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Changing Role of General Counsel in Germany

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FOREWORD

It is a fact that in the last couple of years the role of legal departments in Germany - and, consequently, the role of General Counsel - has changed significantly. To the better, by the way.

In the aftermath of the financial crisis back in 2007/2008 a lot of German companies have redefined the strategic position of their in-house legal departments. A few years later one can clearly see how this has influenced the balance of power in the German legal market. Today, more than ever, legal departments and General Counsel in particular play a decisive role within the legal market. For instance it is entirely up to them to mandate external law firms (and therefore organize the amount of legal spend of the company), to decide which tools are to be implemented in order to make use of legal technology and, above all, to avoid any legal and compliance risk for the company.

In addition to this, legal departments are no longer to be seen as an inevitable cost center within the company. Expectations have risen. Today legal departments have to act as business units, which should be better prepared to support the overall success of the company. It is fair to say that General Counsel are the masterminds who are in charge to lead and manage this change process internally and externally.

Against this background it is of tremendous importance that Professor Mari Sako has conducted her study into this probably most relevant part of the legal market. Be aware: This is where the legal heart beats right now.

Mari Sako's first-class findings after in-depth and high-level interviews with leading German In-house lawyers are extremely helpful and up-to-date in order to understand the driving forces behind the constant and ongoing change.

Of course, this study is not only excellently written. Above all, it offers a pure wealth of new thoughts and insights for practitioners in legal departments and law firms in this country.

Therefore, I strongly recommend Mari Sako's study on the changing role of General Counsel as a definite must-read for anyone who would like to understand the dynamics within the German legal market.

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Executive Summary of Key Findings

Size and shape of corporate legal departments

- **In-house legal department structure reflects the corporate structure.** Typical organizing principles are by legal specialisms, business lines, and geographies. A tension exists for the legal function between becoming too close to business and becoming isolated in a functional silo.
- **Company-wide corporate restructuring is an occasion to restructure the legal department.** Compliance challenges and efficiency drives have led to centralizing the legal function at the corporate headquarter, leading to better risk control and legal resource use.
- **Most, but not all, companies face the ‘more for less’ challenge in delivering legal services.** Except at young companies experiencing rapid growth, German companies face the ‘more for less’ challenge of increased workload without an equivalent growth in legal resources. They are meeting this challenge by seeing efficiency gains via standardization, and by shifting low-risk non-strategic work to other departments.
- **In-house legal departments prefer to insource as much as possible.** Many respondents expressed a preference for doing as much legal work as possible in-house, in order to better control legal spending and risks.

Relationships with legal service providers

- **Panels of law firms have been established at German and multinational corporations,** to systematize relationships with law firms, and to achieve an optimal balance between competition and collaboration.
- **Alternative billing arrangements are becoming prevalent in Germany.** Respondents noted a wind of change in Germany recently with greater cost sensitivity, leading to harder discount negotiations and the use of alternative billing arrangements. Alternative billing arrangements included the use of fixed fees, capped fees, contingent fees, and retainer fee payment.
- **Corporate legal departments are also accessing newer types of legal service providers including boutique law firms in Germany.** Boutiques are preferred for better focus, greater flexibility, and lower fees.

Lawyers in top management teams

- **In-house lawyers generally play three distinctive roles: service support, risk control, and business partnering.** Balancing these roles is considered essential in ensuring that the company’s executives regard the legal function in good light.
- **In Germany, the most important trigger for enhancing the power of in-house lawyers lies in companies’ need to pay greater attention to risk control in the 2010s.** Consequently, the legal function, alongside the compliance function, has become more visible in corporate organizations.
- **A variety of expectations persist in relation to the other two roles of service support and business partnering.** Some German companies have appointed a chief operating officer for the legal department to promote efficiency in service support, but others have not. Some German companies have a CEO and top managers who expect the general counsel to be business partners, while others do not.

Chapter 1: Introduction

Globalization and digital technology present significant opportunities and challenges for lawyers around the world. In this broad context, in-house lawyers are tasked to balance their three roles: providing service support to their internal clients; controlling company-wide risks; and acting as business partners. The *service support* role is about facilitating business transactions, for instance by drafting contracts and advising on country-specific laws and regulations. *Risk control* has both upside (i.e. risk-taking) and downside (i.e. risk avoidance), but the latter tends to be emphasized. *Business partnering* is for senior in-house lawyers who do not just advise, but participate in the company's strategic decisions. While all three roles are important, their relative importance changes over time. This study sheds light on how and why the mix of in-house lawyer roles has changed in Germany.

