The Evolution of Law Firm Risk

Managing risk in a law firm was once as easy as appointing a managing partner, who, after much kicking and screaming, would assume the role. But now that many law firms are large, global practices facing the same concerns as other multinational corporations, this minimalist approach is no longer enough.

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Effective law firm risk management requires far more expertise today than a reluctant managing partner. Lawyers have slowly discovered that risk exposure now transcends malpractice—the predominant liability of past decades.

Today, there are a variety of new risk exposures. Increasingly complex regulatory schemes, such as securities and taxation, expose attorneys to the heightened possibility of inaccurate client counseling, particularly by lawyers who do not practice full-time in a specialty. An increasing number of merger and acquisition transactions—both among law firms and corporate America—also lead to conflicts of interest that were not anticipated at the outset of an engagement. As firms grow in size and geographic reach, increasing efforts are necessary to ensure that the quality of work remains uniform across all practice groups and all offices. And pre-trial discovery has become substantially more complex as electronic data proliferates through storage devices and formats.

While these exposures were emerging, plaintiffs also began to consider large law firms as potential "deep pocket" defendants. "You may find your firm is the only deep pocket that exists when a client becomes insolvent or otherwise judgment-proof," says Harry Bryans, former general counsel to Drinker Biddle & Reath LLP and now a loss prevention consultant for Aon Corporation. "In fact, in recent years the 'blame game' following the insolvency of a client, or former client, is a source of some of the largest claims against law firms."

Law firm risk management is thus evolving from reactionary and rudimentary to proactive and comprehensive. Brian Kinman, a partner with PricewaterhouseCoopers LLP and leader of the firm's national risk management practice, says law firms are now more aware of risk management efforts of their corporate counterparts. "There's a very different external and internal environment than in the days when malpractice was a firm's main concern," he says. "We're seeing a significant increase in law firms telling us, 'Come to our organization. We need you to help us do the same thing,'" he says.

Many senior partners can likely recall a time when malpractice concerns posed the main risk to a law firm. Lawyers who sued other lawyers comprised a small, contemptible minority within the profession. But lawyers are no longer as reluctant to pursue one another and suits are becoming more costly. In 1996, a state district judge in Dallas ordered Akin Gump Strauss Hauer & Feld to pay a former client $1.1 million in damages arising from a negligence suit. Last summer, the 4th District Court of Appeals upheld a $1-million legal malpractice decision against Florida-based Gunster Yoakley & Stewart awarded to the heirs of the Gannett newspaper fortune. And in July of this year, a $55 million negligence claim was brought against Linklaters, a UK law firm, by a former client.

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These cases and others like them have led professional liability insurers to now consider a well-established risk management program as a pre-requisite for insuring a legal practice. A firm's responses to application questions about risk management and loss prevention programs are often among the most important qualitative information an insurer uses to gauge the risk it may pose, according to Stuart Pattison, a vice president at Chicago-based CNA, one of the nation's largest commercial insurers.

Professional liability insurers have grown more stringent about evaluating law firm risk management in the past decade, says Pattison, who manages CNA's large law firm group for lawyers professional liability insurance. The increased severity of claims against law firms has driven the decline of insurers' loss ratios—the ratio between the premiums paid to an insurance company and the claims settled by the company—and led to rate increases.

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But malpractice is only one of many problems that expose law firms to potential risk in the 21st century. The Sarbanes-Oxley Act of 2002, for instance, is a significant development. It requires the Securities and Exchange Commission to adopt minimum standards of professional conduct for lawyers representing public companies, which, in effect, make lawyers responsible, in some circumstances, for their clients' conduct. An expanding definition of "fraud" in federal and state laws,

and the increased criminalization of so-called "fraudulent" activities, particularly in health care and environmental law, is also of concern to lawyers, particularly when their clients' activities may be questionable.

William D. Heinz, a partner with Jenner & Block in Chicago, says he has observed the expansion of risk exposures during his 35 years with the firm. Laws governing the behavior of lawyers are now far more complex than the mere Rules of Professional Conduct. As an example, Heinz points to recent regulations adopted by the IRS requiring written documentation of conflicts of interest waivers.

Firms have also become much larger and more complex during his years of practice, with offices in different cities and jurisdictions, both in the United States and abroad. In the past, smaller firms generally knew their clients and adversaries, but now many require a computerized database to conduct conflict of interest analyses.

Mergers among firms also increase the risk of imputed conflicts of interest and can sometimes complicate the definition of the "client" in the attorney/client relationship. "When you take on a new client, you can avoid future potential problems if you can make it clear from the start that you either are or are not forming an attorney/client relationship with other corporate affiliates of the new client," says Heinz.

Pattison of CNA says that lawyers can significantly minimize risk at the onset of an attorney/client relationship. He recommends developing a strong client-intake system that weeds out poor quality clients, such as companies with too much red ink that may later be inclined to pursue the firm as a defendant. A well-drafted engagement letter can also spare future turmoil by spelling out the precise nature of professional services including the attorney handling the matter, specific duties that are not covered, a time-frame and a definition of who the firm will—and will not—be representing.

