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"You Had Me At Hello" or "Let Them Go?": Law Firm Selection, Retention, and Defection in the Investment Banking Industry

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"YOU HAD ME AT HELLO" OR "LET THEM GO?": LAW FIRM SELECTION, RETENTION, AND DEFECTION IN THE INVESTMENT BANKING INDUSTRY

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I. ABSTRACT

Drawing upon the theoretical concepts of reputation and social networking, this article's main objective is to assess how investment banks choose external law firms. Using qualitative methods, I show that investment banks, to varying degrees, rely on internal counsel, procurement specialists, and boards of directors to decide which firm to select. When choosing a specific law firm for the first time, corporate decision-makers are likely to evaluate law firms based on intangible factors like reputation and the word-of-mouth referrals of their colleagues. In subsequent selections of a law firm, these factors are transplanted by past results. Firm expertise and cost considerations impact procurement decisions regardless of whether a law firm has been previously retained. Despite claiming that the individual lawyers providing the service is a more important selection criterion than the firm that employs those lawyers, investment banks seem to experience a degree of embeddedness that keeps them using the same firms time after time.

II. INTRODUCTION

Around the world and throughout history, lawyers and investment bankers conjure images of wealth, influence, and success. In Elizabethan England, William Shakespeare wrote of Portia, an elegant and beautiful heiress who disguised herself as a young (and male) lawyer in *The Merchant of Venice*, and centuries later, Agatha Christie bequeathed to the literary world Sir Wilfred Robarts, a seasoned barrister, in *Witness for the Prosecution*. In the United States, public renown for the two industries extends from the early days of the republic.

Of the fifty-six signatories of the Declaration of Independence, eighteen were bankers or merchants, and thirty-five were lawyers or judges. Hollywood has further tattooed perceptions of lawyers and bankers on the human psyche—the tireless Jan Schlichtmann seeking restitution against corporate juggernauts in *A Civil Action*, Patrick Bateman living the life of a self-obsessed profligate in *American Psycho*, and perhaps most famously, Gordon Gekko demonstrating a twisted variation of the American Dream in *Wall Street*. These examples are presented not to glorify or denigrate the banking and legal professions, but rather to illustrate the unique, historical, and indispensable roles the two industries have played in corporate culture.

Incontrovertibly, a great degree of interaction exists between law firms and investment banks, with the latter organizations relying on the former for legal advice on mergers, acquisitions, and complex transactions, as well as for guidance when wading in the pool of varying international regulations. At some level within the hierarchy of an investment bank, an official makes a decision to seek external counsel. That choice is at the crux of this paper.

Drawing upon the theoretical concepts of reputation and social networking, this article's main objective is to assess how investment banks choose external law firms. Specifically, this article posits that firm reputation, social networks, and the media will be more important factors in the initial selection of a law firm than in subsequent selections, which will rely more heavily on criteria like service satisfaction, social ties, embeddedness, and price.

The relationship between an investment bank and an external law firm is best characterized as one between professional service firms. Contemporary theory on the selection of professional service firms is in its infancy. Heretofore, research has focused on client satisfaction and the purchasing decisions made by individuals. Studies centered on investment banks and law firms, as well as the interactions between these two niches within the professional service firm classification, are relatively nonexistent. Generally, researchers have limited their studies of the factors motivating choice to either the initial selection of a firm or to those influencing retention and defection. This article makes an effort to advance present theory and suggest areas for further exploration. Its novelty lies in the fact that selection is carried out by a firm, as opposed to an individual. Furthermore, the end result of that selection sees one professional service firm choosing another to provide a specialized service.

Each section of this article strives to fulfill a particular objective. Culminating with a set of research expectations and implications, Section III presents a comprehensive survey of present academic theory on reputation, social networks, selection criteria, and retention/defection. This thorough treatment of the academic literature allows for an easier understanding of the research methods (outlined in Section IV) utilized to obtain data. Section V examines the collected data, and Section VI discusses how research results met, or differed from, project expectations and contemporary theory, offering commentary on the long-term implications of the gathered data. The article concludes by disclosing the difficulties encountered throughout the project and suggesting topics for future examination.

III. THEORY

This section provides a thorough analysis of the compendium of theory related to the research goals. Whilst ample research exists on professional service firms, it is mainly concerned with client satisfaction and quality assessment. Very few studies have focused on how one professional service firm selects another professional service firm. Fewer still have examined law firms and how they differ from other professional service firms. Those studies that do exist concentrate on individual, as opposed to firm, purchasing decisions. Because of the paucity of information directly related to law firms, this chapter presents a broad overview of the academic literature on social networks, reputation, embeddedness, and the influence of the media. It is acknowledged that theories generated from the study of one professional firm—accounting, for example—may not be transferable to law firms. However, the testing of these broad theories in the context of law firms is one of the overarching goals of this project.

A. Professional Service Firms: An Overview of External Selection

Professional service firms ("PSFs") are "those whose primary assets are a highly educated (professional) workforce and whose outputs are intangible services encoded with complex knowledge."[1] Three characteristics further define PSFs: knowledge is their core resource, their clients are other firms, and the knowledge that PSFs produce is utilized by other businesses as part of their production processes.[2] Both investment banks and law firms fall within this definition, and therefore, both qualify as PSFs.

However, the focus of this paper is not on the services offered by investment banks to clients, which include advice on mergers, divestiture, and acquisitions; rather, this report is concerned with the legal departments of investment banks. Most investment banks have an in-house legal staff, but on certain occasions, they retain external counsel. Corporate clients typically call upon their in-house lawyers to make this decision.[3] Research by Day and Barksdale[4] identified four considerations of corporate decision-makers when selecting a firm. These factors were: "(1) perceived experience, expertise, and competence of the provider; (2) the provider's understanding of the client's needs and interests; (3) the provider's relationship and communication skills; and (4) the likelihood of the provider conforming to contractual and administrative requirements."[5] Though Day and Barksdale's study focused on the selection of architecture firms, similar factors

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[1] Royston Greenwood et al., *Reputation, Diversification, and Organizational Performance in Professional Service Firms*, 16 ORG. SCI. 661, 661 (2005).

[2] Lilach Nachum, *Winners and Losers in Professional Services: What Makes the Difference? Empirical Evidence for the Advertising Industry*, 16 SERVICE INDUSTRIES J. 474, 474 (1996).

[3] *See* Brian Uzzi et al., *Your Client Relationships and Reputation: Weighing the Worth of Social Ties: Embeddedness and the Price of Legal Services in the Large Law Firm Market*, *in* MANAGING THE MODERN LAW FIRM: NEW CHALLENGES, NEW PERSPECTIVES 91, 100 (Laura Empson ed., 2007).

[4] *See* Ellen Day & Hiram C. Barksdale, Jr., *How Firms Select Professional Services*, 21 INDUS. MARKETING 85, 86 (1992).

[5] *Id.*

may be used by investment banks when choosing external legal services.

Thus far, research on PSF selection and evaluation has focused on two distinct periods. Some recent studies have examined the initial stages of firm-client interaction— when a particular client is retaining a specific firm for the first time.[6] This article refers to this initial firm retention as "nascent selection." Other researchers have concentrated on later stages of the firm-client relationship, examining clients' decisions to reuse a PSF beyond the first interaction.[7] I have termed these choices "subsequent selection." In essence, when retaining legal services, a client must make two decisions: whether to retain a law firm used in the past and (if the answer to the first question is to the negative) which new firm to select. I feel it is necessary to distinguish between nascent and subsequent selections because, as academic literature suggests, corporate decision-makers assess the quality of a law firm and approach their choices in different ways depending on the stage of selection.

B. Retaining an External Provider for the First Time

Nascent selection refers to the retention of a law firm for the first time. The professional service firm choosing external counsel faces a high level of uncertainty. Most apparently, the PSF is devoid of firsthand knowledge about the law firm, and it also suffers from a more general disadvantage: the PSF is approaching external legal services precisely because it lacks the skills, manpower, or ability to handle a legal matter within the walls of its organization.[8] Thus, the PSF may not have the tools to evaluate the abilities of law firms whose associates possess specialized knowledge and are highly educated.[9] Corporate decision-makers, for this reason, typically embrace an "intangible" criterion of assessment, that of law firm reputation.

1. Reputation

Fombrun and Shanley first took note of the importance of reputation in the retention of external providers for the first time.[10] Greenwood, Li, Prakash, and Deephouse ("Greenwood et al.") expanded on this idea, showing that reputation is especially important when clients are making purchasing decisions because it helps to allay the fears of clients who are uncertain about a choice of a professional service firm.[11] Uzzi, Lancaster, and Dunlap ("Uzzi et al.") confirmed this notion, demonstrating that in-house counsel typically choose firms higher in status when asked to select outside legal representation because they are more easily able to

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[6] *See, e.g.*, Uzzi et al., *supra* note 3, at 114; Charles Fombrun & Mark Shanley, *What's in a Name? Reputation Building and Corporate Strategy*, 33 ACAD. MGMT. J. 233 (1990).

[7] *See, e.g.*, Dayananda Palihawadana & Bradley R. Barnes, *Client Loyalty and Defection in the Corporate Legal Industry*, 24 SERVICE INDUSTRIES J. 101 (2004); Day & Barksdale, *supra* note 4.

[8] *See* N.A. MORGAN, PROFESSIONAL SERVICES MARKETING (1991).

[9] *See* Greenwood et al., *supra* note 1.

[10] *See* Fombrun & Shanley, *supra* note 6, at 233.

[11] *See* Greenwood et al., *supra* note 1, at 663.

justify their decisions to superiors.[12]

On the flipside of the attorney-client relationship, it is clear that law firms benefit from a positive reputation. Uzzi et al. claimed that demarcations of status, like prestige and name recognition, influence pricing.[13] Firms judged higher in status are able to charge more for their services and still remain profitable.[14] Uzzi et al. attempted to quantify the concept of reputation by encompassing easily measured factors into their assessment. Law firms are deemed higher in status if they are ranked higher by independent assessors and if they attract more graduates of top law schools (based on mainstream rankings like *U.S. News and World Report*).[15] The board membership of partners also increases the status of a firm. Board seats allow law firms to access "inside" information and better market themselves to businesses by differentiating themselves from the competition.[16] Possession of these seats also affects the price of legal counsel. Law firms having one or more partners serving on the board of directors of another corporation charge three times more for legal services.[17]

The concept of "reputation" is difficult to define because it has distinct meanings for different people. Deephouse holds reputation to be "the evaluation of a firm by its stakeholders in terms of their affect, esteem, and knowledge."[18] Research has demonstrated that this relatively ambiguous concept influences corporate decision-making.[19] Factors that help establish a firm's reputation include how often a firm satisfies a stakeholder's expectations and the profitability of the firm.[20] "Perceptions of firms' concern for wider society may influence judgments, with social responsiveness signaling that firms have achieved a mutualistic relationship with potentially powerful groups in their environments."[21] Years of experience, specialty, personal qualities, recommendation, and geographical location have been found to be important characteristics in evaluating law firms.[22] The presence or absence of these qualities influences a client's perception of the quality of the legal services he is receiving.[23] Clients also view

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12 *See* Uzzi et al., *supra* note 3, at 115.

13 *See id.*

14 *See id.*

15 *See id.*

16 *See id.* at 109.

17 *See id.*

18 David L. Deephouse, *Media Reputation as a Strategic Resource: An Integration of Mass Communication and Resource-based Theories*, 26 J. MGMT. 1091, 1093 (2000).

19 *See, e.g.*, Kenneth E. Clow et al., *The Antecedents of Consumer Expectations of Services: An Empirical Study Across Four Industries*, 11 J. SERVICES MARKETING 230, 240 (1997) (demonstrating that a firm's reputation was correlated to consumer expectations and, consequently, to the purchasing decisions made by those same consumers).