This study is a sequel to an earlier study, *General Counsel with Power? (2011)*¹, with evidence from the United Kingdom and the United States. Its aim was to capture a variety of existing practices and thinking, rather than just identifying what is typical or representative in Germany. Interviews were conducted with leading in-house lawyers at 33 companies in Germany during November 2016 – March 2018. The interviews, each lasting one hour, explored three key areas: (a) the size and shape of the in-house legal department, (b) the changing nature of relationships with law firms, (c) the role of general counsel in relation to the corporate top management team. We targeted companies across different sectors, varied nationalities of ownership (21 were German-owned, 12 were German subsidiaries of multinational corporations), and sizes (5 were DAX30 companies, while others were mid-sized, including family-owned and start-up firms). I would like to thank all those who participated in this study, who gave generously of their time in answering my, at times probing, questions.

Given that our sample includes not only German companies with global presence, but also German subsidiaries of multinational companies which hail from several different countries ((Finland, France, Japan, South Korea, Spain, Switzerland, and USA), this study identifies trends and issues which are hopefully of interest to in-house lawyers outside Germany, in different parts of the world.

The report is structured as follows. Chapter 2 analyzes the size and shape of legal departments in recent years. Chapter 3 examines the changing nature of relationship between in-house departments and law firms. Chapter 4 discusses general counsel's role in relation to the corporate executive team. We conclude by raising key issues for further consideration.

¹ M. Sako (2011) *General Counsel with Power?* http://eureka.sbs.ox.ac.uk/4560/1/General_Counsel_with_Power.pdf

² M. Sako (2011) *General Counsel with Power?* http://eureka.sbs.ox.ac.uk/4560/1/General_Counsel_with_Power.pdf

³ Gilson RJ, Mnookin RH. 1995. Symposium on business lawyers and value creation for clients. *Oregon Law Review* 75(1).

⁴ Kurer P. 2015. *Legal and Compliance Risk*. Oxford University Press: Oxford.

Chapter 2: Size and Shape of Corporate Legal Departments

The size and shape of legal departments are changing in major business corporations in Germany as elsewhere. The timing for restructuring legal departments has been dictated by company-wide corporate restructuring in some cases. Triggers for restructuring have been attributed to a realization of growing risk, due in some cases to compliance breaches. Other triggers to create an effective modern legal function are associated with the arrival of a new CEO and/or a new board member. In executing changes, in-house lawyers face competing logics (or organizing principles) when they consider (a) the way the legal function reflects corporate structure, (b) the nature of legal budget control, and (c) the optimization of legal resources internally and externally.

Shape of Legal Departments

The internal legal department mirrors corporate structure. At its simplest, a single product firm operating only in Germany requires a small legal department at its headquarter. The structure inevitably becomes more complex with multiple business lines and/or international operations. With complexity comes a certain degree of freedom to choose among alternative structures for the in-house legal function.

There is clearly a trade-off in this choice. The advantage of a centralized legal function is that the general counsel is in full control of overseeing all in-house lawyers. However, in-house lawyers may not be able to give the best advice if they are remote from the business units they service. By contrast, the advantage of a decentralized legal function that is embedded in business units or country operations is that in-house lawyers acquire an intimate knowledge of the business they support. However, this devolved structure hinders the sharing of best practice and the optimal allocation of legal resources across business units.

Over time, corporate growth in Germany has led to the decentralization of the legal function. In particular, a corporation with a focused product or service line may expand internationally, creating a legal department in each country-based or regional operation. In such a structure, only the headquarter-based lawyers have a solid reporting line to the group general counsel; country-based lawyers have a solid reporting line to the country general manager and only a dotted line to the group general counsel. When companies also diversify their product or service lines, they create business divisions and subsidiaries each with its own legal department. Thus, it is easy to see how growth biases the legal function to become decentralized.

Restructuring Legal Departments

It is against this backdrop that some German corporations have effected a major restructuring of their legal function. Structurally, in-house legal departments must take account of three organizing principles, first according to legal specialism (such as litigation, employment, corporate transactions, etc.), second according to business lines, and third according to geographies. A predominant feature of recent legal function restructuring in Germany is towards centralization, and towards privileging legal specialism over the other two organizing principles. For example, at a number of companies in this study, whereas in the past a few hundred subsidiaries had their own legal departments with legal heads reporting to the subsidiary CEO, now all in-house lawyers in the corporate group report directly to the group general counsel. More likely than not, such legal function restructuring was part and parcel of a corporation-wide restructuring to consolidate core functions at the group level.

The benefits of centralizing the legal function are clear. First, the legal function becomes better at risk control, as it now has central oversight of what is going on in different business lines and geographies. Second, the centralized structure enables greater sharing of legal resources, including learning from each other about best practice by building 'centres of expertise' or 'centres of excellence', thus preventing legal departments at business units from *'re-inventing the wheel'*, as one GC put it. Nevertheless, changing reporting lines in a matrix structure (legal function, product, and geography) is one thing. Changing mindsets and habits is another. The tension between being too close to business (which comes with focusing on the service support function) and becoming isolated in a functional silo (which may be the danger with focusing too much on the risk control function) would not go away. General Counsel interviewed are fully aware of the need to achieve a good balance between service support and risk control, by devising not just an appropriate reporting structure but also appropriate processes and informal coordination. Implementation of legal function restructuring, therefore, takes some time to complete, requiring personnel turnover in some cases.

