Monitor risks through established regular updates
 - Provide independent, informed credible challenges of management's assumptions, biases and opinions of risk
 - Receive assurance of risk management effectiveness from internal audit

Increased Emphasis on Risk Management Generally

The Board of Directors Role in Risk Management

- Understand the entity's risk philosophy and concur with the entity's risk appetite
- Know the extent to which management has established effective enterprise risk management of the organization
- Review the entity's portfolio of risk and consider it against the entity's risk appetite
- Be apprised of the most significant risks and whether management is responding appropriately

Increased Emphasis on Risk Management Generally

The Board of Directors Role in Risk Management

- Questions for the Board
 - Does the Board have the right expertise to provide risk management oversight?
 - Is the Board structured to provide sufficient time for risk management oversight?
 - Is the Board holding management accountable for achieving its stated strategic objectives?
 - Is the Board sufficiently independent?
 - Is the Board using external experts and the independent internal Audit function to gain assurance over the risk management practices and information?

Increased Emphasis on Risk Management Generally

Board's Legal Responsibility

- The Business Judgment Rule applies
 - Traditionally a low standard
- However, the Board may not simply blindly rely on management
- Recent claims against Boards in cyber security and compliance generally, whether or not ultimately successful, merit a review of the Board's responsibilities in this area

Increased Emphasis on Risk Management Generally

Board's Legal Responsibility

- The duty of care and the duty of loyalty are the two main fiduciary duties of directors
- Delaware (and other states) have created a “Duty of Oversight”. Also called “Caremark” duties in Delaware
- This is a corporate compliance related duty, as interpreted

Increased Emphasis on Risk Management Generally

Board's Legal Responsibility

- 1996 – Caremark: directors have an affirmative duty to establish and exercise oversight over some form of internal compliance activity
- Requires a good faith attempt to establish a corporate information and reporting system
- “Red flags” versus “yellow flags”; No oversight versus flawed oversight
 - Failure to meaningfully respond to a troubling, continuing pattern of noncompliance
 - Knowing approval of a business strategy that specifically incorporates illegal actions
 - Tolerance of operations that knowingly defy law
 - “Utter failure” of the information reporting system

Increased Emphasis on Risk Management Generally

Board's Legal Responsibility

- Even if there might not be legal liability:
 - Reputational harm to directors and the company even from a “win” (because, again, bad faith is a low standard)
 - Flawed or inattentive oversight may pass a Caremark claim challenge, but could also affect availability of D&O coverage and indemnification protection if there are breaches of common law duties of care and loyalty?
- Is there a compliance mechanism in place?

Increased Emphasis on Risk Management Generally

Board's Legal Responsibility

- Ability to appreciate the types of information and activity that might be a “red flag”
 - Regulatory climate for your company
 - What is the internal compliance program and how is it supposed to work?
 - Can you identify patterns of conduct that may rise to the level of creating “actual knowledge”
 - Whistle blower reports
 - Letters to the board or audit committee
 - Numerous and related civil claims
 - Understanding the extent to which corporate ethics are embedded across all levels of employees

Risk Management in the Context of Vendor Management⁽¹⁾

- It is inevitable that an organization will use outside parties to perform some functions, some of which will be “critical”

⁽¹⁾ This portion of our presentation relies heavily on the Office of the Comptroller of the Currency Bulletin 2013-29 “Third Party Relationship: risk Management Guidance issued on October 20, 2013: “A bank’s use of third parties does not diminish the responsibility of its board of directors and senior management to ensure that the activity is performed in a safe and sound manner and in compliance with applicable laws.”

Risk Management in the Context of Vendor Management

- The OCC has made the following points as to risk management of third party relationships of national banks:
 - A bank should adopt risk management processes commensurate with the level of risk and complexity of its third-party relationships.
 - A bank should ensure comprehensive risk management and oversight of third-party relationships involving critical activities.

Risk Management in the Context of Vendor Management

- An effective risk management process throughout the life cycle of the relationship includes
 - plans that outline the bank's strategy, identify the inherent risks of the activity, and detail how the bank selects, assesses, and oversees the third party.
 - proper due diligence in selecting a third party.