20 *See id.* at 232.

21 Fombrun & Shanley, *supra* note 6, at 239.

22 M.A. Hughes & J.J. Kasulis, *The Production Cue Hypothesis and the Marketing of Legal Services*, *in* SERVICES MARKETING IN A CHANGING ENVIRONMENT 112 (Thomas M. Bloch et al. eds., 1985).

23 *See* F.G. Crane, *Choice Criteria and Cue Usage in Selecting Lawyers*, 5 J. PROF. SERVICES MARKETING 113 (1989).

larger law firms as "better" and "more prestigious."[24]

Interestingly, firm size and geographical location seem to be double-edged swords for law firms. Spar points out that "global" law firms are among the highest ranked in terms of profits per partner.[25] On the other hand, a number of potential clients are skeptical of these mega-firms, seeing them as the Wal-Marts of the legal world—massive bureaucratic structures that overshadow personal relationships with clients.[26] Particularly in the nascent stage, when clients are dealing with such a high level of uncertainty, they might be more likely to retain a local firm perceiving it to be easier to contact and more personal.[27]

Crane distinguished the criteria that clients consider important when choosing a law firm from the "cues" that indicate the fulfillment of those criteria. This paper has already expounded upon the traits that encompass a positive law firm reputation (recommendations and personal qualities, among others), but where does a potential client acquire information about the reputation of a specific law firm?

2. Social Networks

In situations where a corporate decision-maker does not possess the appropriate skills to assess the quality of legal services, he often relies upon information garnered through his social network. This information comes in the form of word-of-mouth ("WOM") referrals or recommendations.[28] Presently, academic literature is focused on two components of WOM referrals: input and output. Output WOM is best categorized as a characteristic of the post-service stage, and thus, this paper will reserve discussion of that topic until subsequent selection is analyzed. WOM input refers to the solicitation of another individual's (or firm's) opinion about a certain service provider. Conditions in which WOM input is especially important include times of high risk, greater complexity of evaluation, and situations where there is a gap in knowledge between the client and service provider.[29]

While opinions dispensed by PSFs through their social networks impact a law firm's stature, a law firm's reputation is also predicated on information disseminated to the public at large. This information can be classified into one of two categories.[30] Private information is that which is "subjective" and "verifiable

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[24] Debora L. Spar, *Lawyers Abroad: The Internationalization of Legal Practice*, CAL. MGMT. REV. 8 (Spring 1997).

[25] *See id.* at 18.

[26] *See* Barnaby J. Feder, *The Unorthodox Behemoth of Law Firms*, N.Y. TIMES, Mar. 14, 1993, *available at* http://www.nytimes.com/1993/03/14/business/the-unorthodox-behemoth-of-law-firMs.html?src=pm.

[27] *See* Vincent-Wayne Mitchell, *Problems and Risks in the Purchasing of Consultancy Services*, 14 SERVICE INDUSTRIES J. 315, 326 (1994).

[28] *See* Karen Maru File & Russ Alan Prince, *Positive Word-of-Mouth: Customer Satisfaction and Buyer Behavior*, 10 INT'L J. BANK MARKETING 25 (1992).

[29] *See* Karen Maru File et al., *Word-of-Mouth Effects in Professional Services Buyer Behavior*, 14 SERVICE INDUSTRIES J. 301, 303 (1994).

[30] *See* Uzzi et al., *supra* note 3, at 96.

by a third party."[31] In contrast, public information is readily available to the public and is put forth by third parties.[32] Media portrayals are examples of public information that affect firm reputation.

3. The Media

Independent reports by the media include television news stories, newspaper coverage, and ranking lists of popular periodicals. Suchman highlights the link between media coverage and reputation, stressing the enormous power the media wields in establishing a perception of legitimacy around a firm.[33] In the public's estimation, "legitimate organizations" are thought to be "more meaningful" and "more trustworthy."[34] For this reason, legitimate firms are accorded a type of "institutional capital" as a result of positive media coverage which, in turn, raises their worth in the minds of potential clients.[35] The notion of "information cascades" best explains this process. In selecting a professional service firm, a client faces a degree of uncertainty; that is, he may be unable to distinguish the merits of one firm over another. To overcome his selection uncertainty, a client might embrace the viewpoint of an opinion leader—the media reporting on the firms.[36]

Timothy Pollock[37] and Violina Rindova[38] point out three ways in which increased media coverage improves firm reputation.[39] First, exposure and familiarity to a firm increases that firm's favorability.[40] Second, simple repetition of information leads to the belief that it is valid.[41] Finally, the more information

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[31] *Id.*

[32] *Id.*

[33] *See* Mark C. Suchman, *Managing Legitimacy: Strategic and Institutional Approaches*, 20 ACAD. MGMT. REV. 571, 587 (1995).

[34] *Id.* at 575.

[35] *See, e.g.*, Michael Lounsbury & Mary Ann Glynn, *Cultural Entrepreneurship: Stories, Legitimacy, and the Acquisition of Resources*, 22 STRATEGIC MGMT. J. 545, 557 (2001); Timothy G. Pollock & Violina P. Rindova, *Media Legitimation Effects in the Market for Initial Public Offerings*, 46 ACAD. MGMT. REV. 631 (2003); Maxwell McCombs et al., *Candidate Images in Spanish Elections: Second-level Agenda Setting Effects*, 74 JOURNALISM COMM. Q. 703 (1997).

[36] *See* Hayagreeva Rao et al., *Fool's Gold: Social Proof in the Initiation and Abandonment of Coverage by Wall Street Analysts*, 46 ADMIN. SCI. Q. 502 (2001).

[37] Timothy Pollock is a professor of management and organization studies at the Smeal College of Business at Pennsylvania State University. Penn State, Smeal College of Business, Faculty Directory: Tim Pollock, http://php.smeal.psu.edu/smeal/dirbio/displayBio.php?t_user_id=txp14. His research over the year has focused on how social and political factors, including media accounts, have influenced firm performance, survival, alliance formation activities, and executive compensation, particularly in the initial public offerings market. *Id.*

[38] Violina Rindova is a professor of business at the McCombs School of Business at The University of Texas at Austin. University of Texas, Austin, Robert H. Smith School of Business, Faculty Directory: Violina Rindova, http://www.rhsmith.umd.edu/Faculty/vrindova/. Her research has focused on intangible assets, such as corporate reputation and firm celebrity, value creation, and competitive advantage. *Id.*

[39] *See* Pollock & Rindova, *supra* note 35.

[40] *See id*. at 631.

[41] *See id.* at 633.

available about a firm, the less "risky" that firm is perceived to be.[42] Do the media actively shape a firm's reputation in the minds of the public, or do they simply report the preconceptions already held by the public? Research exists to support both claims. According to David Weaver and G. Cleveland Wilhoit, journalists place a premium on neutral, unbiased reporting.[43] Deephouse refuted this notion, emphasizing that the media presents "reputational assessments" to its audience.[44] For example, firms that received more positive media coverage were ranked higher on *Fortune Magazine*'s "Most Admired Companies of the Year" list.[45]

Strictly speaking, firm-sponsored forms of advertising (e.g. television adverts) do not constitute sources of public information according to the definition of Uzzi and his colleagues (and adopted herein). Such advertisements have not been disseminated by a third party meaning that the veracity of the information can be questioned. With that said, this paper will turn its attention to law firm advertising because it highlights the enormous importance firms place on their reputations.

Self-promotion to actively solicit business can be viewed as unprofessional by many PSF employees, particularly those who work in the legal industry. Attorneys view their profession as a noble one, distinguished by its rich history and long-held traditions, and they are wary of behavior that might denigrate it.[46]

Advertising is viewed as taboo—the domain of used-car salesman, miracle weight-loss pills, and late-night infomercials. Yet, law firms are increasingly providing "service handbooks" which provide details about staff attorneys and their practice areas.[47] These brochures are sent to potential clients through direct mail campaigns. However, firms are quick to refute the notion that these guidebooks are promotional and stress that they are meant for purely informational purposes.[48]

With such an emphasis placed on safeguarding reputation, it must be queried whether a media-crafted reputation actually affects firm performance. Admittedly, "performance" is an ambiguous concept in itself, especially when dealing with the legal industry. Whilst some law firms might be keen to see a steadily increasing bottom line from quarter to quarter, others might be less profit-driven and more concerned with client satisfaction or the pursuit of justice. Pollock and Rindova demonstrated that information relayed by the media on public offering firms profoundly influenced the IPO selections of investors.[49] More significant in shaping investor preferences is the tenor of media coverage, which the authors

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[42] *See id.*

[43] *See* DAVID H. WEAVER & G. CLEVELAND WILHOIT, THE AMERICAN JOURNALIST: A PORTRAIT OF U.S. NEWSPEOPLE AND THEIR WORK (1986).

[44] Deephouse, *supra* note 18, at 1097.

[45] *See* Fombrun & Shanley, *supra* note 6, at 246, 252.

[46] *See* Lloyd C. Harris & Nigel F. Piercy, *Barriers to Marketing Development in the Barristers' Profession*, 18 SERVICE INDUSTRIES J. 19, 25 (1998).

[47] *See id.* at 24.

[48] *See id.* at 25.

[49] *See* Pollock & Rindova, *supra* note 35.

reason increases the perception of value of a firm.[50] This inference is supported by the fact that positive and negative stories about law firms are often accepted as true by the public.[51] This research has profound implications for law firms which, at their core, must be able to attract and retain clients.

C. Subsequent Selection: Retention and Defection

Thus far, this paper has concentrated on an investment bank's selection of a new law firm, one that a bank has never contracted with before. "Subsequent selection" refers to choices to re-retain the services of a previously used law firm. While nascent selection forced a PSF to choose legal services without firsthand knowledge, subsequent selection allows a client to reflect on prior dealings with a law firm. Not surprisingly, during subsequent selections, criteria like previous personal experiences and caring for the client's needs become crucial in a PSF's decision to continue using a particular law firm.[52] Overall, law firms receive most of their new contracts from existing clients.[53] Firm reputation might explain an investment bank's initial choice of external legal services, but other factors likely account for the subsequent instances in which the law firm is used.

Services can be divided into two categories: those that are best managed as one-time transactions and those best delivered through a preexisting customer relationship.[54] Professional services fall into the latter category. These business relationships are frequently long-term—lasting from seven to eleven years,[55] and it has been argued that the relationship between the client and the service provider becomes stronger with the passage of time.[56] The fact that trust and communicative ability often develop over time lends credence to this argument.[57]

A prior relationship has two effects on future interactions with a firm.[58] First, trust develops between the client and service-provider. This trust is grounded in historical precedent—both parties have fulfilled their respective ends of a contract in the past; hence, it seems safer for the client to retain the same firm than to switch to an "untested" one. Secondly, inertia might draw a client to a previously contracted firm, and this occurrence is associated with the concept of embeddedness.

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[50] *See id.* at 631.

[51] *See, e.g.*, Kimberly D. Elsbach, *Managing Organisational Legitimacy in the California Cattle Industry: The Construction and Effectiveness of Verbal Accounts*, 39 ADMIN. SCI. Q. 57 (1994).

[52] *See* Day & Barksdale, *supra* note 4.

[53] *See* Palihawadana & Barnes, *supra* note 7, at 102.

[54] *See* ADRIAN PALMER, PRINCIPLES OF SERVICES MARKETING (1994).

[55] *See* Dennis W. Carlton, *The Rigidity of Prices*, 76 AM. ECON. REV. 637, 655-56 (1986).