The structure of the legal function gives some, but not full, insight into how the general counsel controls the legal budget. There is much variation in how much information the central legal function holds about the legal spending of business units and subsidiaries. Some multi-divisional firms hold information about legal spending of all divisions and subsidiaries centrally; others admit to not having a fully functioning central record of the total corporate legal spending. Moreover, although keeping a tightly controlled central legal budget might look simpler, some group-level general counsel thought that devolving legal budgets to business units might give better incentives and lead to greater accountability.

Multinationals' Perspectives on Legal Department Structure

By focusing on the German subsidiaries of multinational corporations, this study obtained a unique insight into the importance of the geographic dimension of the legal function structure. After all, laws are local, applied within a geographic jurisdiction. For multinational corporations, the German subsidiary is typically part of the EMEA region. The reporting line for the German Head of Legal may be

to the CEO of the German subsidiary, or it may be to the EMEA Head of Legal, who in turn reports to the General Counsel at the headquarter location.

Multinationals strike a different balance in how much the regional organizing principle is privileged over the business line organizing principle. In some cases, the Germany subsidiary has a team of German lawyers dedicated to being generalists with country knowledge. Their role is to be *'the eyes and ears for external stakeholders, including politicians'*, as one GC stated, i.e. to earn trust of the general public and the politicians, for example over social concerns about privacy or cloud computing. And the German Head of Legal is fully part of the local management team. Thus, of the two hats that he or she could wear, the local cross-functional hat is more important than the hat of being part of the global legal team. According to one in-house lawyer: *'We see a lot of stuff happening which is not legal-related... so we're involved very closely with the business decision takers.'*

In other cases, multinationals have restructured to centralize the legal function, and to give business lines greater responsibility for profit and loss. In these situations, regional and country Heads of Legal face high demand on their time, as they not only give attention to country- or region-based legal affairs, but also join executive management teams for product lines. One regional GC used to attend one cross-functional management leadership team meeting for the EMBA region. After restructuring, she also attends two further gatherings of the product business line leadership team and the legal leadership team. Greater coordination and communication cannot be harmful, but they come at the expense of time. Moreover, paying equal attention to multiple organizing principles might lead to potentially losing sight of the coherence of the multinationals' local presence. As one GC puts it, *'it's very challenging because from a legal perspective, the law is local, and by separating the business into different units and management teams, you sort of lose the full picture of what is going on in a legal entity in Germany'*.

At one multinational company, restructuring was driven by the need for localization and local accountability. This has meant an enhanced presence in Germany, with implications for the legal function. In the past, Germany-based in-house lawyers had two equally important reporting lines, one to the business unit head and the other to the country-based legal head; now, the former is only a dotted line. National differences continue to matter, and country presence requires a country focus in legal service delivery.

The 'More for Less' Challenge

In our sample, the absolute size of the legal department varies enormously, ranging from a small department of eight in-house lawyers to a globally distributed legal function with around 800 in-house lawyers (see Table 1). This variation is not fully explained by differences in firm size, reflecting different company growth trajectories and management policies concerning the insourcing – outsourcing balance.

With respect to growth trajectories, relatively young companies were expanding their business rapidly, entering new geographic markets and diversifying into new areas of business. The implications of such exponential growth on the legal function are that: first, the general counsel interviewed for this study

was the first to be hired in-house to create a legal department from scratch; and second, specific efforts were made to build a legal function by increasing the in-house lawyer headcount. The so-called ‘more for less’ challenge is therefore not a concern for some young high growth companies.

By contrast, in many larger established corporations, German or multinational, the general counsel interviewed were of the opinion that whilst in-house lawyer headcount was growing, it was not keeping pace with the growth in legal demand from internal clients. Legal work has been rising in volume in specific areas, notably (a) competition law and anti-trust, (b) regulatory work, (c) compliance work particularly at companies that recently faced government investigations about compliance breaches, (d) acquisitions, some involving access to new technologies such as cloud computing and artificial intelligence, (e) data protection, and (f) privacy. Some lawyers interviewed considered this increase in legal work to be of their own making, due to the desire to have closer interaction with business: *‘We’re in the kitchen, in an attempt to demonstrate that lawyers add value’*, according to one GC. Something similar was happening at another company that restructured to become close to customers; for example, lawyers are now present in client meetings for public procurement.