Risk Management in the Context of Vendor Management

- written contracts that outline the rights and responsibilities of all parties.
- ongoing monitoring of the third party's activities and performance.
- contingency plans for terminating the relationship in an effective manner.
- clear roles and responsibilities for overseeing and managing the relationship and risk management process.
- Documentation and reporting that facilitates oversight, accountability, monitoring, and risk management.
- Independent reviews that allow bank management to determine that the bank's process aligns with its strategy and effectively manages risks.

Risk Management in the Context of Vendor Management

- An effective third-party risk management process follows a continuous life cycle for all relationships and incorporates the following phrases:
 - Planning
 - Due diligence and third-party selection
 - Contract negotiation
 - Ongoing monitoring
 - Termination

Risk Management in the Context of Vendor Management

- In addition, a bank should perform the following throughout the life cycle of the relationship as part of its risk management process:
 - Oversight and accountability
 - Documentation and reporting
 - Independent reviews

Risk Management in the Context of Vendor Management

Due Diligence and Third-Party Selection

- Gather Information Through:
 - RFP's
 - Financial Statements
 - Questionnaires
 - References
- Strategies and Goals



Risk Management in the Context of Vendor Management

Due Diligence and Third-Party Selection

- Legal and Regulatory Compliance
- Financial Condition
- Business Experience and Reputation
- Fee Structure and Incentives
- Qualifications, Backgrounds, and Reputations of Company Principals

Risk Management in the Context of Vendor Management

Due Diligence and Third-Party Selection

- Information Security
- Management of Information Systems
- Resilience



Risk Management in the Context of Vendor Management

Due Diligence and Third-Party Selection

- Incident-Reporting and Management Programs
- Physical Security
- Human Resource Management
- Reliance on Subcontractors
- Insurance Coverage
- Conflicting Contractual Arrangements with Other Parties

Risk Management in the Context of Vendor Management

Contract Terms

- Use risk assessment (how critical is this vendor?) and due diligence when developing contract terms
- Considerations
 - How important is this product/service, and how much risk is associated with it?
 - What are your expectations for performance? How would define a successful vendor relationship?

Risk Management in the Context of Vendor Management

Contract Terms

- Contracts should generally address the following:
 - Nature and Scope of Arrangement
 - Services or Products
 - Performance Measures or Benchmarks
 - Responsibilities for Providing, Receiving, and Retaining Information

Risk Management in the Context of Vendor Management

Contract Terms

- The Right to Audit and Require Remediation
- Responsibility for Compliance with Applicable Laws and Regulations
- Cost and Compensation
- Ownership and License

Risk Management in the Context of Vendor Management

Contract Terms

- Confidentiality and Integrity
- Business Resumption and Contingency Plans
- Indemnification



Risk Management in the Context of Vendor Management

Contract Terms

- Insurance
- Dispute Resolution
- Limits on Liability
- Default and Termination

Risk Management in the Context of Vendor Management

Contract Terms

- Subcontracting
- Documents



Risk Management in the Context of Vendor Management

Contract Terms

- Most contract disputes involve faulty performance issues
 - Be specific about performance expectations (specifications) – when, what kind, how many, how much, how soon, how quickly, how often, how much deviation, how many misses...
 - Consider adding performance standards
 - Legal warranties are a “catch all” and not specific (good and workmanlike manner, in accordance with industry standards, in compliance with specifications, reasonable diligence, competence and skill...)
 - Understand the vendor’s expectations of your company

Risk Management in the Context of Vendor Management

Contract Terms

- Be on the look out for:
 - “Sole and exclusive” remedies
 - Termination fees
 - Limits on the vendor’s liability or responsibility to make things right
- Termination
 - How easily can you find a new vendor?
 - Do you need existing vendor help to move on?
- Main reason to terminate is “breach” – how is that defined?
 - Another reason to be specific about expectations
 - Is offering a “cure” period for breach reasonable under the circumstances? If so, how long can you wait?