[56] *See* Daniel A. Levinthal & Mark Fichman, *Dynamics of Interorganizational Attachments: Auditor-Client Relationships*, 33 ADMIN. SCI. Q. 345, 348 (1988).

[57] *See* Stewart Macaulay, *Non-Contractual Relations in Business*, 28 AM. SOC. REV. 55, 55 (Feb. 1963).

[58] *See* Levinthal & Fichman, *supra* note 56, at 366.

1. Embeddedness and Price

Gulati and Gargiulo discussed the influence of uncertainty and embeddedness, including prior mutual alliances and common third-party associations, on the formation of new social relationships.[59] Uzzi presented a more detailed account of embeddedness and its effect on firm performance.[60] He highlighted efficiency, mutually-agreed upon problem solving strategies, and reduced search costs as benefits of embeddedness.[61] PSFs can be unique organizations, and they might favor service providers who have already learned the nuances of their firms and acquired relation-specific knowledge. These relationships may only strengthen over time.[62] Both the client and service provider would be more likely to accommodate the wishes of the other and invest in "specialized equipment."[63] At the same time, they would acquire knowledge particular to the other organization. Knowledge and investment particular to one client—"specialized investments"— cannot easily be applied to another client.[64] The termination of a relationship with such a high degree of asset specificity thereby diminishes the value of such specialized investments. Thus, "where asset specificity is great, buyer and seller will make special efforts to design an exchange that has good continuity properties."[65] The service provider has a strong incentive to retain clients— a company can improve profits twenty-five to eighty-five percent just by retaining five percent more clients.[66] By focusing its attention on retaining clients, a firm also saves on the cost of marketing to new firms.[67]

Uzzi, Lancaster, and Dunlap explored the relationship between social ties and the price of legal services. Their study of mega-law firms incorporated numerous theories of organization, including embeddedness, transaction cost economics, and reputation. Their study demonstrated that embeddedness was inversely related to price: the closer the ties between a particular law firm and a professional service corporation, the lower the cost of legal services.[68] In the long run, however, these embedded relationships proved mutually beneficial. Professional service corporations enjoyed reduced prices for legal work billed per hour, which provided an incentive to continue using the same law firm.[69] These

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[59] *See* Ranjay Gulati & Martin Gargiulo, *Where Do Interorganizational Networks Come From?*, 104 AM. J. SOC. 1439 (1999).

[60] *See* Brian Uzzi, *Social Structure and Competition in Interfirm Networks: The Paradox of Embeddedness*, 42 ADMIN. SCI. Q. 35 (1997).

[61] *See id.* at 38, 47, 49-50.

[62] *See, e.g.*, OLIVER WILLIAMSON, MARKETS AND HIERARCHIES, ANALYSIS AND ANTITRUST IMPLICATIONS: A STUDY IN THE ECONOMICS OF INTERNAL ORGANIZATIONS (1975).

[63] *Id.*

[64] *See* Oliver Williamson, *The Economics of Organization: The Transaction Cost Approach*, 87 AM. J. SOC. 548 (1981) (proposing the theories of "value" and "asset specificity").

[65] *See id.* at 555.

[66] Frederick Reichheld & David W. Kenny, *The Hidden Advantages of Customer Retention*, 13 J. RETAIL BANKING 19 (Winter, 1990).

[67] *See* PHILIP KOTLER, MARKETING MANAGEMENT: ANALYSIS, PLANNING, IMPLEMENTATION AND CONTROL (1994).

[68] *See* Uzzi et al., *supra* note 3, at 106.

[69] *See id.* at 107.

law firms, in turn, increased their profits over time because of the steady stream of work provided by a single client.[70]

2. Defection and Client Satisfaction

Despite the perceived benefits of PSFs maintaining long-term relationships with other firms, "defection" does take place. Defection occurs when a PSF breaks some or all of its ties to a service provider and retains another firm. Clients defect to cut costs, "trade up" to a superior product, obtain better service, and to placate internal or external political forces.[71] A long-term relationship that ceases to evolve with the client is also at risk for defection.[72] For example, a client's needs may have expanded with the passage of time, requiring new forms of expertise from the service provider. Service providers must perceive this shift and adapt to their evolving client, ensuring that they continue to offer "value and satisfaction."[73]

Continuing to offer value and satisfaction to their clients can be a difficult proposition for some law firms, especially considering that the interests of law firms and their corporate clients may be at odds. According to Leblebici, "[a] law firm's objective is to increase return to its partners; a client's goal is to maximize value and minimize costs."[74] Current practices within law firms exacerbate this conflict. One-third of the revenue generated by associates is transferred to a firm's partners as deferred compensation.[75] Hence, an associate is encouraged to bill the most hours possible to increase his personal income and that of the partners. One apparent problem with this payment method is that it rewards attorneys solely on the basis of hours billed—not on the quality of the results delivered to clients. If Leblebici's thesis is correct, the billable-hours method of payment has interesting consequences for the legal profession, especially when placed in the context of Fombrun and Shanley's study on reputation and retention. Theoretically, a large firm could maintain a positive reputation by billing an increased number of hours (hence generating greater profits) in spite of not always meeting client expectations.

Palihawadana and Barnes postulated that "satisfaction with service" was the chief reason clients continued to retain a law firm.[76] However, how does one define satisfaction? Over the last three decades, the academic literature has attempted to establish a framework for understanding this amorphous concept. LaBarbara and Mazursky described the concept as "the extent to which a product

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[70] *See id.*

[71] *See* Palihawadana & Barnes, *supra* note 7, at 105 (quoting Glenn Desouza, *Designing a Customer Retention Plan*, 13 J. BUS. STRATEGY 20, 24 (1992)).

[72] *See* Levinthal & Fichman, *supra* note 56, at 366.

[73] *See* HELEN PECK ET AL., RELATIONSHIP MARKETING STRATEGY AND IMPLEMENTATION 28 (1999).

[74] Huseyin Leblebici, *Determining the Value of Legal Knowledge: Billing and Compensation Practices in Law Firms*, *in* MANAGING THE MODERN LAW FIRM: NEW CHALLENGES, NEW PERSPECTIVES 117, 128 (Laura Empson ed., 2007).

[75] *See id.*

[76] *See* Palihawadana & Barnes, *supra* note 7, at 105.

(or service) meets customers' expectations (or requirements)."[77] In their study of architectural and engineering firms, Day and Barksdale linked the notion of "satisfaction" to "quality," showing that clients used similar criteria when evaluating both ideas. The factors were: "(1) provider's understanding of the client's needs and interests; (2) the provider's relationship and communication skills; (3) the provider's conformance to contractual and administrative requirements; and (4) actual performance."[78] Jackson and his colleagues carried out an extensive study on how CEOs evaluate legal services. Results showed that CEOs ranked legal expertise, interpersonal relationships with clients, and the quality of the written product as the most important determinants when assessing the quality of a law firm's work.[79] Finally, Young and Denize disputed the importance of quality to firm retention. Demonstrating that service providers and their clients can maintain strong ties even when their clients believe that the quality of service is subpar, Young and Denize concluded that asset specificity, inertia, and embedded ties were more important indicators of retention than quality.[80]

3. Social Networks

WOM output is another method of exploring client satisfaction in the post-service stage. Output WOM is the sharing of information about a previously-retained PSF with another individual or organization. A PSF is more likely to express an opinion of a law firm that it has retained for a long period of time.[81] Expertise in a client's area of need, approachability, and the qualifications of law firm personnel are prominent reasons for recommending a law firm to a professional colleague.[82]

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[77] *Id.* at 106 (quoting Priscilla LaBarbara & David Mazursky, *A Longitudinal Assessment of Consumer Satisfaction/Dissatisfaction: The Dynamic Aspect of the Cognitive Process*, 20 J. MARKETING RES. 393 (1983)).

[78] Day & Barksdale, *supra* note 4, at 88.

[79] D.W. Jackson et. al., *Business Executives' Evaluation of Various Aspects of Outside Legal Services*, *in* SERVICES MARKETING IN A CHANGING ENVIRONMENT 130 (Thomas M. Bloch et al. eds., 1985).

[80] *See* Palihawadana & Barnes, *supra* note 7, at 104.

[81] *See* File et al., *supra* note 29, at 311.

[82] *See* Nick Ellis & Claire Watterson, *Client Perceptions of Regional Law Firms and Their Implications for Marketing Management*, 21 SERVICE INDUSTRIES J. 100, 112 (2001).

IV. RESEARCH METHODS

A. Data Collection

Data for my project was provided by executives from nine investment banks located in Europe or the United States.[83] These executives were typically attorneys overseeing a bank's legal services for a specific region of the world.[84] My interactions with all of these sources took the form of semi-structured,[85] open-ended interviews which occurred either in person or via telephone.[86] Interview questions were designed to garner responses that would aid me in my quest to find answers to the questions guiding my research[87]:

Who within an investment bank is empowered to contract outside lawyers?

How does reputation affect client choice?

To what extent do investment banks rely on their social networks to select external legal services?

Are clients attracted to individual lawyers, law firms, or both? How does this

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[83] My exploration of the ways in which investment banks retain external counsel began in November 2007 and spanned nine months, concluding in August of the following year. During the first four months, I immersed myself in the academic literature and theories of research related to my project goals. This information has been detailed extensively in earlier sections. The next four months focused on data collection, and the final month concentrated on data analysis and presentation.

[84] To gain access to appropriate initial interview sources, I emailed a description of my project to the legal or media relations departments of the world's top fifty investment banks, as ranked by the *Vault Guide to the Top 50 Banking Employers (2008 Edition).* Firms interested in participating in my project would then reply to my email with the contact details of the person best able to assist. Some of these initial contacts were able to provide the names of colleagues in other banks who would be able to impart further data.

[85] Since my interviews were semi-structured, it is not possible to provide a script of interview questions.

[86] Interviews ranged from thirty-five to seventy-five minutes, lasting forty-five minutes on average. I took detailed field notes of each interview and often asked respondents to repeat statements to ensure that direct quotations were accurately recorded. Following each successive interview, I synthesized my notes, concentrating on the emerging themes. By augmenting my list of interview questions following each successive interview, I overlapped the processes of data collection and analysis. *See generally* BARNEY GLASER & ANSELM STRAUSS, THE DISCOVERY OF GROUNDED THEORY: STRATEGIES OF QUALITATIVE RESEARCH (1967) (describing the merits of semi-structured interviews and the analysis thereof). Overlapping the processes of data collection and data analysis allowed me "to take advantage of flexible data collection . . . .the freedom to make adjustments during the data collection process." Kathleen M. Eisenhardt, *Building Theories from Case Study Research*, 14 ACAD. MGMT. REV. 532, 539 (1989). After completing an interview, I examined my notes to pull out themes that were important (within-case analysis). These provided the background for the next interview I would conduct. In this way, I allowed the information gathered during each interview to build upon previously obtained data. When all of the interviews had been completed, I once again reviewed the notes of each interview, coding statements that reflected themes deduced from multiple interviews (cross-case analysis). This process allowed me to construct the overarching descriptive themes, drawing parallels between them when appropriate. *See* HERBERT J. RUBIN & IRENE S. RUBIN, QUALITATIVE INTERVIEWING: THE ART OF HEARING DATA (1995).

[87] While many studies are organized to test hypotheses, mine was more focused on theory building. The lack of academic research focused on my area of study made the formulation of precise hypotheses difficult; thus, I designed my study to explore the answers to research questions. *See* Eisenhardt, *supra* note 86 (explaining the qualitative methods that I believed were best suited to my project aims).

preference affect choice?

What qualities do clients believe are indicative of superior law firms? Do these qualities change based on past usage of a law firm?