In response, legal departments have looked for the types of work that the legal function can get rid of because they are low risk or not strategic. Shifting the task of reviewing licensing agreements and marketing materials to the marketing department is one example. In other cases, contracts, such as non-disclosure agreements, may be standardized so that instead of negotiating, the company may offer only certain kinds of contracts and digitize the signature and approvals process.

Table 1: Size of in-house legal departments in 2017/8

Sector	Number of companies in sample	Number of in-house lawyers (range)
Automotive	2	100-350
Electrical & electronic	7	11-800
ICT	6	6-30
Manufacturing (diversified)	4	8-10
Logistics & transport	3	n.a.
Healthcare	3	10-20
Financial services	5	15-55
Other sectors*	3	12-85
TOTAL	33	8 - 800

Source: Author’s interviews. * This category includes a collection of companies, so as not to identify individual companies; n.a. = not available.

Thus, the so-called ‘more for less’ challenge – i.e. legal resources not keeping pace with increased workload -- was felt by some legal departments but not all (notably start-up and young firms). Even among mature corporations, responses to the challenge differ. For example, the lawyer headcount was cut by 20% at one major German corporation that implemented legal function restructuring. At another

corporation, boosting the legal headcount substantially was considered essential to demonstrate its commitment to preventing compliance breaches in the future.

Preference for Insourcing

This study explored with respondents how best to quantify the degree of reliance on insourcing versus outsourcing in legal resources. But cross-company comparisons are difficult. First, a standard way of accounting for in-house legal costs is absent. Second, unanticipated litigation and M&A costs create spikes in actual legal spending from year to year. The interviews, however, identified one trend, which is a preference for doing as much legal work as possible in-house. In reality, this preference applies to familiar jurisdictions for which in-house legal resources already exist; in jurisdictions new to the corporation, it has no choice but to rely on external counsel.

This preference for insourcing legal work in Germany is due to a mix of reasons, including growing attention to legal budget control and better risk management, and in-house lawyers' greater knowledge about the company compared to external lawyers. Within Germany, as elsewhere, preferences vary according to the philosophy of executive managers and the legacy of the company. For example, at one young company, the GC considered the company at the extreme end of preferring insourcing compared to its peer companies of similar size and youth, and attributed this practice to the company's philosophy.

Tight cost control is associated with insourcing, with external resources used only if absolutely necessary. The main occasion for enforcing this insourcing policy is the legal function restructuring discussed earlier. Greater central oversight is intended to prevent local business unit managers from paying legal fees for external lawyers who were consulted informally, for example over playing golf. This amounts to having a central approval system for legal spending, so that in-house lawyers must think twice about the necessity of putting work out to external lawyers. The resulting practice of considering the use of in-house resources first before going out-of-house has the dual benefit of cost efficiency and risk control.

Summary

The 2008 financial crisis was a major event for US and UK companies when an earlier study *General Counsel with Power?*² was conducted. Back then, soaring billable hours charged by law firms led major corporations to insource as a key response to cutting legal spending. Ten years later in the late 2010s, major German companies also prefer insourcing but for a different reason, namely greater transparency and risk control. A policy to insource as much as possible gives in-house lawyers not just greater legal budget control but also better risk control, and the general counsel values this centralized oversight at the headquarter. However, no company does 100 per cent of its legal work in-house. For reasons of capability (expertise) and capacity (resources), companies rely to a varying extent on external lawyers. We turn, in the next chapter, to the nature of relationships between the corporate legal department and law firms, and how it has been changing.

² M. Sako (2011) *General Counsel with Power?* http://eureka.sbs.ox.ac.uk/4560/1/General_Counsel_with_Power.pdf

Chapter 3: Relationships with Law Firms and Other Providers

A preference for insourcing legal services in Germany, as discussed in the previous chapter, is driven just as much by the need for greater transparency and internal risk control, as by the desire to avoid expensive external lawyers. German companies with international presence and German subsidiaries of multinational corporations rely on external lawyers around the world. So this study attempted to capture recent trends in relationships corporate clients develop with their law firms globally and specifically within Germany. We focus on three areas: the development of panels; alternative billing arrangements, and the emergence of boutique law firms and alternative legal service providers.

Corporate legal departments make use of law firms in order to access *expertise* that is not available in-house and when there is not enough *capacity* in-house. A third reason for using law firms, mentioned by a handful of respondents, is to seek *external validation* on specific matters for additional protection, or to seek a second opinion on a legal question when *'we know the law but the law is unclear'*. Against this backdrop of generic reasons, the in-house lawyers interviewed for this study were in the midst of systematizing, or had only recently systematized, the management of external lawyers. The key aim is to achieve better visibility of external legal spending and better quality of legal services offered by external lawyers. The practice of business units going out to contact their external lawyers without central clearance is being stamped out, and is quickly becoming a thing of the past.