Risk Management in the Context of Vendor Management

Contract Terms

- Don't get "caught" by:
 - Evergreen contracts
 - Requirements to purchase "exclusively"
 - Automatic price increases
 - References to outside documents that can be "modified from time to time"
 - "Harmless looking" documents

Risk Management in the Context of Vendor Management

Contract Terms

- What are the most significant legal concerns?
 - Compliance
 - Confidentiality/non-public Personal Information
 - Data security
 - Specific laws and regulation
 - Use of subcontractors who haven't been vetted
 - Ability to audit
- Protecting the company
 - Indemnification
 - Limits of Liability
 - Insurance requirements
 - Reasonable right to terminate/be made whole

Vendor Management in the Context of Managing Outside Counsel

- We will discuss strategies to assist you in accomplishing your goals in the management of outside legal counsel relationships:
 - Control Costs
 - ACC Value Challenge Covenant with Counsel
 - Control Risk
 - Achieve Company's Goals

Vendor Management in the Context of Managing Outside Counsel

HOW

1. SELECT - Better selection process
2. SCOPE – Clear understanding of matter scope and client concerns and a more detailed retention letter and fee arrangement
3. BUDGET – Use of budget and project management
4. COMMUNICATION – The foregoing requires enhanced and effective communication

Vendor Management in the Context of Managing Outside Counsel

SELECT

This presentation is focused on selection and retention of counsel for a specific, discrete matter, such as a lawsuit or a transaction.

Selection and retention for broader purposes, such as serving outside general counsel or advisory role may involve different considerations.

Vendor Management in the Context of Managing Outside Counsel

SELECT

The specialization which is now pervasive in the legal profession has made the selection of a generalist advisor or general counsel more complex.

Considerations such as broad and diverse experience, style, approach, trust and industry knowledge may override specific expertise in such circumstances.

Vendor Management in the Context of Managing Outside Counsel

SELECT

Many clients seek input from others in their industry and rely on referrals and references.

Others use the “beauty contest” as a means to select.

Achieving the company’s goals of controlling cost and risk requires a thoughtful approach to the use of a request for proposals or “RFP”.

Barley Snyder

Vendor Management in the Context of Managing Outside Counsel

SELECT

In addition to asking the usual RFP questions regarding (1) capabilities and knowledge and (2) fees and charges, some very specific questions aimed at achieving your goals should be included in the RFP (or used in less formal interviews).

Vendor Management in the Context of Managing Outside Counsel

SELECT

To focus the selection process on your goals, consider asking these questions:

1. Have you handled a matter similar to this and, if so, what was the outcome?
2. Provide a proposed budget for this matter, broken down in stages, phases and tasks.
3. Have you provided budgets for matters in the past and, if so, how did you perform vs. budget?
4. How do you work together with clients to manage a matter within a budget?
5. Have you utilized fee arrangements that encourage efficient management of matters?
6. Are you willing to meet with us at the conclusion of the matter to assess “lessons learned” as a value add?

Vendor Management in the Context of Managing Outside Counsel

SELECT

The considerations you will likely focus on in selecting counsel are myriad, but our suggestions here focus on achieving your goals while controlling costs and risk.

Vendor Management in the Context of Managing Outside Counsel

SCOPE

Unlike accounting engagements, retention arrangements for lawyers quite often are not very detailed – although there are exceptions, typically involving complex matters.

However, more detailed and specific engagement agreements are beneficial to both clients and lawyers.

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SCOPE

Things to discuss and possibly include in a law firm engagement agreement:

1. What the lawyers will be handling and doing.
2. What the lawyers will not be handling and doing.
3. Specific considerations, cautions and desired outcomes important to you.
4. Timing.
5. Budget or cost estimates.
6. Which lawyers will be handling the matter.
7. Fees and costs – hourly rates, fixed fee or other hybrid arrangements.

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SCOPE

The New World of Alternative Fee Arrangements

Law firms and clients have, since the beginning of the Great Recession in 2008, begun to negotiate fee arrangements that are more creative than “rate X hours” or “% of recovery”. Some firms began before 2008. These arrangements have come to be known as “alternative fee arrangements” or “AFAs”.

Devising an AFA that is suitable for the matter at hand and encourages the best and most efficient approach requires:

- Analysis
- Communication
- Trust

Vendor Management in the Context of Managing Outside Counsel

SCOPE

What do AFA's Look Like?

