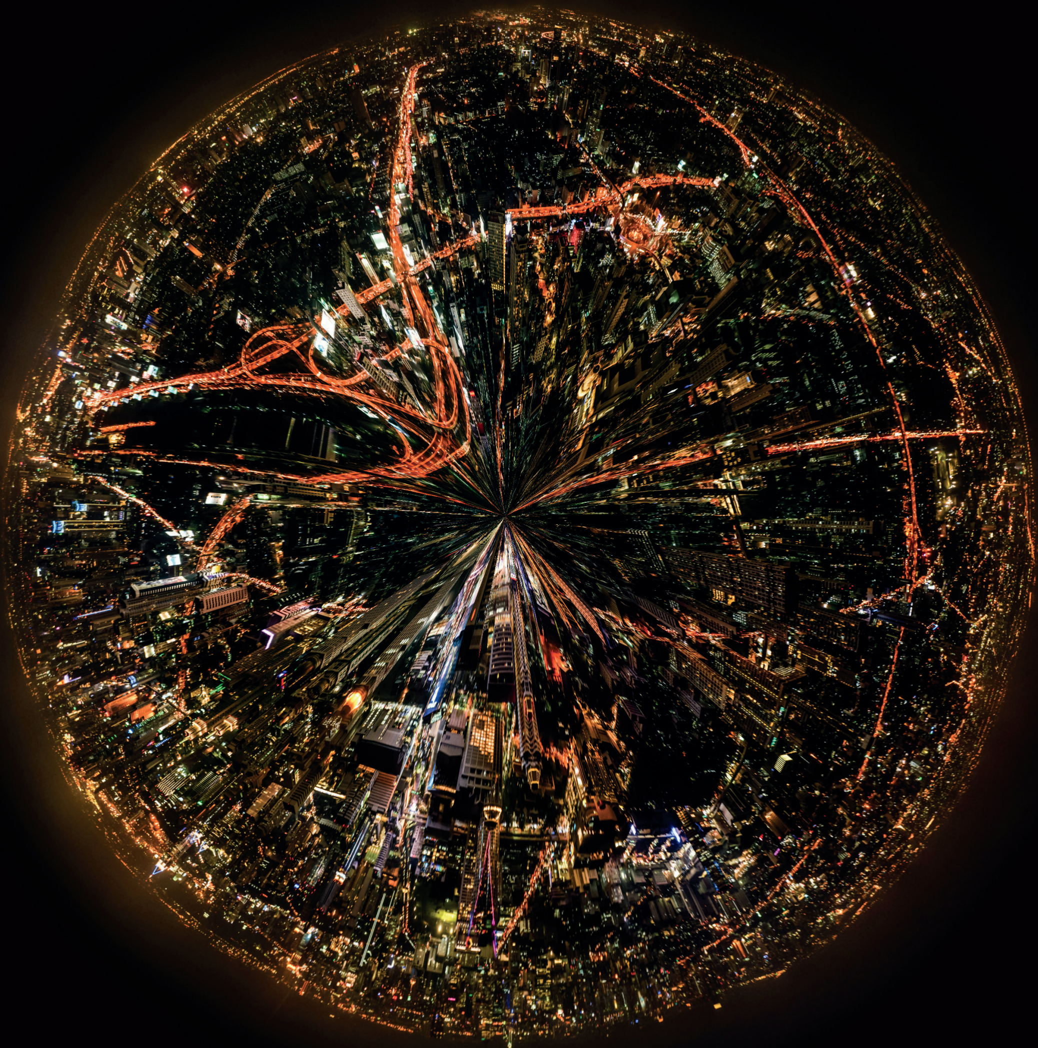


Canadian legal landscape 2017

Issues and trends facing Canadian in-house counsel and law firms

Introduction

In 2016, Deloitte set out to understand the current legal landscape in Canada, and how in-house counsel and law firms are dealing with disruption. We spoke with participants about how legal services are currently performed and how they see the legal industry adapting in the future.

We conducted approximately 100 interviews with in-house counsel and representatives of law firms across Canada. A common theme emerged: **client service excellence**. Both in-house and external counsel want to provide practical, business friendly advice to their clients. Similarly, regulatory risks and the so-called “unknown unknowns” keep lawyers awake at night across the board.

Regulatory compliance is the #1 issue keeping CLOs up at night.

Executive summary

Our view is that in order to stay relevant, legal departments must align with the key performance indicators of the broader business.

Historically, cost was often the primary driver for how decisions were made in legal departments. Low value tasks were reallocated to ever-growing in-house teams to limit external spend (e.g. contract management, NDAs).

Today, legal departments must be strategic and continuously add value to business leaders. Continuing education is necessary to align with the future needs of a given business. For example, how will blockchain impact banks in this age of digitization? What is the legal impact of autonomous vehicles on the insurance industry?

In order to attract the kind of talent that can service these needs, what kind of differentiated experience will legal departments have to offer up and coming lawyers? With head offices increasingly moving outside of urban centres, what kind of remote working arrangements will need to be available?