Panels of Law Firms

A prominent feature of the systematization of law firm management is the establishment of panels. To the question 'does your company have a panel?' nearly all respondents said yes, while a few said they did not have panels but had preferred law firms or strategic partners instead. In Germany as elsewhere, in-house lawyers see a clear advantage in retaining law firms that *'know our business'* and *'get to know us better'* over the long term.

A panel is a stable group of preferred regular suppliers of legal services, which has:

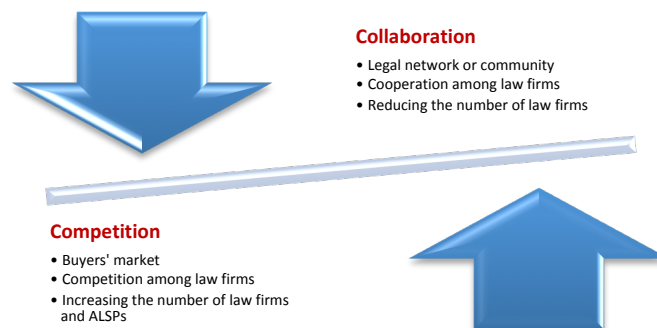
- (a) a rigorous process of selection onto the panel with specific criteria such as expertise and market reputation; and
- (b) a periodic review of panel members using multiple criteria such as the quality of service provided, responsiveness to requests, respect for deadlines, and cost transparency, leading to some turnover in the membership of the panel.

There are, however, significant differences among companies in the structure of panels. In particular, major German companies with international presence started establishing, or are thinking of

establishing, a panel to cover the German jurisdiction only. Other mid-sized and smaller German companies have long-term relationships with preferred law firms in specific areas (such as M&A, litigation and arbitration) and see no need for panels for now. By contrast, multinational companies had multi-tier panels, i.e. panels at the global, European, and German levels. Multinationals with a global panel specified as few as three, and as many as ten, global law firms that they use worldwide, typically in charge of litigation and cross-border corporate transactions. European-level panels make sense to deal with matters concerning EU regulation, while panels for Germany have German law firms to deal with local matters such as in employment law, privacy, and compliance. Thus, there is a hierarchy of global to local legal matters for which panels are formed at corresponding levels.

The key benefits of having panels actually derive from balancing collaboration and competition (see Figure 1). As a starting point, the practice of law is based on building and maintaining relationships. Personal rapport remains highly significant particularly for high-end bespoke work in litigation or corporate transactions. Some in-house lawyers interviewed stated, not surprisingly, that instructing a specific lawyer was more important than, or just as important as, retaining specific law firms. However, except in narrowly defined strategic areas, the panel institutionalizes corporate relationships with law firms. By reducing the number of law firms in the panel, each law firm is in regular contact with the corporate client, and develops a deep understanding of the client's business, products, and management. At the same time, the panel enables the corporation to drive a hard bargain, to negotiate lower fees in return for economies of scale, by bundling the company's legal demand across different business units.

Figure 1: Balancing Competition and Collaboration among Law Firms



Balancing competitive forces and collaborative commitment to source legal services also requires scanning the market to ensure access to legal expertise that is required only once in a while. To satisfy such need, in at least one case, the company makes explicit three types of relationships, an active regular relationship, an inactive relationship which becomes active on a if and when necessary basis, and a dormant relationship which is unlikely to be activated. In other cases, competitive forces are

sometimes provided by resorting to so-called 'boutique law firms' and in a minority of cases by searching for alternative legal service providers (ALSPs).

Billing Arrangements

Billable hour – charging for legal service by the time spent by lawyers – remains the norm and the benchmark for external lawyers in Germany as elsewhere. But the interview respondents for this study noted a recent wind of change in Germany with greater cost sensitivity, leading to harder discount negotiations and the use of alternative billing arrangements. Large German and multinational corporations are able to negotiate harder, even with international law firms, by specifying the scope of work more clearly, setting milestones for large projects, and demanding greater transparency from law firms about leverage (i.e. the use of associates versus partners) in specific projects.

Moreover, when asked about alternative billing arrangements, many respondents were quite vocal about the use of fixed fees, capped fees, contingent payment with fees determined by the value of claims, and retainer payment if specific legal work is anticipated to last a long time. Secondment – i.e. law firms sending their lawyers to client corporations – was also considered by some to be part of obtaining better rates. As compared to large corporations that can exercise bargaining power vis-à-vis international law firms, mid-sized and small corporations sought alternative billing arrangements and lower fees from boutique law firms. In most cases, corporations therefore combined the use of billable hour and alternative billing arrangements, except in a few cases where the respondents stated that they *'try to avoid billable hours'* as much as possible. Another GC made a stronger assertion that *'I don't believe in hourly rates...fixed fee is the norm now'*, noting how fees quoted by law firms differ widely when they respond to a request for proposal (RFP) for the same project.