The terms of an AFA are only limited by the inventiveness of the lawyer and client.

Examples:

- Lower hourly rate plus lower % of recovery
- Fee caps and collars
- Fixed fee for all or portions of a case or transaction
- Different rates for various parts of matter
- Incentive fees based on timing and results
- Incentives to meet budget parameters

However, the arrangement must make sense for both the lawyer and client and comply with legal profession ethical rules.

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SCOPE

Law firms that have been slow to drive efficiencies and effectiveness in their service delivery and management of their “projects” (cases or deals) will have greater difficulty agreeing to an AFA and performing it.

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SCOPE

The fee arrangement, whatever its nature, should be in writing and should incorporate the budgeting and planning aspects described below.

Vendor Management in the Context of Managing Outside Counsel

Matter Budget and Management

Managing cases or transactions against a budget and schedule is not always a familiar concept in the legal world – but it is growing.

Admittedly, legal matters often present both “known unknowns” and “unknown unknowns”, requiring subsequent changes in strategy and approach, as well as budget and time line.

Barley Snyder

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Matter Budget and Management

However, not unlike a construction project, the owner (client) will want a budget, understanding that the excavators may hit bedrock (or your litigators may encounter stubborn parties), and “change orders” are not unusual.

A budget can take either of two forms:

1. A firm understanding with “not to exceed” amounts – an arrangement likely reflected in the fee arrangement, or
2. A budget intended as a guide and management tool to be used jointly by the client and lawyer in managing the matter and making decisions.

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Matter Budget and Management

Many matters do not lend themselves to a “firm” budget. The client and lawyer should have very explicit communication and an agreement on the purpose of and uses for the budget. The primary purpose of the budget in each case is to foster efficiencies, effectiveness and communication. If an additional purpose of the budget is to share the financial risk of the matter (such as a fixed fee in litigation), this should be clearly understood and reflected in the fee agreement. Arrangements involving risk sharing may affect the motivations of the parties (such as when to settle).

Barley Snyder

Vendor Management in the Context of Managing Outside Counsel

Matter Budget and Management

Interestingly, a majority of our clients continue to find that the traditional “rate x hours” formulation meets their needs . . . despite our offer of alternatives. But this is slowly changing.

Vendor Management in the Context of Managing Outside Counsel

Matter Budget and Management

It will not surprise you that the creation of budgets and work plans generally revolves around breaking the case or matter into phases and tasks and estimating required effort, timing, costs and milestones for each phase and task.

One difference in the legal world may be the inclusion of a number of alternative outcomes and their probability of occurring. In litigation, in particular, this is an important part of any attempt to manage the process (such as creation of a tree diagram).

Vendor Management in the Context of Managing Outside Counsel

Matter Budget and Management

The purpose of a budget and project management plan is not merely cost control, but to also manage risk and foster communication.

The client and lawyer should agree to confer regarding the budget and plan. When?

- At regular intervals
- When there are major events and needed strategy changes
- When results substantially vary from the budget.

Avoid “scope creep”. And if scope changes, it is useful to have specified a “change order” process in the fee agreement.

Barley Snyder

Vendor Management in the Context of Managing Outside Counsel

Communication

Communication is the key to controlling costs and risk and achieving your objectives. Frank communication.

If you agree upon a budget and management plan for your legal matter, also consider including specifics about communication.

Vendor Management in the Context of Managing Outside Counsel

Communication

How?

1. Who will communicate?
2. When?
3. By what means? Email can both help and hurt effective communication.
4. Should there be scheduled discussions?
5. How often should updates to the budget and plan for the project be discussed? What about “scope” changes? What about “change orders”?
6. Are formal reports necessary?
7. What sort of discussion should occur when “something big” happens, whether good or bad?

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Vendor Management in the Context of Managing Outside Counsel

Communication

Consider two key communication events:

1. A “kick-off” meeting or conference to introduce team members on both sides and discuss details, as well as the budget and plan timing and milestones. Client input and assistance is always needed to get started – discuss who, when and how.
2. A “post-project review” meeting to assess the performance of everyone against the budget and plan. Also, it is an opportunity to review what could be done better, what improvements can be made and how you avoid future risk.

Barley Snyder