Within all of these constraints, legal departments continue to face budget pressures. While significant improvements have been made, external spend remains a priority for in-house counsel, who are now largely satisfied with their external providers. Legal departments are clear that a key priority is to find improvements internally (again, with more than just cost savings as a necessary outcome). This typically begins by optimizing existing organizational structures in order to meet the multitude of competing demands.

Perhaps our most interesting finding is that, while technology is arguably the biggest enabler of achieving best in class status, it is largely under-exploited by both in-house legal departments and law firms. There is tremendous opportunity within the legal industry to increase efficiency through technology, which will propel the entire industry forward by changing how work is performed, and by whom. Organizations that invest time and resources to integrate technology and legal services will weather many of the challenges currently facing the legal industry. Technology can provide critical benchmarking data to support Alternative Fee Arrangements, enhanced contract management and workflow optimization.

As in-house departments continue to evolve, law firms find themselves at a crossroads, contemplating a shift away from the traditional legal model as they adapt to a changing talent profile. With a large population of millennial talent and increased demand for 'experienced' associates, many firms are considering shifting from a traditional 'pyramid' model to more of a 'diamond' model, with fewer equity partners and junior resources. We anticipate heightened demand for legal talent as both in-house legal departments and law firms seek to hire experienced lawyers, requiring both groups to have a good understanding of their value proposition in order to attract and retain top talent. Law firms will need to invest heavily in technology and talent to match the pace of change of in-house talent, in order to stay aligned with their clients.

External legal spend:

Dollars and sense

Over 90 percent of chief legal officers (CLOs) surveyed indicated that they were satisfied or very satisfied with their external legal service providers.

While one third of respondents ranked controlling legal spend as a top priority over the next year, less than 50 percent of the in-house legal departments surveyed apply any benchmarks or conduct any detailed analysis to assess their external legal spending levels, mainly due to a lack of relevant and readily available data.

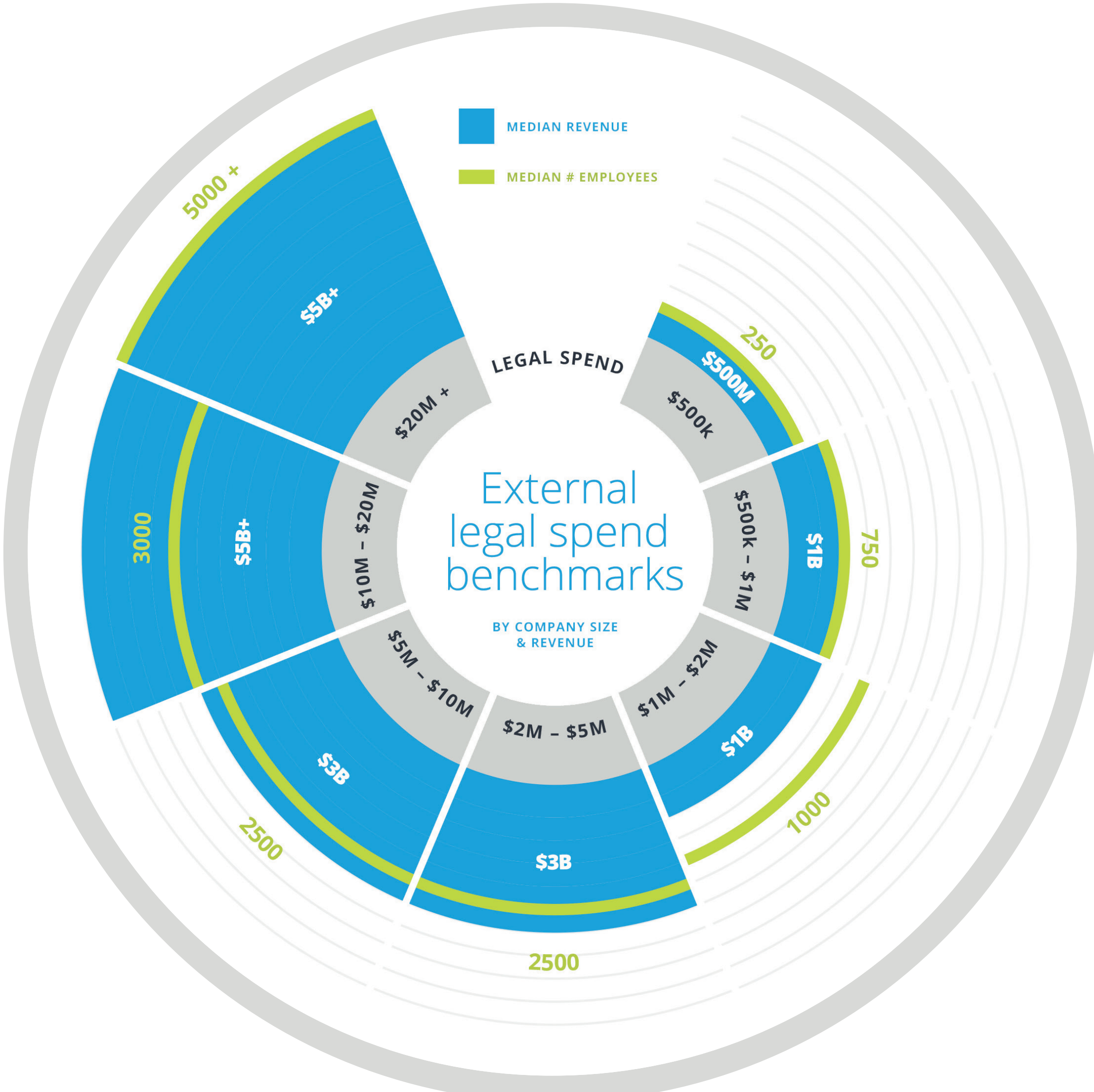
CLOs are, however, focused on Alternative Fee Arrangements (AFAs). Almost half of the CLOs interviewed are currently using AFAs and expect to increase their use over the next year. Law firms are responding to meet this client demand, but some are struggling to maintain profit margins in the process. Nearly two thirds of the law firms that provided AFAs stated that they are not as profitable as traditional hourly billing.