Different Types of Legal Service Providers

Several interview respondents mentioned the rise of boutique law firms in Germany. They are typically specialized law firms set up by younger lawyers who used to work for international law firms. International law firms are full-service, but their fee structure is considered inflexible and too high; interview respondents were critical of their practice of sending a partner to discuss a matter and making associates to do the work. By contrast, at boutique law firms, the fee is lower and the service is better as they focus on a narrow practice area, e.g. employment law. International law firms may treat employment law as of secondary importance to litigation or corporate transactions. Over time, with accumulated experience of multiple clients in that focused practice area, boutique law firms enhance their expertise and competence due to greater exposure, for instance, to employment litigation and works council negotiations. Boutique law firms also exist in other areas including anti-trust, licensing, real estate, and public tendering, bringing valued inputs, according to quite a few in-house lawyers interviewed for this study.

This study did not ask systematically about the use of new technology and alternative legal service providers (ALSPs). Nevertheless, in the course of the interviews, some respondents mentioned initiatives to make a step change in legal department efficiency by investing in an e-billing system to standardize processes; a corporate-wide decision to use ALSPs to draft NDA and other agreements; and corporate involvement to sponsor legal tech start-ups based in a major German city with a view to using their technology in future.

Summary

Without speaking directly with law firms involved, this study cannot claim full coverage and total objectivity in the account above. Nevertheless, this study has captured the perspectives of in-house lawyers in Germany. And there is a strong current toward systematizing corporate relationships with law firms, first by establishing panels with formal law firm performance reviews, second by insisting on greater cost transparency from law firms by practising alternative billing arrangements, and third by accessing newer providers of legal services including boutique law firms and alternative legal service providers. Boutiques are preferred for better focus, greater flexibility, and lower fees. Consequently, in-house lawyers in Germany are in a situation to better control the procurement process, by balancing collaboration and competition.

The next chapter addresses how in-house lawyers generally, and the general counsel in particular, relate to the company's top management team.

Chapter 5: Lawyers in Top Management Teams

In-house lawyers wear multiple hats in their day-to-day work. This chapter analyzes how and why the mix of hats in-house lawyers are expected to wear has changed in the recent past, and draws implications for their role in relation to the company's top management team. First, we spell out each of the multiple roles for in-house lawyers led by the general counsel. Second, we garner from the interviews a variety of things that the company's top managers in Germany expect of its legal function. Top managers generally expect the general counsel to boost the risk control role, but their expectations on business partnering vary from company to company. Third, we examine the two-tier boards at DAX30 companies in order to note some shifts in the way legal knowledge is represented at the board level.

What do In-house Lawyers do?

In-house lawyers provide service support to their internal clients; they are also expected to lead in company-wide risk control; last and not least, they act as business partners who advise and steer business decisions. All three roles are important across different companies and sectors.

The *service support* role applies to all in-house lawyers, and is about facilitating business transactions, for instance by drafting contracts and agreements, structuring M&A deals, and advising on country-specific laws and regulations. Legal scholars have referred to a business lawyer as a 'transaction cost engineer',³ noting first and foremost this service support role.

The *risk control* function of in-house lawyers is potentially extensive. Although risk has both upside (risk-taking) and downside (i.e. risk avoidance), risk control has emphasized the latter, as is evident from the definition of legal risk as 'the risk that a business faces in connection with a negative legal event such as sitting on an unenforceable contract or collateral, paying damages to a third party, ... or indictment of the company or its executives'.⁴ Many legal departments have responsibilities, and work with other departments, to ensure legal compliance with respect to anti-trust, anti-corruption, data protection, export control, and technical compliance. Moreover, today, risk is not just financial or legal, but also a matter of corporate reputation.

The *business partnering* role applies to the general counsel and lawyer-directors on corporate boards. As the term 'partnering' implies, these in-house lawyers at the top do not just advise, but participate in decisions about the strategic direction of the company.⁵ In this role, the general counsel and lawyer-

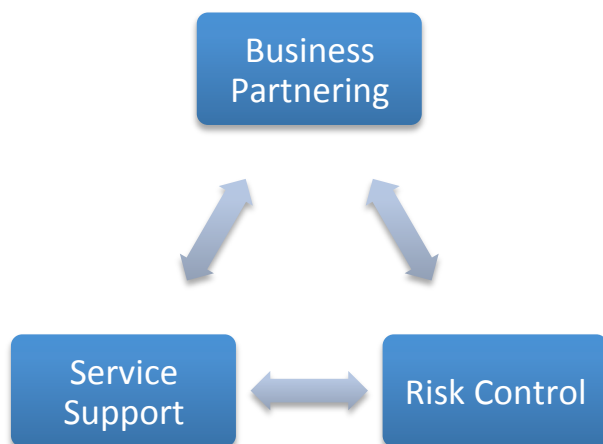
³ Gilson RJ, Mnookin RH. 1995. Symposium on business lawyers and value creation for clients. *Oregon Law Review* 75(1).