More specifically, I asked each respondent which individuals participated in the process of choosing external counsel and what factors they considered when making such a selection. I also queried the circumstances that would lead in-house attorneys to retain an outside law firm. Because "reputation" can have very personal meanings, I always asked my interview subjects to explain their perception of this term.

B. Research Context

For organizations, the process of selecting external counsel is often complex and multifaceted. Various individuals within a firm could be empowered to retain outside legal services, and they can do so in scores of unique circumstances. Before examining the data in the next section, this article explores the mechanisms organizations have in place to aid the process of contracting external firms. To clarify, the aim in this section is to provide a suitable research context to make the results enunciated in Section V more understandable.

1. In-House Legal Counsel

Discussing "external counsel" is slightly presumptuous as it implies the existence of internal counsel—attorneys directly employed by the organization. To be fair, it may not be economically feasible for smaller firms to have lawyers on the payroll. They could rely exclusively on the expertise of an independent law firm. In these situations, a procurement specialist, a person who contracts outside services, may be utilized to evaluate and retain law firms.

Larger PSFs typically have legal departments in some manifestation. These "general counsel" are solicitors or barristers in an English sense or members of a state, appellate, or federal bar in the United States. Aside from providing legal advice to their corporate employers, general counsel often oversee teams of attorneys, paralegals, and legal secretaries within the firm context. In situations when their organization needs to retain external counsel, general counsel are often instrumental in the selection process.

Of my nine interview subjects, eight were certified attorneys overseeing legal departments ranging in size from five to 250 lawyers. One interviewee was a procurement specialist. His investment bank, because of its small size, relied exclusively on external firms for its legal needs. These professionals were employed by investment banks in the United States or Europe that employed globally forty-eight to 280,000 people. This information is summarized more explicitly in the tables below.[88]

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[88] All subjects agreed to be interviewed on the condition that their identities and the identities of their firms remain confidential. To honor their wishes, I have provided stand-in names in place of their actual names and the names of the firms that employ them.

Table 1 **Investment banks profiled**

Investment bank	**Main bank headquarters**	**Total global bank size (individuals employed)**
Rhine Bank	Germany	75,000
Swiss Financial	Switzerland	82,000
Keystone Investors	USA	1,200
Frankfurt Securities Investment Bank	UK	6,000
Nippon International	Japan	15,000
Hamilton Grey	USA	48
Alpha	USA	2,100
Britannia Bank Corporation	UK	280,000
Columbia Capital	Russia	120

Source: The author's research

Table 2 **Interview subjects**

Resp.	**Position**	**Investment bank**	**Bank branch location**
Mr. McCarthy	General Counsel	Rhine Bank	London
Mr. Stengel	Managing Director, Legal Department	Swiss Financial	London
Mr. Huggins	General Counsel	Keystone Investors	Pittsburgh
Mr. Martin	Head of Legal Services	Frankfurt Securities Investment Bank	London
Mr. Lemon	General Counsel	Nippon International	London
Mr. Houk	Procurement Specialist	Hamilton Grey	New York
Mr. Dickey	General Counsel	Alpha	New York
Mr. McGraw	Director of Legal Services	Britannia Bank Corporation	London
Ms. Harris	Head of Legal Department	Columbia Capital	Moscow

Source: The author's research

Table 3 **Legal department breakdown of profiled investment bank branches**

Investment bank	**Number of legal department employees**
Rhine Bank	150
Swiss Financial	100
Keystone Investors	36
Frankfurt Securities Investment Bank	110
Nippon International	100
Hamilton Grey	0
Alpha	40
Britannia Bank Corporation	260
Columbia Capital	5

Source: The author's research

2. Elite Law Firms

Both the United States and the United Kingdom have groups of law firms that are widely regarded as the "most prestigious" by businesses and other professional service firms. Prestige, like reputation, is not precisely defined; however, it is not within the scope of this project to explain why certain firms are deemed higher in prestige. Nevertheless, since this factor may influence the law firm choices of investment banks, it is worthwhile to point out that *ceteris paribus*, some firms are regarded as more prestigious than others.

In the United Kingdom, one group of law firms that arguably benefits from a perception of prestige and is associated with high performance is the "Magic Circle."[89] Membership in the Magic Circle is exclusive to five London-based law firms: Allen and Overy, Clifford Chance, Freshfields Bruckhaus Deringer, Linklaters, and Slaughter & May.

Falling directly below the Magic Circle in terms of prestige is the "Silver Circle." These are powerful mid-market English law firms that have profits per partner levels on par with the Magic Circle despite employing fewer attorneys and generating less revenue. Typically, these firms draw their clients from within the UK. The Silver Circle designation traces its roots to a 2005 article in *The Lawyer*, which applied the term to five firms: Ashurst, Macfarlanes, SJ Berwin, Herbert Smith, and Travers Smith.[90]

Law firms in the United States are less stratified, reputation-wise, than their

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[89] While the five firms encompassing the United Kingdom's Magic Circle were not labeled as such until the 1996 edition of *The Legal 500*, they were linked together as early as 1989. *Compare* THE LEGAL 500: THE MAJOR LAW FIRMS IN ENGLAND, SCOTLAND, AND WALES, AND FOREIGN LAW FIRMS IN LONDON (John Pritchard ed., 1989) (grouping the later-named Magic Circle firms together), *with* THE LEGAL 500: THE CLIENTS' GUIDE TO UK LAW FIRMS (John Pritchard ed., 1996) (applying the term "Magic Circle" to the firms). Tracing its origins to The Magic Circle, a London-based organization for professional and amateur magicians distinguished by its extreme secrecy, the term has been readily applied to the most prestigious law firms in the country over the course of the last decade.

[90] Dan Box, *"Silver Circle" Firms Upset the Legal Order*, TIMES (U.K.), Aug. 28, 2005, *available at* http://business.timesonline.co.uk/tol/business/industry_sectors/support_services/article559686.ece.

counterparts in the UK; however, certain firms can be pointed to as the American elite. "Big Law" refers to the nation's largest 250 law firms, as ranked by the *National Law Journal*. The most prestigious of these firms are further distinguished as "White Shoe Firms,"[91] though considerable debate exists as to which firms qualify as members of this group. This article applies the term synonymously to the firms Peter Sherer nicknamed the "Circle of Elite": Cadwalader, Wickersham & Taft; Cravath, Swaine & Moore; Covington & Burling; Davis Polk & Wardwell; Debevoise & Plimpton; Milbank, Tweed, Hadley & McCloy LLP; Shearman & Sterling; Simpson, Thacher & Bartlett; Sullivan & Cromwell; Paul, Weiss, Rifkind, Wharton & Garrison; Proskauer Rose; Skadden, Arps, Slate, Meagher & Flom; and Weil, Gotshal & Manges.[92] These firms share some common characteristics including a moderate size, high profits per partner, and a modest international presence.[93]

3. Billing Practices

The billing practices of law firms and the complications associated with current remuneration systems, for the most part, are not within the scope of this project. However, because academic theory has suggested that cost could be a determinant in the procurement choices of organizations, this section provides a brief overview of the common payment procedures of lawyers and law firms.[94]

There are three dominant billing schemes utilized by law firms. Of these, the most straightforward is the fixed-rate system, whereby a client pays a flat fee for a legal service. This system, despite being easily understood by clients, is fraught with complications. Since it does not account for the time an attorney spent providing a particular service, the price charged may be unfair to either the lawyer or the client.[95] This system also removes the quality of the legal service provided from the payment equation. Contingency fee arrangements, in contrast, allow an attorney to collect a percent (typically one-third) of the client's recovery in litigation.[96] However, an early settlement could net a lawyer a handsome payment for little work, or a loss at trial could net him nothing. By far the most favored billing method for law firms is the billable hour. Firms bill clients a set monetary amount for each hour that an attorney spends working for them. This system ensures that lawyers are paid for their time, but it could also discourage attorneys

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[91] Writer William Safire traces the origin of this term to a style of shoe popular among the upper-class New Englanders who staffed elite PSFs in the early twentieth century. *See* William Safire, *On Language; Gimme the Ol' White Shoe*, N.Y. TIMES, Nov. 9, 1997, *available at* http://www.nytimes.com /1997/11/09/magazine/on-language-gimme-the-ol-white-shoe.html.

[92] Peter D. Sherer, *Your Competitors: Mapping the Competitive Space of Large U.S. Law Firms: A Strategic Group Perspective*, *in* MANAGING THE MODERN LAW FIRM: NEW CHALLENGES, NEW PERSPECTIVES 162, 170 (Laura Empson ed., 2007).

[93] *See id.*

[94] *See* Leblebici, *supra* note 74, at 117 (providing a comprehensive analysis of law firm billing practices, including their histories, complications, and suggestions for improvement).

[95] *See id.* at 127.

[96] *See id.* at 128.

from working efficiently.[97]

V. RESULTS

A. Why Do Banks Retain External Counsel?

Of the nine investment banks profiled, eight had some form of an internal legal department. Yet, all of the banks routinely utilized the services of external counsel. For one bank, external legal services were operationally necessary. Hamilton Grey, a very small investment bank, outsourced all of its legal needs and employed no practicing lawyers. Representatives of the other eight investment banks cited three reasons for retaining external attorneys: transfer of risk, financial benefit, and expertise.

Four investment banks used internal law firms to minimize the risks associated with certain types of transactions, such as leveraged buyouts. Retaining external law firms places the onus for the legal aspects of a transaction on a party outside of the investment bank. Hence, disputes stemming from this work, as well as any civil suits, will be directed primarily at the external law firm and not the investment bank.

> Some large transactions force us to take on a lot of debt, to assume a great deal of risk. In that type of climate, we're looking to shove off as much risk onto others as possible. Spread it around a little. So you can understand why we would pass off responsibility for legal matters onto external providers.[98]

Rhine Bank, Keystone Investors, Nippon International, and Frankfurt Securities outsourced legal work for financial reasons.

"Essentially, it's a question of what makes sense to do internally versus externally. What is the most cost-effective way of handling our legal affairs?"[99]

"We don't deal with a lot of litigation here. Therefore, it does not make financial sense to hire internal litigators. Our branch in the U.S., however, faces much more litigation, so they hire those people."[100]

For these banks, it seemed that cost-benefit analyses played a part in whether certain legal services were managed internally or outsourced.

Law firm expertise was named by three investment banks as a reason for seeking external legal services. Frankfurt Securities, Alpha, and Rhine Bank used their internal legal departments to handle routine legal matters, but relied upon law firms for unique or complex subjects, or for transactions occurring in foreign or unfamiliar jurisdictions. In these situations, the investment banks felt more comfortable turning to expert advice from attorneys outside of the organizations.

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97 *See id.* at 128-29.
98 Mr. Martin, Frankfurt Securities Investment Bank.
99 Mr. McCarthy, Rhine Bank.
100 Mr. Lemon, Nippon International.

B. Who Retains External Counsel?

The nine profiled investment banks afforded their respective general counsel varying degrees of authority in the selection of external firms. Hamilton Grey and Keystone Investors entrusted their procurement advisors with full authority to contract law firms of their choosing. Rhine Bank, Swiss Financial, Nippon International, and Britannia Bank Corporation permitted their internal counsel to retain external services from a list of preapproved law firms (the panel system). Finally, Frankfurt Securities, Alpha, and Columbia Capital required their boards of directors to make the final selection. However, all of the banks utilized the "panel system" in some form.