Virtually none of the CLOs or law firms we interviewed offered any truly innovative approaches to AFAs, and fixed fee mandates continue to dominate. Law firms noted that AFAs were most commonly used for transactional work, though some were offering partial AFAs to large institutional clients for litigation matters on a phase-by-phase basis or as part of an annual retainer covering varying matters. Law firms that are first to offer novel, yet profitable, approaches to AFAs are likely to see more long-term success and achieve a true partnership with their in-house clients.

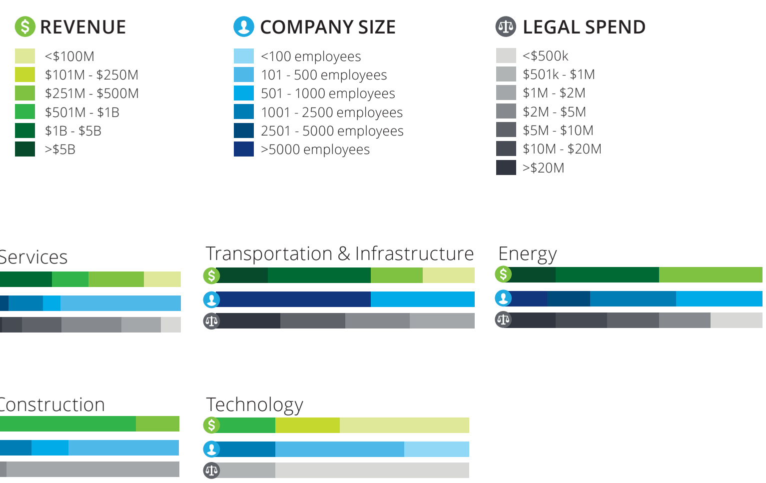
"AFAs are not necessarily about saving money, it's about driving value, and not paying for no value."

Gordon Currie
Executive VP and
Chief Legal Officer,
George Weston Limited

Key benchmark measures



Distribution of revenue, company size and legal spend by industry:



Organizational structure:

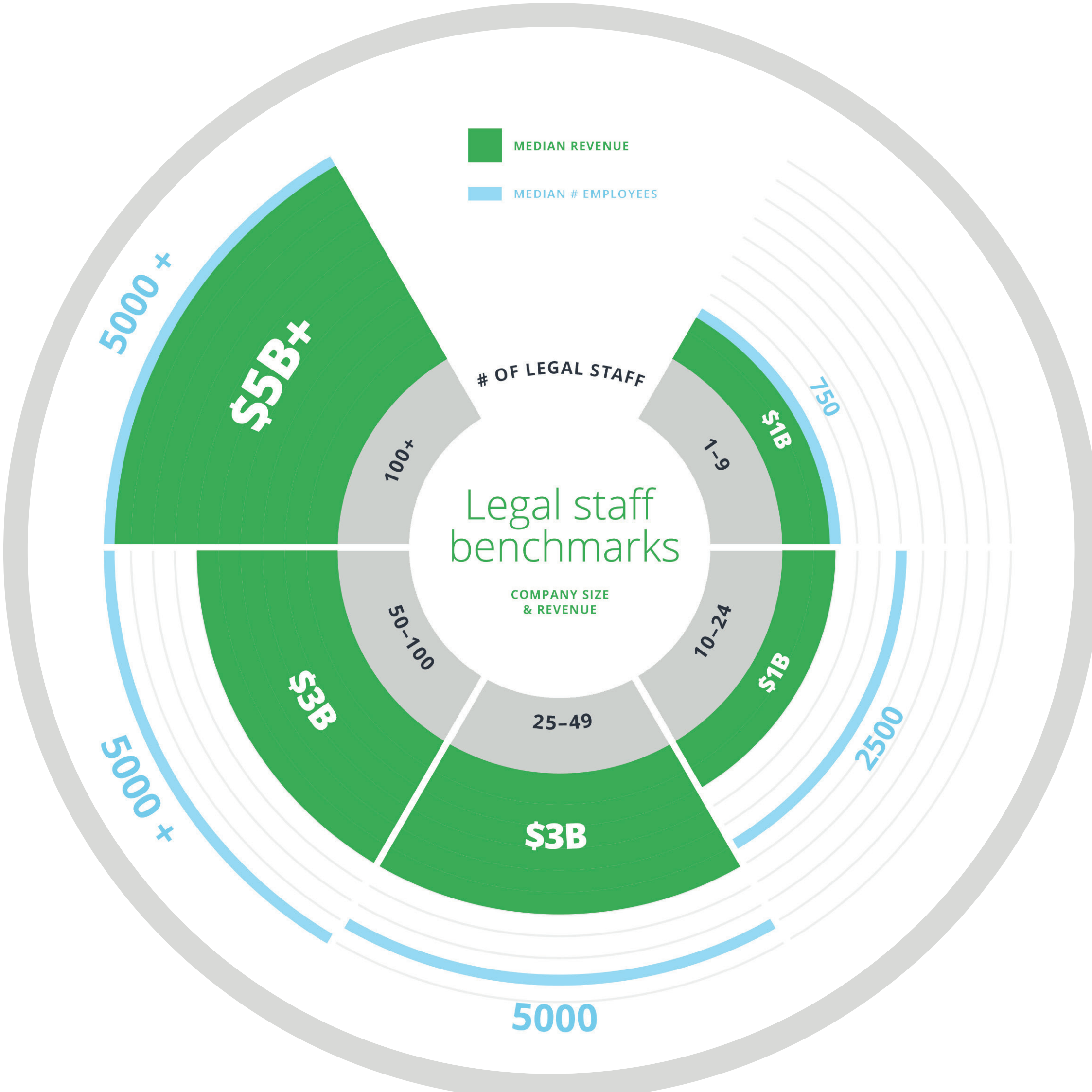
The looming war for talent

Numerous factors are changing the way law firms and in-house counsel departments are structured, with the net result that non-core tasks are increasingly being outsourced to external providers by both groups.

Continuing the trend from our last survey, the majority of CLOs plan to insource more high value work formerly performed by law firms, yet only 41 percent plan to increase headcount in their legal department. To address this gap, it appears that CLOs are focused on how best to drive increased efficiency within legal departments, with higher numbers considering or implementing process improvement activities. In-house counsel are also increasingly focused on defining a strategy for the legal department that aligns with the overall organizational strategy, and how best to organize the structure of their legal departments to achieve the efficiencies sought.

Yet over 80 percent of CLOs surveyed do not apply any benchmarks or comparative analysis to evaluate the size and structure of their legal departments, despite a clear appetite for quantifiable metrics. Developing reliable benchmark measures and industry standards for in-house department structures will be crucial to determining whether legal departments are adequately resourced, particularly as new technology is employed.

As CLOs shift more work in-house, law firms have also begun to restructure to accommodate their clients' needs. Commoditized legal work is increasingly being outsourced or performed by clerks and other staff with specialized skills.



These three industries reported having the largest legal departments:

- Financial Services
- Public Sector
- Transportation and Infrastructure

61 percent of Canadian millennials believe they will leave their organization before **2020** has passed.

Over the last five years, the number of equity partners in law firms has declined, and the number of non-equity partners has grown by nearly 50 percent, with the number of associates remaining largely static. Nearly 60 percent of law firms surveyed indicated that they currently have non-partner track associates, and of those firms without such positions, 74 percent are contemplating creating them. Firms are also hiring less articling students compared to previous years.

The growth in non-equity partners and 'career associates' may broaden the middle ranks of law firms. It may also indicate a shift from the traditional 'pyramid' operating model with a large number of junior associates, to one resembling a 'diamond', where a large percentage of a firms' talent is comprised of more senior associates with greater technical expertise.

This shift in operating model may ultimately assist with retention of millennials and succession planning, common concerns cited by most firms. In fact, 72 percent of firms noted staff retention and succession planning as key strategic priorities.

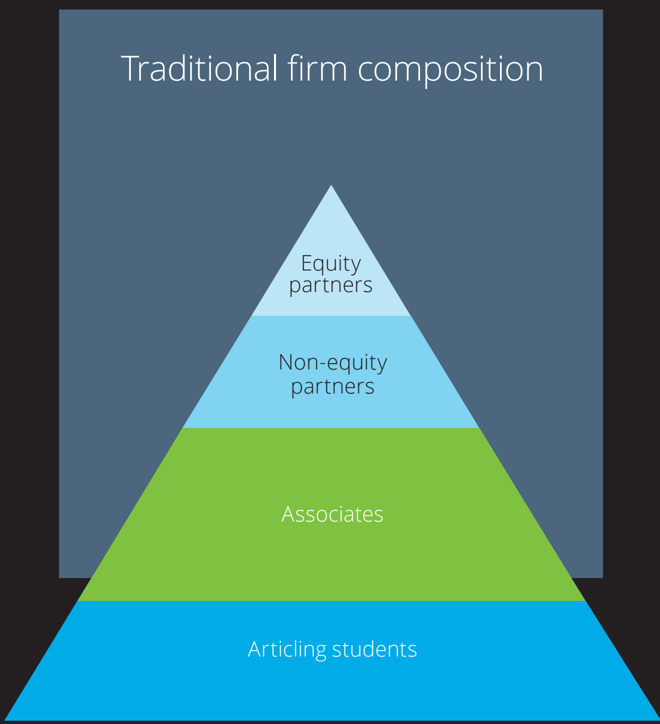
In addition, 50 percent of firms identified issues surrounding staff retention and the succession and retirement of partners as key threats their firm will face within the upcoming year, while 89 percent of firms noted that engaging and retaining millennials was a key issue. Despite retention and succession issues being a strategic priority for law firms, half of the firms surveyed indicated that they are not doing anything, or do not know what to do about the issue. The challenge to retain millennials was felt even stronger amongst smaller to mid-size firms which typically have a smaller talent pool to draw from.