⁴ Kurer P. 2015. *Legal and Compliance Risk*. Oxford University Press: Oxford.

⁵ Veasey EN, Guglielmo CTD. 2012. *Indispensable Counsel: The Chief Legal Officer in the New Reality*. Oxford University Press: New York.

directors must navigate a fine line between being lawyers first and foremost with professional ethics as guide for their conduct on the one hand, and being business managers endorsing and pursuing business opportunities on the other.

Figure 2: Three Roles Played by In-house Lawyers



In the United States and Britain, the power base of in-house lawyers has become more extensive relative to external lawyers, slowly since the 1970s and more surely since the 2008 financial crisis. Cost pressures led some companies to appoint a chief operating officer (COO) for the legal department in charge of more efficient and effective service support delivery. This has facilitated the rise of business partnering for general counsel, some of whom carry the managerial titles of Executive Vice President or Senior Vice President. Corporate executives at legally astute firms look to the general counsel as joint risk managers.⁶ Not only does the general counsel front-load legal inputs to pre-empt disputes, thus reducing litigation costs significantly. They also alert CEOs to potential risks arising from likely government investigations in a tougher regulatory environment. Moreover, CEOs look to the general counsel to endorse upside risk-taking when they make decisions about new market entry or large M&A deals. The general counsel's intimate knowledge of the business is indispensable, and they consider this an advantage in offering better legal advice. In the words of one US general counsel, *'I'm a business person who happens to be a lawyer, a business partner who brings legal background to business problems.'* Thus, the power of general counsel in the United States and Britain rose as a result of higher expectations put upon the GC to become business partners.

There are similarities but also significant differences in Germany. Put simply, the 2010s created a climate for greater emphasis on risk control, but business partnering remains a somewhat less pressing issue in some German companies.

⁶ Bagley, C. E. 2008. Winning legally: the value of legal astuteness. *Academy of Management Review*, 33(2): 378-390.

Trend to Strengthen Risk Control in German Companies

In the specific context of German companies, gentle transformation appears to be happening in some quarters. Across the companies interviewed for this study, the most prominent general trend is an increase in the risk control function of in-house lawyers. At the same time, wide variation persists in terms of the extent and style of business partnering by in-house lawyers in different companies.

As is well known, the 2010s saw some German companies suffer major compliance challenges, including government investigations over anti-trust violations, bribery, and the emissions scandal. These compliance challenges have led them to re-examine internal control systems with a view to implementing a zero tolerance policy against illegal activities. As a result of such policy, the risk control function of in-house lawyers received greater attention. Moreover, even for privately held companies in Germany, media attention (or 'mediatization' as one GC put it) on corporate scandals raises concerns over damage to corporate reputation. Thus, the respondents for this study were clear about the heightened importance of the legal and compliance function. There is, however, no consensus on whether or not the legal department should incorporate, or be separate from, the compliance function. Proponents of the view that the two – legal and compliance – should be separate emphasize the need to have a separate investigative body when in-house lawyers may have been party to business transactions and decisions under investigation. Supporters of combining the two feel that it makes sense because of the necessity for tight coordination and communication in executing the lines of defence.

Business Partnering Practices Vary in German Companies

Business partnering is where actual practice and philosophy differ quite a lot from company to company. As noted in Chapter 2, in-house lawyers at some companies are increasingly getting involved in business decisions. This applied most to the general counsel who was part of the country or regional organization unit in a multinational structure. Our focus now is at the group level, right at the top of the corporate hierarchy, in relation to the two-tier boards (the Management Board and the Supervisory Board) in Germany. The study identified three patterns here.

In the first pattern, the general counsel keeps an arms-length distance from the Management and Supervisory Boards. Only if the CEO requests the presence of the general counsel on a specific agenda item with a legal angle would the general counsel be asked to be present at the Board meeting, but just for that item. One GC said that he had no loyalty to any specific board member, and the most important thing about boards is transparency. He attributed this view to his career of having spent longer than his predecessor as an external lawyer.