Respondents from the latter three banks, when describing their methods of choosing external counsel, explicated a difference between the *de jure* selection process and the one occurring *de facto*. In principle, the task of the general counsel of these banks was to present their boards of directors with options whenever the investment bank required external representation, highlighting the strengths and weaknesses of each firm, the costs of each, and the attorneys from each firm who would be involved. However, in practice, general counsel at Frankfurt Securities, Alpha, and Columbia Capital selected external law firms from lists—panels of law firms favored by the organization. Thus, internal counsel was free, within the confines of the list of approved firms, to use their discretion to retain legal services.

"Procurement functions through delegated authority. Theoretically, my choices have to be approved by the board, but in practice, I've negotiated rates with a number of law firms, and the eventual selection comes from this panel of firms."[101]

One must be careful not to undervalue the role of the board of directors in procurement, especially if the board plays a part in determining organizational direction and goals. Mr. Dickey described how the subprime mortgage crisis, perpetuated by the bursting of the housing bubble in the United States, directly affected his job:

> There is a constant debate between high road and low road strategies—whether we're focused on revenue generation or cost control. It's all very bureaucratic. If I have a doubt about the cost of firm I want, I have to pick up the phone and call someone internally—find out their perception of the business environment.[102]

Four investment banks—Rhine Bank, Swiss Financial, Nippon International, and Britannia Bank Corporation—admitted that they had a list of favored firms from which they selected external counsel. The law firms on these panels had been approved previously by the banks' governing boards, and general counsel could use any of the firms on their respective bank's panel at their discretion. Retaining a law firm not already on a bank's panel was much more difficult for internal attorneys:

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[101] Mr. Martin, Frankfurt Securities Investment Bank.

[102] Mr. Dickey, Alpha.

"A panel is essentially a list of firms that we have relationships with. I can't think of a reason why we would need to look for providers not on our panel, but if we did, it would be very complicated and require internal meetings and board approval."[103]

Even Hamilton Grey and Keystone Investors, banks that allowed internal counsel or a procurement specialist full discretion to choose external firms, almost always used one of two firms for their legal needs. The reasons for this occurrence will be addressed later in this section. In the interim, this article turns its attention to how law firms are selected—the characteristics banks consider when retaining external counsel.

C. Which Law Firm will be Selected?

Irrespective of whether a governing board or general counsel made the final selection decision, all of the banks profiled had a procurement staff responsible for examining the positive and negative traits of law firms under consideration. The factors they considered in their selections are subsequently examined.

1. Expertise

All nine of the investment bank executives interviewed named firm expertise as the primary factor influencing their decisions. To these individuals, expertise encompassed a firm's intimate knowledge of a specific area of the law, as well as its institutional capital—the attorneys it employed. At the same time, the interview subjects stressed the importance of "bench depth"—the ability of a single law firm to oversee all aspects of a transaction, from its inception through any litigation. Hence, they favored full service law firms over boutique firms, but they still strove for representation possessing the level of institutional knowledge of specialized firms.

> If we are taking part in a leveraged buyout in a foreign country, for example, I want knowledgeable advice on all of the nuances of that transaction from the firm we're using. I want to know about the regulatory climate of the country; I want to know about the tax laws; and I want consultation on the more mundane as well: on contracts, etc.[104]

The staff employed by a law firm was a crucial consideration in the decisions of the interviewees. One law firm may have a staff with extensive knowledge of mergers and acquisitions, while another may excel at litigation.

"Look, you wouldn't ask [criminal defense attorney] Bob Shapiro for advice on hostile takeovers."[105]

"I want outside lawyers who are smarter than me. They should be a step ahead. Otherwise, what's the point in hiring them?"[106]

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[103] Mr. McGraw, Britannia Bank Corporation.

[104] Mr. Lemon, Nippon International.

[105] Mr. Martin, Frankfurt Securities Investment Bank.

[106] Mr. McCarthy, Rhine Bank.

Seven respondents believed that the individual lawyers working on the banks' transactions were more important than the firms that they worked for.

"We hire lawyers, not law firms."[107]

Two firms, Keystone Investors and Britannia Bank Corporation, felt that the law firm itself took precedence over the lawyers who were in its employ.

In an attempt to gauge just how committed the interviewees were to the individual over the law firm, I next asked them if they would follow an attorney if he transferred from one firm to another. The responses to this question were varied. Britannia Bank Corporation and Hamilton Grey would not transfer their respective business from one firm to another for the sake of an attorney.

"We've worked hard to build relationships with the law firms on our panel. Our loyalty is with them."[108]

Keystone Investors, likewise, would be reluctant to switch firms because a lawyer transferred; however, this stance was conditional:

> Several people have left firms over the years, and we haven't followed a single one to his new firm. But, no one who has left has been a key player for us. If a key player were to leave, I guess it would be difficult not to switch over to the new firm.[109]

Frankfurt Securities, Alpha, and Columbia Capital stated that they would start retaining the services of the lawyer's new firm. The remaining three firms—Rhine Bank, Swiss Financial, and Nippon International—would switch to the new firm if two conditions were met. First, the attorney's new law firm would have to be similar in prestige and stature to his previous one, and secondly, that firm would have to be on the legal panel of the investment bank making the choice.

"If he switched to a firm not already on our legal panel, it would be extremely difficult to follow him. The board would have to step in and approve the firm first."[110]

Lastly, the respondents felt that results were the true litmus test for the evaluation of law firm expertise. These individuals were in agreement as to what constituted good results: "the completion of the service expeditiously and cost-effectively;" if external counsel represented the bank in a litigation proceeding, "good results" meant that the bank "won the case in court or reached a settlement favorable to the firm."[111]

2. Social Networks

All of the respondents relied on their social networks to assist with their procurement choices. For them, a trusted referral of a certain law firm or lawyer dramatically pushed them toward making that selection. These referrals came from colleagues in other banks, professional organizations, and attorneys. The

[107] Mr. Stengel, Swiss Financial.

[108] Mr. McGraw, Britannia Bank Corporation.

[109] Mr. Huggins, Keystone Investors.

[110] Mr. McCarthy, Rhine Bank.

[111] Mr. Dickey, Alpha; Mr. Martin, Frankfurt Securities Investment Bank.

amount of credibility the interviewees placed in a referral was contingent upon how close of a relationship they had with the referrer and whether the recommended legal advisor had completed similar work for him.

Every banking executive confirmed that he would hold a referral from a counterpart in another bank in the highest regard.

> We're looking to retain law firms with high degrees of expertise. Really, expertise is a subjective concept. It has no definitive meaning. So, how do we determine if a firm we're thinking of hiring is any good? We do it by asking trusted colleagues.[112]

One respondent, Ms. Harris from Columbia Capital, relied upon a corporate counsel association to share information about external providers. Frankfurt Securities' Mr. Martin also utilized contacts from his days of working at a Silver Circle firm for recommendations:

> The law firm network is a small and intimate one. All of us corporate counsels [sic] started out working in law firms. We all have mates we've left behind still working there. So we pick up the phone. "Who's a good guy for derivatives at Linklaters? Do you know anyone at Clifford Chance who does excellent M&A work?" In this network, a verbal referral really matters.[113]

Despite the fact that respondents based much of their selection criteria on the recommendations of others, many revealed an unwillingness to communicate a negative opinion of a particular provider to a colleague. Nippon International, Alpha, Keystone Investors, and Hamilton Grey expressed this sentiment. They would only share an opinion about a certain law firm if it were positive. If asked about a firm they had a negative experience with, they would either provide a neutral assessment ("the firm was fair") or, if possible, deny using that particular firm.

"It would be very rare that I'd express a negative opinion. What's that expression your mother tells you? 'If you don't have anything nice to say, don't say anything at all.'"[114]

Columbia Capital and Rhine Bank would be reluctant to express a negative opinion of a law firm, but might do so under certain circumstances. Both bank representatives pointed to issues of confidentiality connected with the attorney-client relationship. However, if they were close to the person enquiring about a firm, and if they were talking informally ("off the record"), they would feel comfortable relating a negative experience.

Mr. Stengel, internal counsel for Swiss Financial, stated that he would never share his personal opinion of an external firm with a colleague. Yet, he would feel comfortable expressing the collective opinion of the bank's legal department, even if that opinion were negative:

> The problem with sharing an opinion about a law firm's performance is that it's

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112 Mr. Dickey, Alpha.

113 Mr. Martin, Frankfurt Securities Investment Bank.

114 Mr. Huggins, Keystone Investors.

> wholly subjective and based on the interpretation of a single person. We as an organization form an opinion collectively about the firms we work with. It's how we know whether or not we will ever be using a firm again. I would willingly share this opinion with corporate counsel at another investment bank because it represents more than just the perception of a single individual.[115]

Two investment banks, Frankfurt Securities and Britannia Bank Corporation, defied the consensus of their peers, saying they would have no qualms about sharing a negative law firm experience with colleagues.

"My experiences with external providers, whether positive or negative, are word-of-mouth messages communicated on jungle drums."[116]

3. Cost

With the exception of Rhine Bank, all of the profiled investment banks named cost as a major determinant of which external law firm would be selected. However, five of these banks were careful to state that it was not a primary consideration, but rather "the third most important factor" ranking below such criteria as expertise, reputation, and staffing. Price was most often balanced against expertise to assess the value of the service being provided by the external law firm. Corporate counsel sought to maximize the legal expertise available to them while minimizing the cost of that advice. Eight interviewees stressed that superior law firms billed their clients "fairly." A "fair price," in their estimation, was one competitive with the rates charged by law firms of similar stature for comparable work, completed in the same amount of time. When making this assessment, the interview subjects compared the billing systems utilized by law firms, as well as any discount being offered by the external provider based on work volume.

In their discussions of fair pricing as a characteristic of superior law firms, respondents revealed deep-seated resentment toward the billable-hours payment system. Mr. Huggins felt that the system was "better for [the law firms]." Ms. Harris stated a preference for fixed-rate billing, fearing that under the billable-hours system, a law firm would be exceedingly liberal in assessing the number of hours it spent providing a service to her bank.

"I know how long it should take somebody to do something, and how much it should cost. There is so much pressure in firms to bill hours. They call you to wish you 'happy birthday' and bill the call to [Columbia Capital]."[117]

Hamilton Grey, Frankfurt Securities, Columbia Capital, Britannia Bank Corporation, and Keystone Investors had unique billing arrangements with one or more law firms. Some law firms that ordinarily billed by the hour provided a fixed-rate alternative to investment banks that used them often. Typically, this option was offered for more commonplace work, such as registering one of the bank's clients with the United States Securities and Exchange Commission. Some law firms also presented investment banks with a billable hour discount whereby

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[115] Mr. Stengel, Swiss Financial.

[116] Mr. Martin, Frankfurt Securities Investment Bank.

[117] Ms. Harris, Columbia Capital.

the market rate per hour was inversely proportionate to the volume of work provided by the bank. Keystone Investors took advantage of both forms of discounts, and Mr. Huggins reported that the bank benefited more substantially from a discount in billing by the hour:

> We see higher quality work from the firm that bills us by the hour. They're both more knowledgeable and more responsive. Maybe it's because the fixed rate is a disincentive for the associates working at the other firm. They aren't billing hours, so they aren't generating revenue by picking up the phone and calling us.[118]

Cost was the main reason that Hamilton Grey decided to dismantle its legal department and outsource all of its legal needs. A partner at a major law firm approached the organization with a proposal to assemble a team of attorneys specifically for the bank. The team included an attorney specializing in every area of the law relevant to the company; essentially, the law firm provided the bank's legal department.

"They gave us a legal team and granted us a unique pricing model. We have now outsourced for the same cost of our old internal legal department. It's a win-win: they get volume and predictability. We get predictability and cost-efficiency."[119]

4. Reputation

The respondents perceived the notion of reputation differently. Four claimed it was the overarching viewpoint of a firm—society's collective evaluation of an organization's performance. Three interview subjects mentioned that integrity and competence were crucial components of a corporate reputation. Another group of three respondents felt that reputation was merely a byproduct of a social network, and they formed an opinion of a law firm's reputation from conversations with their colleagues.