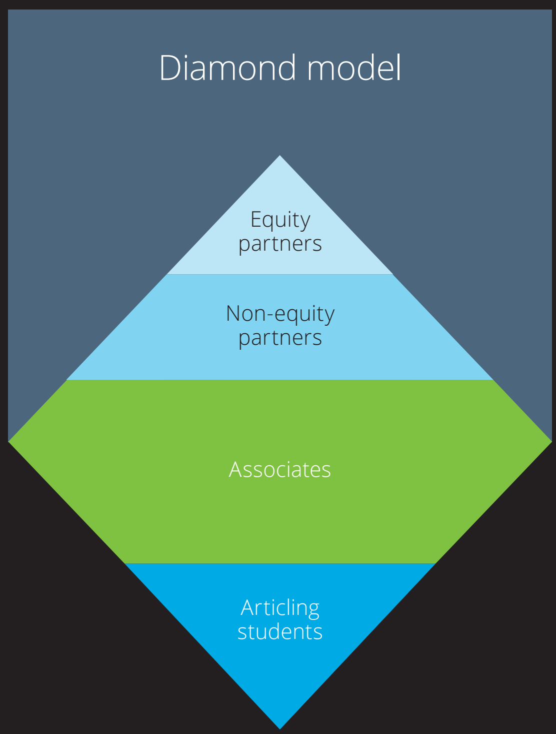
The advent of non-partner track and career associate positions will better align with the career priorities of a workforce increasingly made up of millennials, who place a higher emphasis on work/life balance and flexibility. Similarly, organizations who provide associates for less than full-time arrangements may also be key to law firms meeting the priorities of the millennial workforce. These non-traditional positions, whether inside or outside of the traditional law firm, could address millennials' needs to balance job flexibility with career progression and assist law firms to attract top talent.

The mental health of employees within the legal department, and the company as a whole, is becoming an important priority.

> "I worry about employees being overly stressed in general; and the cultural effects of people being constantly connected to work."
>
> **Anne Fitzgerald**
> **Chief Legal Officer, Cineplex Inc.**

By around 2020, we expect a tipping point for individual firms which will impact the competitive landscape and the role of talent in law firms.



