

Growing Company
6. LEGAL

When's the Right Time to Hire In-House Counsel?



QUICK SUMMARY

Owners of growing businesses often approach the question of whether or not to create a position for a full-time attorney as an “either/or” decision: *Either we have a general counsel on staff or we outsource everything to a law firm.* In fact, companies that have their own general counsel still tend to use outside law firms for specialized work.

That's why you can't just assume that it's time to hire a general counsel when your legal bills are approximately the same as a full-time lawyer's salary. It's really more a question of what kind of legal issues you face and your philosophy about adding an attorney to your senior management team.

Defining the Duties of In-House Counsel

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- Emerging businesses tend to encounter complex or specialized legal issues, such as employment contracts, complex relationships with large enterprises, stock issuance, and other securities issues.
- An in-house attorney's job may include selecting and managing outside vendors, as well as handling issues internally and providing business counsel.
- Many general counsels are part of their company's senior management team, contributing to key business decisions—even when legal issues are not directly involved.
- Based on their personal expertise, general counsels may want to redo legal work put in place before they arrived—such as your IP protection strategy.

Pros and Cons of In-House Counsel

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- In-house counsel—like any senior manager with power and influence—adds value when doing the job well, but can become an obstacle if his or her management style is ineffective or does not fit the culture.
- Your company benefits from an in-house attorney who is tightly aligned with business objectives, but there are risks if he or she is too much of a generalist or a specialist.
- The attorney can be a strong decision maker...or a bottleneck.
- Granting stock incentives gives your general counsel greater ownership of outcomes, but can also cause him or her to lose objectivity.
- There is no question that in-house counsel is subject to potential conflicts of interest. This is normal and simply needs to be managed with transparency and clear ethical guidelines.

Compensation and Alternative Approaches

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- Hiring an experienced attorney is costly; salaries vary with geography and industry.
- Alternative compensation approaches include hiring a junior attorney (with fewer responsibilities) or using equity in addition to a below-market salary for a senior attorney.
- Outsourced general counsel arrangements are also becoming widely available.

Authors: Michael and Ellie Sheldon



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Defining the Duties of In-House Counsel

As a growing business, you've certainly addressed the basic legal requirements: setting up an appropriate business structure; protecting your name, copyrights, trademarks, and other intellectual property (IP); getting the right licenses; and selecting a location where the zoning requirements won't obstruct your business plan.

In addition, you've probably encountered questions or situations where you've sought out advice from a law firm or an individual with special expertise: an IP attorney for advice about patenting a technical innovation; the local law firm that helped you draw up a complicated employment contract when you hired a CFO to spearhead fundraising; and an even bigger law firm that guided you through negotiations to become a supplier for a large corporation.

At some point, every business owner will notice the rising cost and frequency of legal bills and ask, "Couldn't we handle this more cost effectively by having a lawyer on staff?"

The simple answer is "probably not." Experts say that retaining in-house counsel is really a strategic move, designed to up your game in terms of business competitiveness. In fact, companies with in-house counsel typically find that they continue to outsource tactical projects that are outside their attorney's area of expertise. In fact, that's one of the major roles for in-house counsel. And that's why hiring in-house counsel typically increases legal expenses rather than lowering it.

In-house counsel can be essential, however, if you are in active fund-raising mode. Deals involving company stock are always complex. They also involve striking a proper balance between investors and management. Usually, in-house counsel is in the best position to understand the sensitivities and achieve a positive alignment of interests.

Similarly, in-house counsel often plays a role in formulating policies and making business decisions—even those that are not specifically legal in nature. Many business owners like to get the perspective of a smart, disciplined thinker on a wide range of issues including acquisitions, key hiring decisions, and even marketing strategies.

In-house attorneys tend to have a philosophy about the law, compliance, and best practices—particularly within their area of specialization. Inevitably, this leads to projects to upgrade their company's approach. Examples include rewriting articles of incorporation, EEOC compliance policies, NDA forms, and employment contracts. Or, you could find yourself revamping your IP protection measures from top to bottom.



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When lawyers are around, costs cannot go down. While that little ditty provides a practical rule of thumb, you can read a more thoughtful discussion of how to evaluate the costs of in-house counsel at <http://www.asaecenter.org/Resources/ANowDetail.cfm?ItemNumber=44083>. It's written for nonprofits, but these points apply directly to small businesses, too.

Did you know that only 8% of lawyers in the U.S. are employed by businesses? You can find that, and other statistical information about the legal profession, in this section of the American Bar Association's website: http://www.americanbar.org/resources_for_lawyers/profession_statistics.html

If job descriptions of in-house business attorneys are of interest, you can find a selection at <http://www.goinhouse.com>.

And the ABA also has a tool that can help you find legal help in your state: <http://apps.americanbar.org/legalservices/findlegalhelp/home.cfm>.

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Pros and Cons of In-House Counsel

As with any senior position, the individual characteristics of the lawyer you hire are probably more important than the intrinsic strengths or weaknesses of the role itself.