"The world is very small. Corporate counsels [sic] always discuss the law firms we use. So, a law firm's reputation is tacit knowledge among internal counsel."[120]

One interviewee disagreed with the idea that reputation was a purely social construction. He asserted that reputation emerged from a combination of personal interactions with an organization and public perception:

"A reputation is the public's perception of something. When it comes to law firms, it's a bit more complicated than that. It's our own experiences with a firm coupled with public perception, and we ascertain public perception from the anecdotes of colleagues."[121]

Another banking executive regularly consulted popular magazines and trade publications for its rankings of the top law firms and lawyers:

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[118] Mr. Huggins, Keystone Investors.
[119] Mr. Houk, Hamilton Grey.
[120] Ms. Harris, Columbia Capital.
[121] Mr. McCarthy, Rhine Bank.

"I know those rankings catch a lot of heat for being inaccurate or biased, but they have been a staple in the industry for years. The public pays attention to them, so we must as well."[122]

All of the respondents expected law firms with very high reputations to be more knowledgeable than their less-prestigious peers and to produce positive results for the investment banks.

> Prestigious law firms—those with lofty reputations—should be experts in the law, and they should be responsive to their clients' needs. We expect them to get good results. That means, if it's litigation, we win. If it's registering one of our clients, they didn't get hung up. If it's an acquisition, the acquisition went smoothly.[123]

Seven investment bank executives reported considering a law firm's reputation in their selection decisions. Five of these individuals argued that it was not the most important criterion in choosing an external provider. Despite this fact, a majority of those same respondents (three of the five) characterized their relationships with Magic Circle and White Shoe firms as "very strong." Client expectations was one reason corporate counsel flocked to elite law firms.

> It's the nature of our business. We're a prominent bank, and our clients expect us to use the best resources at our disposal. We have enormous relations with all of the Magic Circle firms, which are viewed as the top firms. Within that group, we pick the top firms based on practice areas. For example, if we need someone for derivatives, we'll go to Allen and Overy or Linklaters, as they are viewed as the best.[124]

Internal counsel were careful to select elite law firms to safeguard themselves in case complications arose.

"No one will ever blame me for hiring Allen and Overy, but if it were a less-prestigious firm, I could face criticism. If something unforeseen occurred, a client could say 'why didn't you hire Allen and Overy?'"[125]

Nippon International and Frankfurt Securities dismissed the role of reputation in the purchasing decisions they each made. Both investment banks stressed that they were after quality service, not a brand name.

"Reputation is an impression, a subjective opinion. It's as fragile as a rose petal in the wind."[126]

Both respondents were also adamant that the best legal service did not come from the elite firms, but from those of slightly lesser prestige.

"Lawyers at Magic Circle firms are comfortable at the top. They're less hungry, less eager to impress clients. The best attorneys are in the Silver Circle, those still out to prove something."[127]

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[122] Mr. McCarthy, Rhine Bank.

[123] Mr. Huggins, Keystone Investors.

[124] Mr. McCarthy, Rhine Bank.

[125] Mr. McGraw, Britannia Bank Corporation.

[126] Mr. Lemon, Nippon International.

[127] Mr. Martin, Frankfurt Securities Investment Bank.

5. Personal Service

The amount of personal service received from law firms was an important factor in the selection decisions of six investment banks—Alpha, Frankfurt Securities, Keystone Investors, Rhine Bank, Hamilton Grey, and Columbia Capital. Corporate counsel at these banks considered which firm attorneys were working on their cases and the strength of their personal relationships with these lawyers. Five investment banks preferred to interact with the same group of lawyers whenever they used a certain law firm.

"The teams of lawyers we retain at Clifford Chance and Linklaters understand the bank and how it operates."[128]

"I would not say that it's an absolute requirement to use the same lawyers. If we can under the circumstances, we would try to use the same people."[129]

All factors being equal, the investment banks would prefer to work with attorneys who were approachable, pleasant, and responsive.

"The bottom line when scrutinizing an attorney is 'can we see ourselves working with this person?'"[130]

However, for certain types of work, such as litigation, some banks would prefer an attorney who was abrasive.

"It really depends on what we need at the time. If we need to be strongly defended in litigation, we will hire an 'attack dog.' It's crucial that we show we're serious."[131]

Rhine Bank also occasionally considered the personality of the attorneys it would be working with depending on the type of service it required:

"If it's routine legal work, I'd go with the nice guy over the bastard; however, if we needed complex work done, you can bet the bank that I'd go with the best person I could find regardless of his personality."[132]

Six out of the nine interview subjects commented that personal service distinguished the top firms from those deemed mediocre. Responsiveness and partner involvement were amongst the explanations.

Responsiveness included mainly accessibility factors—for example, a general counsel's ability to reach an attorney within a firm to ask a question and the length of time it takes for an external attorney to return a call or respond to an email. One interviewee highlighted the importance of partner involvement in client affairs stating:

"I like to know the names of the partners overseeing the attorneys working on my case. They're experienced and have seen it all, so it really only makes sense to deal with a partner. Our business is too important to be used for associate training."[133]

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[128] Mr. Dickey, Alpha.
[129] Mr. Martin, Frankfurt Securities Investment Bank.
[130] Mr. Martin, Frankfurt Securities Investment Bank.
[131] Mr. Huggins, Keystone Investors.
[132] Mr. McCarthy, Rhine Bank.
[133] Mr. Houk, Hamilton Grey.

6. Beauty Parading

Beauty parading is a method by which an organization invites potential external providers to present and interview before company executives. Hamilton Grey, Swiss Financial, Keystone Investors, Columbia Capital, Alpha, and Frankfurt Securities acknowledged that beauty parading was a part of their procurement processes. The investment banks routinely "beauty paraded" between two and four external law firms, questioning each one to determine its expertise in the legal matter at hand, the firm attorneys who would be providing the service, and whether these individuals had any conflicts of interest. My interviews revealed that beauty parading functioned less as selection mechanism and more as an elimination tool. The firms called to beauty parade were all qualified to handle the legal service required by the bank, and the executives called upon to evaluate the firms seemed to be searching for a reason that an individual firm should not be retained.

> By the point of beauty parading, we're fairly convinced that a firm is capable. We're looking to see if we can work with the people at a certain firm. A few years ago, we brought in someone from a White Shoe firm we were quite impressed with. We could not have been in the room with him longer than five minutes before he made a crass joke. My associates were stunned. It was as if the mood of the room had been deflated. Totally unprofessional. Needless to say, we didn't hire them. That particular firm lost $100,000 in business because of that one guy.[134]

The six investment banks were evenly split as to which individuals interviewed the external law firms. Hamilton Grey, Swiss Financial, and Columbia Capital restricted the meetings to corporate counsel and executives of the organizations. In contrast, Keystone Investors, Alpha, and Frankfurt Securities asked their clients to attend. These clients were usually using the investment banks for advice on complex transactions, and the banks were retaining external counsel on behalf of these clients for clarification on legal matters stemming from those transactions. Frankfurt Securities and Alpha, reserving the final selection choices for themselves, invited clients to the interviews simply as a means of keeping them informed.

> If a company had a preference for one firm over another, we would try to accommodate its wishes, but corporate counsel and our board make the final choice. We would never ordinarily solicit a client's opinion about the law firms on beauty parade, and typically, they defer to our professional judgment.[135]

Keystone Investors, on the other hand, had a different philosophy regarding client input:

> We work for our clients. If, after the completion of the interview process, a client preferred a specific firm, we would honor that request. If there were a conflict between the general counsel and a client on the choice of a law firm, we would make our opinion known, and strongly so, but we would still defer to the client's

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[134] Mr. Dickey, Alpha.

[135] Mr. Martin, Frankfurt Securities Investment Bank.

preference.[136]

Frankfurt Securities, Alpha, and Keystone Investors sometimes appended an additional step to the beauty parading process. If the bank had not retained a law firm in a prior instance, it would ask the firm to complete a small amount of legal work that had been previously taken on by another law firm. Or, the new firm might be simultaneously working on the same matter as another firm. Through these piloting methods, the investment banks assessed the quality of the new law firm and determined whether its services would be retained for more substantial matters.

D. Data Assimilation

At the beginning of Section IV, five research questions were constructed to aid with the data collection process. This section will assimilate the gathered data, grounding it in the applicable research theory and establishing a framework for the analysis that follows in Section VI.

1. It's My Prerogative: The Power to Choose External Legal Services

Research by Uzzi et al., File and Prince, Gulati and Gargiulo, and Ellis and Watterson has suggested that in-house legal counsel choose external legal providers with input from their colleagues.[137] The nine interview subjects, for the most part, confirmed previous findings as well as research expectations. In discussing who is empowered to make procurement choices for an investment bank, it is imperative to distinguish between the *de jure* and *de facto* selection processes.

Only one bank explicitly granted general counsel with the authority to retain external legal services. Another, Hamilton Grey, employed no in-house lawyers and relied on a procurement specialist to select law firms. The remaining seven investment banks utilized some form of the panel system. Internal counsel was free to exercise discretion in selecting legal service providers from these lists of favored law firms. In practice, in-house lawyers (or procurement specialists) chose external counsel for all of the banks profiled; however, in principle, the boards of directors made the procurement decisions for three of the investment banks.

2. I See No Changes: Reputation and Client Choice

Reputation, as it relates to the selection choices made by investment banks, is best examined by considering two factors. First, how do investment bankers define the concept of reputation? Second, to what extent do the individuals making a procurement decision allow their perceptions of a firm's reputation to influence their choices?

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[136] Mr. Huggins, Keystone Investors.

[137] *See* Uzzi et al., *supra* note 3; File & Prince, *supra* note 28; Gulati & Gargiulo, *supra* note 59; Ellis & Watterson, *supra* note 82.

Over the years, academic scholars have attempted to explain the components that make up a firm's reputation. Uzzi et al. proposed that organizations with positive reputations charged more for their services and had greater name recognition.[138] They also placed higher in rankings of the top law firms.[139] Deephouse held that expertise, popular esteem, and institutional knowledge were determinants of a good reputation.[140] To varying degrees, the nine respondents verified these past definitions of reputation. All confirmed that knowledge and expertise primarily accounted for a law firm's reputation. Popular esteem, competence, and integrity were also attributed to these organizations.

Clow et al. and Hughes and Kasulis demonstrated that firm reputation was correlated to the purchasing decisions made by consumers.[141] Seven interview subjects acknowledged considering law firm reputation when choosing external counsel, but a majority of these respondents claimed that it was not the most important criterion. The profiled investment banks typically maintained relationships with law firms with high reputations: all utilized the services of White Shoe or Magic Circle firms in the past, and three claimed that they had strong ties to these elite firms.

3. All I Want is a Little Conversation: Social Networks and Buying Decisions

Studies by File and Prince, File et al., and Uzzi et al. concentrated on the role of social networks in procurement choices.[142] These researchers asserted that corporate decision-makers turned to their social networks for recommendations or referrals of external providers. The nine profiled investment banks relied extensively on the suggestions of colleagues, attorneys, and professional organizations for insight on external law firms. All of the interviewees highly regarded the opinions and recommendations of colleagues, especially those of individuals with whom they shared a close relationship.