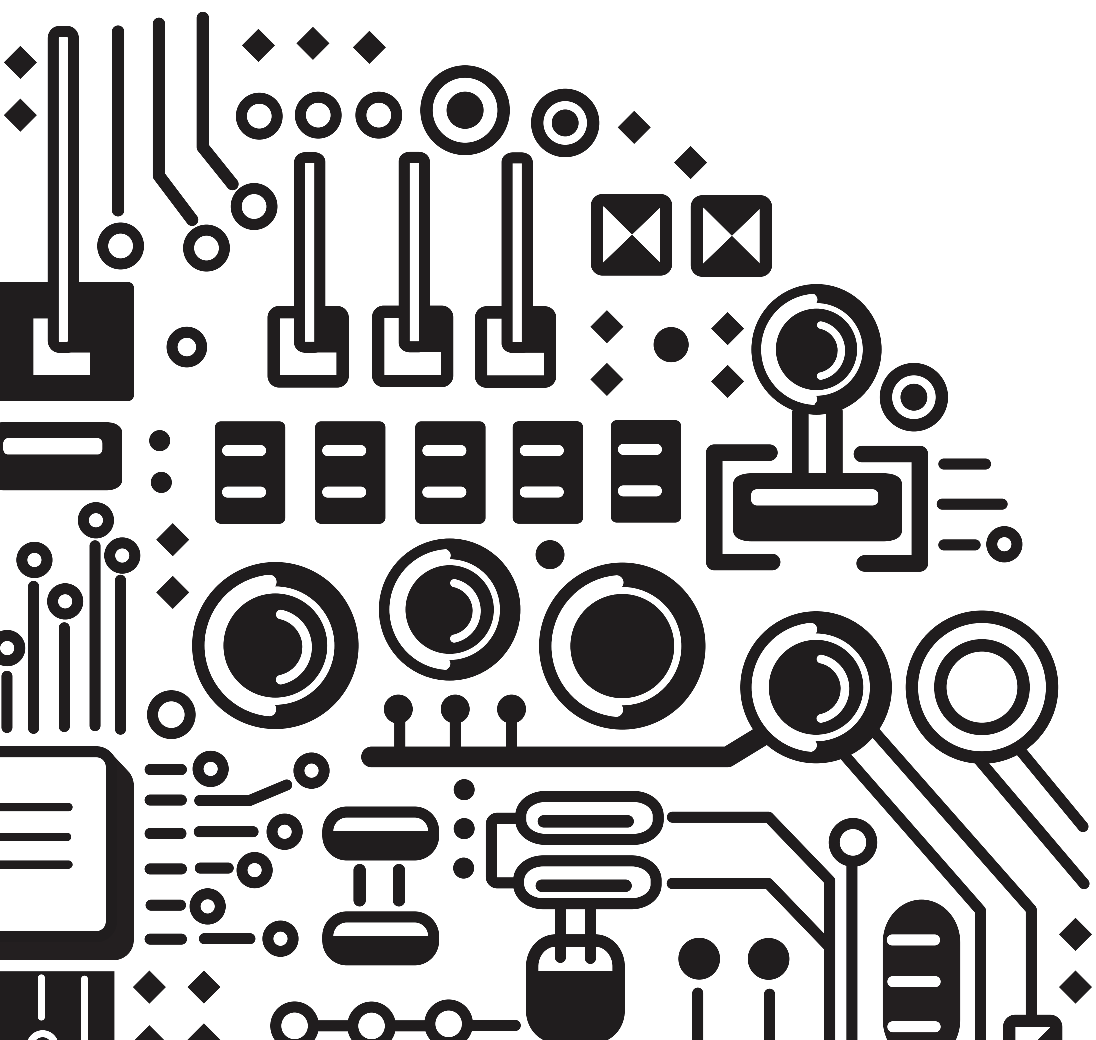


As law firms outsource more of the commoditized work previously performed by junior associates, they will require more experienced lawyers within a 'diamond model' to form the core of the interdisciplinary and technically sophisticated teams required to service their clients. These same associates are prime acquisitions for CLOs as they expand the scope of work completed in house and require more experienced lawyers trained by top tier law firms to round out their talent profile. This inherent competition will be amplified by wider economic trends such as Canada's aging population and the growing demand for diversity within human capital. As talent models in both law firms and in-house departments transform the way they work and who forms the core of their staff, it is possible that the career trajectory of the most sought after legal talent will adjust to the new market. It is not unforeseeable that a new breed of "industry experts" will emerge, with specialized areas of expertise built through both in-house and law firm training.

50 percent of respondents indicated there was room for improvement in diversity of legal departments.

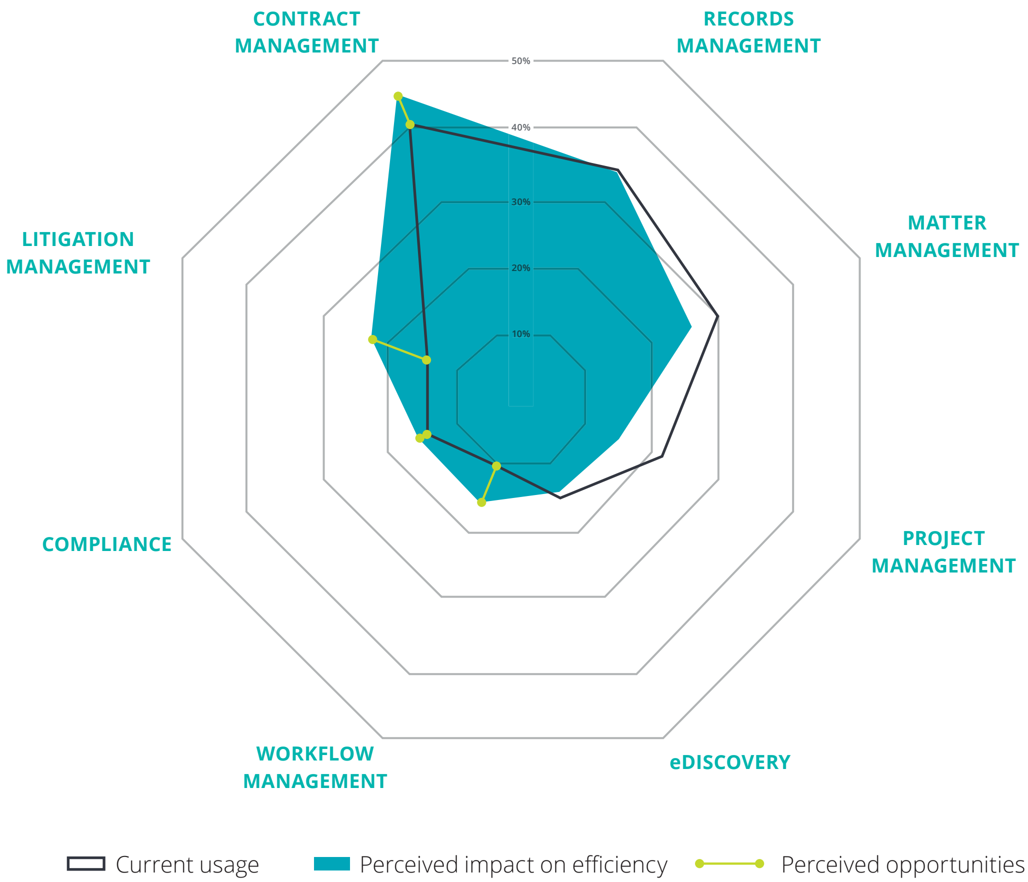
Technology:
The critical missing factor

We predict that the war for talent will be won by the organizations that innovate and fundamentally revisit the established way of doing things.