For example, let's start with decision-making. One of the advantages of in-house counsel is that you add a legal dimension to key decisions, which should improve the company's risk management profile. But what if the general counsel proves to be a slow decision-maker, or, to put it less politely, a bottleneck? That's a serious problem. The point is, not all attorneys are decisive. If you've decided you need in-house counsel, then make sure you hire one with a proven track record of timely decisions.

Another typical trade-off relates to the legal background and industry experience of the business attorney. For example, if you own a growing technology company, it may seem obvious to hire an IP attorney with experience in your segment of the industry. Such a person would be tightly aligned with your business and understand the issues from the ground up. However, on the downside, he or she might not have the management skills to deal with outside law firms needed to help with fundraising and securities issues. Or the general business knowledge to negotiate successfully with clients in other industries.

Perhaps most important are the issues that arise when the in-house counsel also has an ownership stake in the company. Granting shares in the company is a normal, accepted practice to provide an extra incentive for employees in key positions to do their best work. However, your advocate could lose objectivity—in the form of lower standards for due diligence—when he or she stands to gain financially from a specific deal. In fairness, this would be true of anyone, in any role, with a stake in the company and responsibility for the decision. But it's particularly true of attorneys who are involved in writing and negotiating the specific terms of deals that may impact them personally.



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A lot of these trade-offs seem a lot less problematic when you focus on business reasons to hire in-house counsel—rather than the limitations of individuals or the role itself.

If you need in-house counsel, then be sure to hire a person with the attributes you need. Most companies hire a generalist who is skillful and experienced in managing outside counsel as needed. If you feel you need a specialist in-house, then be sure to have a plan in place to make sure the other legal issues get addressed properly.

As for decision-making and other personal qualities, just be sure to screen your candidates carefully. Keep in mind the statistic that only 8% of all lawyers are in-house business attorneys. That's a small subset and it's useful to understand what motivates them as a group. When you search the Internet for "Pros and cons of in-house counsel," you will find that many of the articles are written by lawyers advising colleagues about the trade-offs between working inside, or for a law firm. You may want to read a few of these to learn about the trade-offs from the lawyers' perspective. For example, "quality of life" or "work-life balance" is an important issue for attorneys who are attracted to the in-house counsel position. There's a perception, which is certainly not true in all cases, that law firms pay better but require much longer hours. Fair enough. But it's a red flag that tells you to probe candidates about their expectations regarding the length of the work week.

Similarly, with decision-making. Does he or she expect to have board-level authority on every strategic decision? If so, does that expectation match your team's needs? And, while it's important to put processes in place that manage the company's legal risks, will they be so comprehensive or intrusive as to stifle productivity or interfere with the sales process?

As for potential conflicts of interest, these exist in virtually every area of public life today, and especially wherever law and business come together. The legal profession makes an effort to police itself, and you can get a sense of this on the website of the Association of Corporate Counsel www.acc.com. As with the other topics, if you need in-house counsel, then hire the best one you can find—and continue to perform due diligence on a regular basis.

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Compensation and Alternative Approaches

In the first two topics, the “in-house counsel” role we’ve been discussing has been a senior position that’s basically a “General Counsel” or something similar. That would be a normal migration path for a company that had been using a law firm (or firms) to provide a variety of services. In many cases, a growing company’s need to raise capital by issuing securities is the catalyst that sparks the transition. .

But what if your company would like the benefits of in-house counsel, but can’t afford a General Counsel’s salary, which may be in the neighborhood of \$250,000 per year? Experts say there are several good alternatives.

First, if you really need an experienced general counsel, you can try to negotiate an alternative compensation plan that’s heavy on company stock and relatively light on salary. In effect, you are deferring compensation and, if your business is successful, the package could be far more rewarding for the attorney than the salary would have been. Here, you’ve got to be careful not to overpay. And definitely use a vesting schedule for any stock grants—otherwise future potential investors might view this one-sided commitment as a negative.

The second alternative allows you to cut costs by hiring a junior-level attorney. This person’s primary responsibility would be managing relationships with outside law firms. You’d get the insider’s perspective and commitment, with outside counsel providing the expertise. But you wouldn’t benefit from the judgment of a senior person on strategic business decisions.

The third option, known as “outsourced general counsel,” provides a middle path. Basically, you contract with a law firm that offers flexible arrangements depending on your needs. For example, they might provide access to a lawyer any time you need one, by the day, by the week, or at specific times that you designate in advance—such as for quarterly board meetings or other scheduled events.



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What is the actual cost of hiring an in-house attorney? Specific salary information is hard to find. This site provides a survey of law school graduates’ starting salaries: http://www.nalp.org/starting_salaries_class_of_2012. But remember, they go up from there. The ABA Journal published an overview based on data from the Bureau of Labor Statistics. http://www.abajournal.com/magazine/article/what_americas_lawyers_earn/. While these data include salaries for lawyers at all experience levels, there is no break-out for corporate attorneys as opposed to those working at law firms. However, you can see average salary differences geographically.

It’s interesting to look at the specific services offered by firms that are innovating the “outsourced General Counsel” model. Here’s a link to one such site, chosen at random. <http://flexbyfenwick.com/clients/>

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