Ellis and Watterson discussed WOM output referrals, citing expertise and approachability as reasons one firm would recommend an external provider to another organization.[143] However, seven of the profiled investment banks expressed reservations about sharing a negative opinion of a specific law firm with another bank. These results were especially surprising because of the worth these same interview subjects placed in the referrals of others. It seems that within the referral dynamic, the respondents valued a colleague's assessment of an external provider, but they were unwilling to contribute their negative perceptions of a law firm for the benefit of colleagues. Therefore, the extent to which corporate decision-makers should rely upon the referrals of colleagues deserves further scrutiny.

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138 *See* Uzzi et al., *supra* note 3, at 115.

139 *See id.*

140 *See* Deephouse, *supra* note 18.

141 *See* Clow et al., *supra* note 19; Hughes & Kasulis, *supra* note 22.

142 *See* File & Prince, *supra* note 28; File et al., *supra* note 29; Uzzi et al., *supra* note 3.

143 *See* Ellis & Watterson, *supra* note 82.

4. Torn Between Scylla and Charybdis: Lawyers, Law Firms, and Client Loyalty

Individuals empowered to choose external legal services for investment banks were attracted to both law firms and the individual lawyers in their employ. Seven respondents explicitly stated that the individual attorneys working on behalf of their respective bank were more important than the law firms they worked for, while two interview subjects expressed a preference for the law firms.

Despite the fact that a majority of interviewees believed that specific lawyers were more important than specific law firms as criteria for selection, the respondents always discussed their relationship with the firm rather than the individual. Only three investment banks would transfer business to a new firm to continue using a lawyer who was switching employment. The remaining six investment banks either would refuse to follow a departing attorney, or they would follow him to a new firm only under certain circumstances. Thus, while general counsel may believe that the lawyers working on a case are more important than the firm that employs them, investment banks foster relationships with law firms, not attorneys. The data suggest that maintaining strong relations with specific law firms is of more concern to investment banks than the services of any single lawyer.

5. A Question of Choice: Selection, Retention, and Defection

Academic theorists have generally focused their studies of procurement decisions on either the initial choices of external firms or on subsequent selection. This previous research has identified different sets characteristics that decision-makers consider depending on whether a nascent or subsequent choice is being made.

Greenwood et al. discussed the impact of information asymmetry on nascent-selection decisions.[144] He and his colleagues claimed that corporate decision-makers are likely to hold intangible assessment criteria in high regard because they lack tangible evaluative information. Fombrun and Shanley identified firm reputation as a major consideration for individuals selecting external services for the first time, and Uzzi et al. justified their results, asserting that corporate decision-makers could more easily explain a selection choice to superiors if the chosen firm had a positive reputation.[145] WOM referrals from trusted colleagues also factored into corporate selection choices during nascent selection, as did the positive portrayal of a firm through the media.[146]

Academic literature emphasizing subsequent selection was primarily concerned with the factors influencing an organization's continued retention of (or defection from) an external provider. Previous experiences with a firm under-shadowed all of these decisions. Studies by Palmer and Carlton, respectively, explored the qualities of long-term business relationships, and Levinthal and

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[144] *See* Greenwood et al., *supra* note 1.

[145] *See* Fombrun & Shanley, *supra* note 6, at 252; Uzzi et al., *supra* note 3.

[146] *See, e.g.*, File et al., *supra* note 29; Uzzi et al., *supra* note 3; Pollock & Rindova, *supra* note 35.

Fichman proposed mutual trust and inertia as two reasons these relationships exist.[147] Uzzi added embeddedness to this list.[148] Close, time-tested relationships allowed the client to receive more specialized service, as well as price discounts.[149] Interestingly, price and dissatisfaction were the main reasons for a client's defection to a rival firm.[150]

In both nascent and subsequent selection, the nine profiled investment banks cited expertise as the most important criterion in external law firm retention. However, while subsequent selection afforded corporate decision-makers the benefit of past experience to form an opinion about a firm's expertise, internal counsel were forced to rely on more intangible factors during nascent selection. Confirming the results of past studies, the nine investment banks turned to their social networks for recommendations when devoid of personal knowledge about a firm. Cost was a major consideration during both the nascent and subsequent selection processes. When comparing two law firms that were both highly recommended, corporate decision-makers went with the less-expensive alternative. The majority of the profiled investment banks had unique billing arrangements with one or more law firms. Overall, this fact influenced subsequent selection choices. Most of the interview subjects agreed that reputation was one criterion in their decisions, but it was not the most important choice factor. All of the investment banks maintained relations with White Shoe or Magic Circle firms, and the impact of firm reputation on retention decisions is worthy of future study.

VI. REFLECTIONS AND COMMENTS

In seeking to determine the methods investment banks use to retain external legal counsel, this project relied upon original research taking the form of semi-structured interviews. Representatives from nine investment banks in Europe and the United States supplied data, which was then presented in the context of existing academic literature. This section will analyze the gathered data, exploring its relevant trends and noting its broader implications for the legal and banking communities.

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147 *See* PALMER, *supra* note 54; Carlton, *supra* note 55; Levinthal & Fichman, *supra* note 56.

148 *See* Uzzi, *supra* note 60.

149 *See* Uzzi et al., *supra* note 3.

150 *See* Palihawadana & Barnes, *supra* note 7, at 111.

A. Assumptions

Man's attempt to understand the world around him is limited by ontological,[151] epistemological,[152] and methodological[153] assumptions, as well as assumptions related to human nature. Each set of assumptions, in turn, can be divided into two distinct camps according to the subjectivist-objectivist dichotomy.[154] Broadly defined, subjectivism holds that individuals shape the world around them, whereas objectivism charges that individuals are shaped by the world. This article assumes that man is an actor in the world around him, not a constructor of it. Furthermore, all acquired knowledge is assumed to contain a degree of bias.

Assumptions related to human nature are those that concern man's interaction with his environment.[155] For the purposes of this paper, the term "manager" is used to describe a person within an investment bank who is empowered to select external legal counsel. Likewise, "environment" is defined as either the community of investment banks or an individual investment bank.

At both the macro and micro levels, human nature assumptions fall within four distinct viewpoints: system-structural, natural selection, collective action, and strategic choice.[156] The natural selection viewpoint, at a macro level, asserts that

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[151] Finding its roots in the ancient philosophical science of metaphysics, ontology explores the nature of being, and it can be subdivided into nominalism and realism. GIBSON BURRELL & GARETH MORGAN, SOCIOLOGICAL PARADIGMS AND ORGANISATIONAL ANALYSIS: ELEMENTS OF THE SOCIOLOGY OF CORPORATE LIFE (1979) (providing a thorough analysis of sociological paradigms). A nominalist (subjectivist approach) believes that reality is an internal construct of the mind. *Id.* In contrast, a realist (objectivist approach) holds that reality is concrete and tangible, and social structures exist outside of the mind. *Id*.

[152] Epistemology is a branch of philosophy concerned with human knowledge. *Id.* It is subdivided into the positivist (objective) and anti-positivist (subjective) approaches. *Id.* For a positivist, knowledge can only be ascertained through the scientific method; hence, the only real knowledge is scientific in nature. *Id.* An anti-positivist, on the other hand, sees knowledge as a relative concept. BURRELL & MORGAN, *supra* note 151. It is not possible for man to separate himself from the world around him to gain "true" knowledge in a positivist sense. *Id.*

[153] Gareth Morgan & Linda Smircich, *The Case for Qualitative Research*, 5 ACAD. MGMT. REV. 491 (1980) (exploring different areas of the objective-subjective continuum, applying a research design for each theoretical perspective). The authors stressed the advantages of qualitative methods, pointing out that quantitative designs assume that human behavior is standardized, that all people react in the same manner to similar phenomena.

> If one recognizes that the social world constitutes some form of open-ended process, any method that closes the subject of study within the confines of a laboratory, or merely contents itself with the production of narrow empirical snapshots of isolated phenomena at fixed points in time, does not do complete justice to the nature of the subject.

Id. at 498. In sum, as soon as a person acknowledges that human interaction and behavior does not occur in a vacuum, he must discount the superiority of pure quantitative methods. I arrived at this conclusion fairly easily in light of the fact that my personal outlook toward the world is at the center of the objective-subjective continuum. Like Morgan and Smircich, I cannot dismiss quantitative methods as irrelevant; rather, I believe that they can be useful, particularly to a project similar to my own. Nevertheless, due to time constraints, I have been forced to limit my research analysis to qualitative methods.

[154] *See* BURRELL & MORGAN, *supra* note 151.

[155] *See id.*

[156] *See* W. Graham Astley & Andrew H. Van-de-Ven, *Central Perspectives and Debates in*

"the evolution of corporate society and its economic infrastructure is driven by environmental forces."[157] Hence, a manager merely adheres to industry standards when choosing legal services, seldom relying on any personal preference he may have.[158] The collective-action viewpoint is focused on "networks of symbiotically interdependent, yet semiautonomous organizations that interact to construct or modify their collective environment, working rules, and options."[159] A manager, when entrusted with the task of selecting a law firm, would consult with his social network of peers. Perhaps he would consult with colleagues at another investment bank, inquiring which law firms or attorneys they have been most satisfied with. Based on this information, a manager would then make an independent decision of which firm to retain. At the micro level centered on an individual organization, a manager has considerable personal choice to select a law firm according to the strategic choice viewpoint. In essence, this perspective sees reputation as a byproduct of individual managers' choices, not as a determinant of them.[160]

Regarding assumptions of human nature, this article takes the position that both the voluntarist and determinist perspectives have merit in particular situations. For this reason, this article attempts to take an unbiased approach to human nature by examining managerial behavior, determining a manager's degree of autonomy in decision-making counterbalanced by the role of environmental factors on his eventual choice.

B. Trends

1. Risky Business

Corporate counsel in the United Kingdom, Switzerland, and Russia identified "transfer of risk" as a major reason for retaining an outside law firm. In contrast, none of their colleagues in the United States suggested that risk management had anything to do with their choices of attorneys. These results are initially striking—how could it be that in-house lawyers practicing in the litigation

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Organization Theory, 28 ADMIN. SCI. Q. 245, 250 (1983). Of the four views presented, the system-structural view is not applicable to my project because it is focused "not on choice but on gathering correct information about environmental variations and on using technical criteria." *Id.* at 248.

157 *Id.* at 250. This notion can be understood through the concept of industrial structure, the idea that competition within an industry occurs within stable economic parameters. *See, e.g.*, Michael E. Porter, *The Contributions of Industrial Organization to Strategic Management*, 6 ACAD. MGMT. REV. 609, 641 (1981).

158 Economic and transaction cost concerns may also motivate a decision. *See, e.g.*, WILLIAMSON, *supra* note 62. For example, if law firms typically offer discount rates to frequent clients, a manager has an incentive to continuously retain the same firm. Uzzi et al., *supra* note 3. Thus, a desire to maximize profits is at the root of his decision. The natural selection viewpoint is deterministic (objectivist approach) in its outlook-- that is, it assumes that exterior events or conditions force a manager to make a certain choice. BURRELL & MORGAN, *supra* note 151. This idea contrasts with voluntarism (subjectivist approach) which holds that a manager's individual will is the primary factor in his decision. *Id.*

159 Astley & Van-de-Ven, *supra* note 156, at 251.

160 An individual is constrained by neither industry standards nor interdependent relationships. *Id.* Law firms chosen more often by managers (based on individual, personal reasons) would presumably have a better reputation.

capital of the world are less concerned with transaction risks than their European counterparts? Viewing these results through the purview of human nature proves edifying.