Technological investment and its impact on efficiency

Respondents believe more investment in contract management, compliance, litigation management and workflow management technologies would have a material impact on their legal department's efficiency.



Many of the critical issues identified by CLOs, including regulatory compliance, contract management, attraction of talent and "doing more with less", could be alleviated by prioritizing efforts in one area: investment in technological solutions that will accelerate in-house departments from responsive, supporting functions to truly strategic, insight driven organizations.

Surprisingly, investment in technology does not rank highly on the priority list of CLOs we surveyed, with only 15 percent citing technological improvements as a top priority. Nearly 90 percent of CLOs surveyed have ultimate spending authority for technological investment, yet over 50 percent of respondents anticipated no change in technology investments in the coming year.

Many in-house legal departments are not currently using technology they believe would be impactful to their business, such as compliance, litigation management and contract management software, despite the fact that over 50 percent of CLOs we interviewed are not satisfied with how contracts are managed in their department. Many legal departments are, however, using technology that is not impactful to their business, such as e-discovery and project management software. Investing in the right technology will enable CLOs to increase the efficiency of their legal departments and focus on higher value tasks.

There is a real opportunity for CLOs to have a voice in shaping legal technology by defining their requirements and demanding customized solutions that work for their business. An equal opportunity exists for external service providers to incorporate more technological efficiency in the services they provide, to help bridge the gap for in-house legal departments. It appears that law firms are just turning their minds to the issue as the overwhelming majority of respondents identified innovation in technology/service delivery as a major game-changer in the marketplace.

The majority of law firms surveyed are considering adopting some form of new technology within the next five years; however there remains uncertainty regarding which types of technology should be adopted. Firms are aware that they are at a technological crossroads, but they are unsure of which way to go. There is a burgeoning trend of partnerships with non-law firms in the market, which may, for many firms, present a solution to the technological challenges to come. As opportunities arise to leverage these relationships to perform additional legal tasks, further synergies between firms, CLOs, outsourcers and non-traditional players may be realized.

Over half of the law firms we surveyed responded that they utilize analytics to assess pricing and profitability. That said, while firms are sitting down to assess and review profitability, the process is still imperfect and at times ad-hoc, and firms are reporting that they are not completely comfortable with the results of this analysis. Thus, it appears that while law firms recognize their use of technology is necessary, analyzing and interpreting the resulting data is an evolving process.

Innovative technological solutions

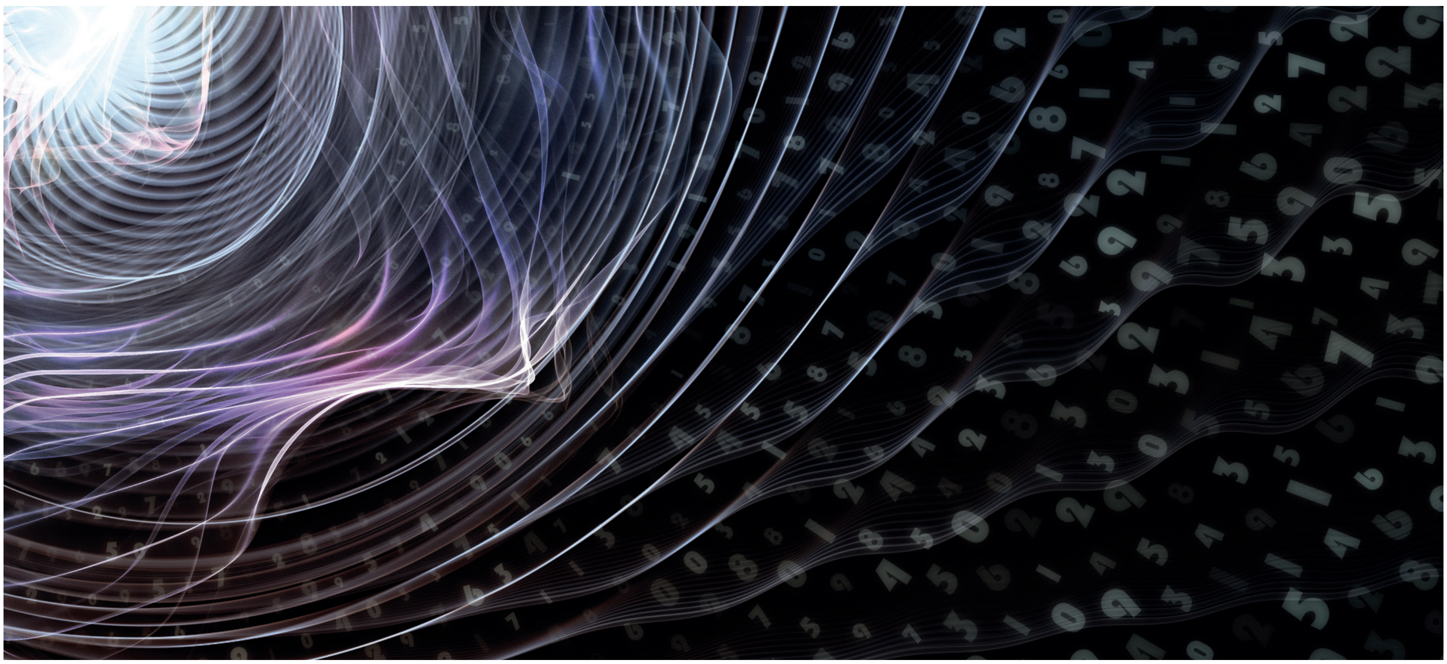
A BILLING SYSTEM
with integrated departmental budgets and industry benchmarks to show what other legal departments are charging for similar types of work.