Technology poses other risks beyond the expertise of lawyers. The challenges can vary from protecting client data in a major disaster, such as Hurricane Katrina, to understanding whether or not opening e-mail attachments from a hotel computer breaches confidentiality. "The human factor—such as writing passwords on sticky notes and putting them on a computer monitor—is the weakest link in information-technology security," says Conrad Jacoby, owner of efficientEDD, a legal technology consultancy.

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The general counsel has emerged in recent years as the gatekeeper of the firm's risk management strategy. "Large firms are recognizing the benefit of concentrating overall responsibility for risk management and related issues, such as professional responsibility, client intake, conflicts and professional liability insurance, in a single role," says Bryans, the Aon law firm risk management consultant and former general counsel for Drinker Biddle. More than two-thirds of the top 200 U.S. law firms have an in-house general counsel, according to a survey conducted by legal consultancy Altman Weil.

Ronald Van Buskirk, general counsel of Pillsbury Winthrop Shaw Pittman LLP, is also an environmental litigator who ran the firm's risk management program for many years without the formal "general counsel" designation. In 1999 (when it was known as Pillsbury, Madison & Sutro and Cushman Darby & Cushman), the firm became one of the first in the country to designate a general counsel in order to centralize the responsibilities. "At the time, we wondered whether it would be useful," says Van Buskirk. "Since that time, it has proven to be the right decision. In fact, it's absolutely critical for large and global law firms. Centralizing the role offers consistency and gives people one place to go if they have a sensitive, complicated issue."

One of Van Buskirk's main responsibilities is overseeing procedures and educational programs to ensure that attorneys fulfill their professional responsibilities while avoiding exposures. That often covers legal ethics and keeping abreast of significant legal developments for the benefit of clients, such as Sarbanes-Oxley and tax compliance. He also oversees business matters that could increase a firm's risk exposure, such as employee relations and third party disputes.

"I have the assistance of a professional responsibility committee and other committees with significant partners in the firm that also help to look after the firm's legal issues and instill a culture focused on ethical compliance," says Van Buskirk.

Self-auditing, another major risk management tool that large firms are developing, is also managed by the general counsel. Large firms are implementing review systems to ensure that clients have signed engagement letters and waived potential conflicts of inter-

est in writing, where appropriate. Professional responsibility and risk management committees also contribute to the initiative by overseeing adherence to risk management initiatives among their respective departments.

Risk management at law firms must become embedded into the firm's culture and led by a full-time, dedicated specialist. It is now a standard for survival in an increasingly complex and competitive business environment. In order to accomplish this, the role of chief risk officer (CRO)—a function that is catching on throughout corporate America—may soon emerge as the next wave of leadership in large law firms. CROs in large corporations were practically unheard of a decade ago, but the role has gained prominence and many sizeable companies—especially in the financial services industry—have since appointed one.

A general counsel's role is critical toward establishing an enterprisewide risk management strategy. A debate wages, however, about whether the general counsel should continue to practice or devote all of his or her time to the firm's needs. Only about one-third of the general counsel surveyed by Altman Weil hold the position full-time. Many also billed as much as 1,500 hours annually on behalf of clients.

DLA Piper is one of the first global law firms to appoint a CRO. Julia Graham, an insurance industry veteran, is currently the firm's CRO overseeing Europe, Asia and the Middle East. Graham was recruited by DLA Piper to "take risk management to the next generation." A successful 25-year career with UK-based Royal Insurance (now Royal & Sun Alliance or RSA), preceded her role at DLA Piper. She became RSA's first risk manager in 1995 after recommending that the organization develop an internal risk management function.

A CRO's function is well-suited to DLA Piper, since the global firm has a structure that is corporate in governance style, she says. Graham notes the firm has a board, audit committee and client committee. The firm's enterprise-wide risk management strategy means that it manages all types of risk together, as opposed to one person managing risk for another. DLA Piper's risk management approach is not for every firm, and is best suited to large international practices, she says.

Graham oversees a 50-person department comprised of three full-time teams handling risk management. The first is a corporate team that develops risk policy, such as principles for client engagement letters. A regional team interacts with DLA Piper offices on a one-on-one basis, troubleshoots potential risks that arise during the course of business and provides training. Finally, there is a central services team that performs back-office functions, such as client identification and conflicts of interest.

The multi-tiered approach helps Graham realistically identify risk. "Very few risks actually manifest themselves in a silo," she says. "It's helpful to be able to think about risk in the way it's actually happening."

A mix of nonpracticing lawyers and other professionals comprise Graham's team. DLA Piper's risk management department has also helped the firm retain exceptional talent, particularly female lawyers, who are seeking a more family-friendly alternative to traditional practice. "It's a great way of delivering diversity to the firm—and providing an avenue for keeping exceptional talent," she says.

Graham views herself as a facilitator rather than simply an executive whose role is to take risk management responsibilities away from the senior partners. "The ownership is still fairly and squarely in the business," she says. "I'm not leading the business, but I'm helping it thrive." ■

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