In the United States, "conversations between a corporation's employees and in-house counsel are protected by [attorney-client] privilege."[161] Likewise, German lawyers who are advising an employer on a legal matter may refuse to turn over internal conversations as evidence,[162] and practitioners in Japan, by virtue of their duty of confidentiality to clients, may refuse to testify about internal conversations.[163] Though the basis for the United States' attorney-client privilege evolved from British common law, the United Kingdom's continued adherence to the concept is debatable in the context of corporate counsel. A 1982 decision of the European Court of Justice held that attorney-client privilege applies only to communications between an organization and external counsel.[164] Likewise, Swiss and Russian courts do not exclude communications with internal counsel from evidence.[165]

Though correlation does not imply causation, it seems plausible that European internal counsel may be engaging in creative lawyering. Investment banks place a premium on secrecy during early discussions of mergers and leveraged buyouts. In an effort to protect confidential company information, corporate counsel in Europe may mitigate risk by channeling private, internal communications through external law firms, thereby cloaking such communications with attorney-client privilege.

2. Culture Club

Rhine Capital, Swiss Financial, and Britannia Bank Corporation characterized their relationships with Magic Circle and White Shoe firms as "very strong."[166] Business culture in Germany and Switzerland, the homes of Rhine Capital and Swiss Financial, respectively, is noted for the value it places on specialized skills and formal education.[167] Magic Circle and White Shoe attorneys typically are hired from the top law schools.[168] Could it be that German and Swiss PSFs use similar evaluative criteria when selecting external law firms and

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[161] Edna S. Epstein, *The Attorney-Client Privilege and the Work Product Doctrine*, A.B.A. SEC. LITIG. 205 (2007).

[162] *See* Michael Molitoris, *Germany, In-House Counsel and the Attorney-Client Privilege*, LEX MUNDI PUBLICATION 1 (2009).

[163] *See* Alvin Hiromasa Shionzaki, *Japan, In-House Counsel and the Attorney-Client Privilege*, LEX MUNDI PUBLICATION 1 (2009).

[164] *See* AM&S Eur. Ltd. v. Comm'n of the European Cmtys., Case 155/79, 1982 E.C.R. 1575.

[165] *See* Robert Furter & Michael Kramer, *Switzerland, In-House Counsel and the Attorney-Client Privilege*, LEX MUNDI PUBLICATION 134 (2009); Erin E. Arvedlund, *Critics Say a Jailed Yukos Lawyer is a "Hostage*,*"* N.Y. TIMES, Mar. 29, 2005, *available at* http://www.nytimes.com/2005/03/29/business/worldbusiness/29yukos.html.

[166] *See supra* Part V.C.4.

[167] *See* World Business Culture, Doing Business in Switzerland, http://www.worldbusinessculture.com/Business-in-Switzerland.html (last visited Feb. 10, 2011).

[168] DAVID CALLAHAN, THE CHEATING CULTURE: WHY MORE AMERICANS ARE DOING WRONG TO GET AHEAD 213 (Houghton Mifflin Harcourt 2004); Maitland Edey, *Behind the Scenes Tour of Lawyers Who Try*, LIFE, Mar. 9, 1962.

hiring employees? Further emphasizing the importance of reputation in Germany and Switzerland, Rhine Capital and Swiss Financial would only follow an attorney to another firm if the new firm had the same level of prestige.

Britannia Bank Corporation seems to undermine the suggestions of the preceding paragraph. First, Britannia is based in the United Kingdom, where corporate culture dictates a less hierarchical, more collegial relationship among employees and superiors.[169] Mr. McGraw's interview responses suggest that his legal department has its proverbial bases covered.[170] It has a strong relationship with the elite law firms on its panel. Britannia Bank Corporation has cultivated these relationships over a long period of time, and it is generally satisfied with the service provided by the firms on the panel. Hence, Mr. McGraw and his legal department have no reason to look elsewhere. Britannia Bank Corporation, for these reasons, may be a cultural outlier.

Among the other investment banks profiled, those based in the United States seem to be highly influenced by cultural norms. The work environment in the United States' banks is rigidly individualistic.[171] Those employees who are producers are promoted, while the consumers are forced out of the organization. Individual responsibility is evident in the gathered data. Keystone Investors and Hamilton Grey are the only two firms profiled that entrusted their procurement specialists with full autonomy when choosing external counsel. All three U.S. firms valued personal service and relied upon some form of beauty parading during the selection process.[172] For U.S. banks, the message sent to law firms during the panel selection process was "show me the money"—demonstrate to us why we should retain your services.

3. Size Does Matter

The data suggest that an investment bank's size[173] may be predictive of the external law firms it will choose. In terms of selection methods, the three largest firms relied on panels.[174] Larger firms also valued personal service less than banks smaller in size.

In the context of size, the strength of relationship between investment banks and elite law firms warrants further discussion. Rhine Bank, Swiss Financial, and Britannia Bank Corporation, the three largest firms, had very strong relationships with Magic Circle and White Shoe firms. At the other end of the size spectrum, the four smallest investment banks had used elite law firms in the past. Frankfurt Securities and Nippon International, two "midsized" banks, had never used White Shoe or Magic Circle firms. Why would midsized firms avoid the world's elite law firms?

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[169] *See* World Business Culture, Doing Business in Britain, http://www.worldbusinessculture.com/Business-in-Britain.html (last visited Feb. 10, 2011).

[170] *See supra* Part V.

[171] *See* World Business Culture, Doing Business in USA, http://www.worldbusinessculture.com/Business-in-The-USA.html (last visited Feb. 10, 2011).

[172] *See supra* Part V.C.5-6.

[173] Size is measured by the number of employees working at a particular investment bank.

[174] *See supra* Part V.B.

As this article has previously alluded, elite law firms charge more per hour than their less-prestigious counterparts. Similarly, larger investment banks have more influence over the market, and therefore, they tend to generate greater revenue. It might be fair to conclude that larger investment banks have strong relationships with elite law firms because they can afford the legal fees. But how does this conclusion explain the fact that smaller investment banks were more likely to use a White Shoe or Magic Circle firm than midsized firms? In an effort to attract clients higher in profile, perhaps smaller investment banks capitalize on the reputations of older, highly regarded law firms.

C. Broader Implications

1. Investment Banks: Let the Good Times Roll

Investment banks should be poised to take advantage of changes occurring within the legal industry. The Great Recession has resulted in a saturated legal market and an eagerness among elite law firms to compete for business.[175] For internal counsel at the world's top investment banks, declining profits in the legal industry should herald the coming of less expensive legal services, greater discounts, and more flexible billing schemes.

Corporate counsel can benefit from the saturated legal market in three ways. First and most obviously, since the data reveal that top law firms offer discounts and investment banks possess buying power, internal counsel can coerce White Shoe and Magic Circle firms to provide the same service at a lower price. Second, having to overcome greater competition for clients from Magic Circle firms, Silver Circle firms will likely charge even less for legal services. If, as Mr. Lemon and Mr. Martin have asserted, the best lawyers are found in the Silver Circle, investment banks can enjoy a superior work product from those firms, at a significantly discounted rate. Finally, the ever-expanding pool of unemployed lawyers may allow banks to minimize legal costs by hiring more internal lawyers for lower salaries.

2. Law Firms: Let's Face the Music and Dance

As competition for clients intensifies in the legal industry, law firms stand to benefit from closely scrutinizing the gathered data. Getting placed on a panel is crucial for law firms seeking investment banks as clients. Transaction costs like board approval and an orientation period[176] raise high barriers to entry for new firms desiring panel selection. In order to maximize the odds of panel selection, law firms must differentiate themselves from competing firms.

Law firms can distinguish themselves from their competitors by increasing the services they offer to clients, hiring attorneys who are experts in their

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[175] *See* David Segal, *Is Law School a Losing Game?*, N.Y. TIMES, Jan. 28, 2011, *available at* http://www.nytimes.com/2011/01/09/business/09law.html?_r=2&emc=eta1.

[176] In this context, "orientation period" refers to the length of time it takes for a new law firm to acclimatize to a bank's internal procedures and processes.

respective fields of practice, and adding value to their clients' organizations. In essence, investment banks want to have their cake and eat it too—legal departments place a premium on full service law firms, those with both transactional and litigation practice groups. At the same time, internal counsel look upon generalists with disdain and derision. The attorneys working on behalf of the bank must be experts in the matter on which they are counseling.

Law firms can add value to an investment bank by lowering the cost of legal services or by delivering a superior result. While investment banks employing a revenue generation strategy may prefer the traditional billable hour, investment banks focused on cost control may be partial to law firms with flat rate billing. By presenting potential clients with different billing options, law firms give investment banks a degree of control over costs and results, and perhaps more importantly, send the message that they understand the unique needs of a particular investment bank.

Because internal counsel feel more secure working with external lawyers they have previously retained, it is important for panel attorneys to maintain a positive relationship with the general counsel or procurement specialist. Such a strong relationship may not be enough to earn panel selection for a particular law firm, but it may contribute to greater amounts of future work for one panel firm over another. Also, since all respondents emphasized the importance of a WOM referral from a trusted colleague, a lawyer's positive relationship with corporate counsel from one bank could lead to retention of his firm by another bank.

Finally, law firms need to be able to prove product superiority. Two-thirds of the profiled investment banks conducted beauty parades. One-third of the banks provided a newly retained law firm with pilot work. Though traditionally shunned by the legal community, law firm marketing is becoming ever more imperative as the industry rebounds from the Great Recession.

This article has spent considerable time exploring the importance of law firm reputation. Examining the data in the context of present economic events, it seems that the elite law firms of tomorrow will not be those with a sterling history or gold-plated letterhead; instead, tomorrow's most sought after firms will be those with the ability to sell themselves, those that can most succinctly connect the law firm's institutional capital to the client's individualized needs.

VII. CONCLUSION

A. Sources of Error

Data gathering for this article occurred at a tumultuous time in the banking industry. The bursting of the housing bubble in the United States led to high default rates on subprime mortgages and triggered a financial crisis felt by investment banks around the world. Northern Rock, Bear Stearns, Merrill Lynch, and Lehman Brothers required government bailouts, and hundreds of other banks suffered significant losses. For these reasons, arranging interviews with banking officials proved extremely challenging.[177]

I was also forced to conduct most interviews via telephone. Academics have pointed out that "in phone interviews, all sorts of conversational cues are missing, making for difficult interviewing under the best of circumstances."[178] While I recognize the barriers that a telephone can erect in terms of gauging emotion and body language, I do not believe that the telephone interviews I conducted adversely affected my data. My goal during the interview stage was to gather facts, and the questions I asked were neither emotionally stirring nor upsetting to the respondents.

Data analysis also presented some difficulties. All of the obtained results were self-reported. The decision-makers I interviewed could have skewed their answers or withheld useful information. My script of prewritten questions invariably infused personal bias into the results, and my construction of questions, as well as their tone, may have elicited tainted responses. Ultimately, I had to interpret the interview responses by amalgamating the information gathered into a narrative, a single explanation of the results.[179] This process again introduced personal bias into the equation.

B. Suggestions for Further Research

While this article has offered some compelling insight into how investment banks select external legal services, its small sample size necessitates further testing. These results could be used to construct survey questions which could be distributed to a wider sampling of global investment banks. A survey would provide for a quantitative analysis of the results, isolating the extent to which geographical location, bank size, and culture influence the criteria considered by decision-makers, thereby testing the queries raised in Section VI of this article. Three of my interview subjects claimed that firm reputation was merely a byproduct of their social networks. The effect of social networks on the construction of firm reputations should be explored. Finally, more information is necessary on PSF loyalty to attorneys switching from one firm to another.

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[177] Only a small percent of investment banks responded to my request for an interview. Hence, I obtained the best possible sample under the circumstances, but the low response rate made quantitative analysis impossible. Conducting a project of this nature in a nine month timeframe drastically constricted the data-collection process.

[178] RUBIN & RUBIN, *supra* note 86, at 141.

[179] *See id.* at 31.