A CLIENT PORTAL
that allows real time collaboration between a legal department and a law firm while working remotely (e.g. live drafting session). This can also allow the use of block-chain technology to automate execution of an agreement when required contract terms are fulfilled.

A WIRELESS DASHBOARD
that provides a high level summary of all pending matters for a legal department (e.g. litigation, contracts, negotiations).

Consolidation:
A continuing trend

In 2016, we saw law firms focused on talent and technology in a marketplace that was characterized by consolidation, a trend that started in 2013, continued throughout 2016, and is likely to continue into 2017.



This industry trend to consolidation brings a set of integration challenges that CLOs and law firms must carefully manage if they want to extract the most value from their talent. To mitigate these challenges, a successful consolidation will include cultural and organizational alignment activities that clearly articulate a future state and identify critical talent gaps that the integrated organizations will need to bridge. This future state vision of the combined organizations, drawn from a systematic cross-functional review process, should balance the need for retaining critical talent with the parallel need for reductions in force (RIF) to meet synergy targets. Careful cultural and organizational assessment work done at the outset of an integration will also support future talent-related activities, such as compensation and benefits package harmonization or operating model restructuring, while minimizing fallout from retention or RIF issues.

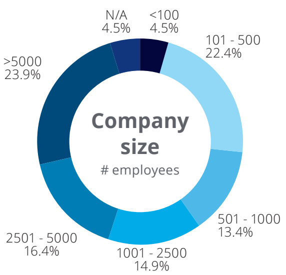
Pre-consolidation technology planning is equally important, but complicated by the fact that a majority of CLOs and law firms do not prioritize technology investments or use tools that adequately manage their business processes. Consolidations run the risk of compounding these shortcomings or further delaying the integrated groups from adopting tools that would improve operating efficiencies or support cost-reduction objectives. Given the cross-functional dependencies the consolidated organization will have on technology, it is imperative to understand the needs of all internal and external business partners at the outset of the integration. Clear and early mapping of these needs across all business teams will minimize disruption to contract management activities, while providing guidance on where to focus future technology investments.

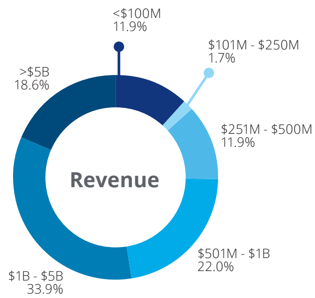
Methodology

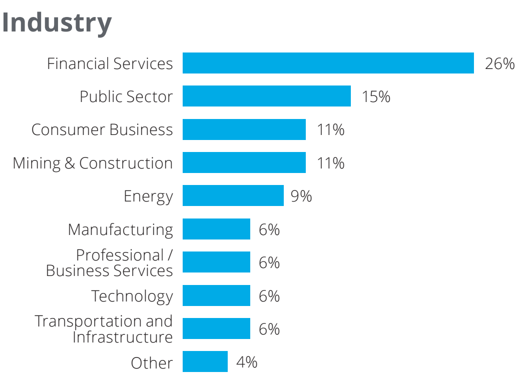
Throughout July to December 2016, Deloitte conducted a survey of approximately 100 chief legal officers and representatives of law firms across Canada to gain an understanding of the current legal landscape in Canada. This report is based on their responses to questions which offered both directed choices and free-form answers.

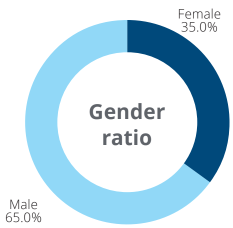
PARTICIPANT PROFILE

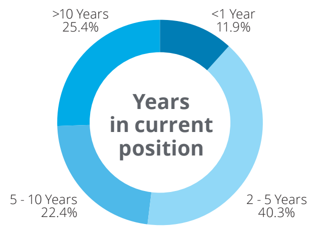
In-house counsel



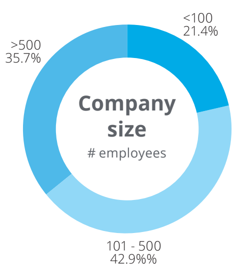


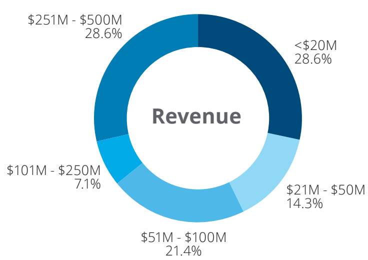


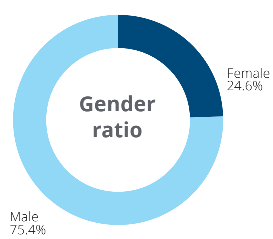




Law firms







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