In the second pattern, the general counsel is the Company Secretary who prepares the agenda and takes minutes of the board meetings. This provides an opportunity for the general counsel to know the nature of board discussion intimately. But the board members do not expect him/her to speak much, unless asked by the CEO for comments primarily from a legal angle. The intimate knowledge of the business of the company is the basis for one GC asserting that *'we are becoming more and more advisors to the board, and to the management of the company.'*

In the third pattern, the general counsel is fully part of the Executive Board (Vorstand), or else an executive committee (normally consisting of the CEO, the CFO, and one or two other functional heads in some cases). In this situation, the general counsel is a full-blown business partner, and is considered part of the executive management team. The rationale for the general counsel becoming closer to the executive management team may arise from the need to prevent the company from running foul of compliance, so the GC does *'not have to preach the importance of legal to the company.'* However, a seat at the table has opened up an opportunity to go beyond this. According to one GC, *'we are all managers, ... legal managers in the business'*. The general counsel interviewed in this category rubbed shoulders with the CEO regularly not just because they report to the CEO, but by dint of having a seat on the corporate executive committee.

Thus, a variety of roles were identified for the general counsel in relation to the company's top management team. The most involved were fully part of the executive team and saw themselves as business managers entitled to speak up on all types of business issues which they consider important for the company; by contrast, the least involved adopting the role of a lawyer who focused on dealing primarily with legal issues. This variety in the involvement of general counsel in top management teams is likely to persist. This is because in Germany, legal became a top management issue via the need to control risks better, and not necessarily via the business partnering route.

Legal & Compliance at DAX30 Companies

We must remember that In Germany until recently, quite a few prominent CEOs themselves were legally trained in Germany, a practice that might be fading.⁷ A brief analysis of the Executive Boards (Vorstand) of DAX30 companies gives a more recent picture. Specifically, only two of the DAX30 companies are headed by a lawyer-CEO in 2017, namely E.ON and HeidelbergCement. There are also two other companies headed by a non-lawyer CEO, who also has Legal & Compliance as part of his responsibilities. By the CEOs on company website as in charge of this function, these companies evidently wish to signal the importance of the Legal & Compliance function.

More broadly, if we define 'lawyers' as those who passed at least the first state exam (some with a doctorate in law, and others with experience of practicing law), 14 (47%) of the DAX30 companies have lawyers on their Executive Boards, and 22 (73%) of the DAX30 companies have lawyers on their Supervisory Boards.

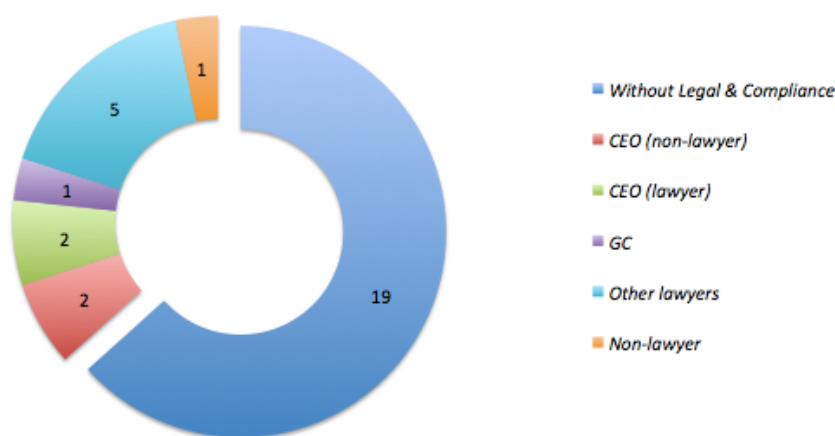
If we focus on the Executive Boards, a third (11) of the DAX30 companies name one member of the Executive Board as being responsible for Legal & Compliance. Beside the four aforementioned companies at which the CEO is responsible for this function, a general counsel is in charge at

⁷ According to Neuscheler, T. 2018. Jeder fuenfte DAX-Chef begann seine Karriere als Unternehmensberater [Every fifth DAX-CEO had a career start as management consultant], Frankfurter Allgemeine Zeitung, 7 June, almost every third CEO of the largest German companies was a lawyer in the early 1990s. See <http://www.faz.net/aktuell/beruf-chance/beruf/jeder-fuenfte-dax-chef-startete-seine-karriere-als-unternehmensberater-15624400.html>

ProSiebenSat, and a lawyer-director is in charge at five companies (Commerzbank, Daimler, Deutsche Bank, Fresenius, and ThyssenKrupp) (see Figure 3). In this last category, some, of not all, lawyer-directors are labour directors (Arbeitsdirektor) in charge of Human Resources. Varied assignments of Legal & Compliance give some flavour to company-by-company variations, notwithstanding the fact that the Executive Board as a whole has the fiduciary duty to stay on top of all corporate matters, including Legal & Compliance.

Figure 3: Legal & Compliance Responsibility in Executive Boards at DAX30 Companies

DAX30 Executive Boards with Member responsible for Legal & Compliance



Source: Author’s analysis based on company websites accessed in November 2017. “Without Legal & Compliance” refers the fact that the company website did not name any specific member as being responsible for Legal & Compliance. This does not, of course, mean the absence of a director in charge.

Summary

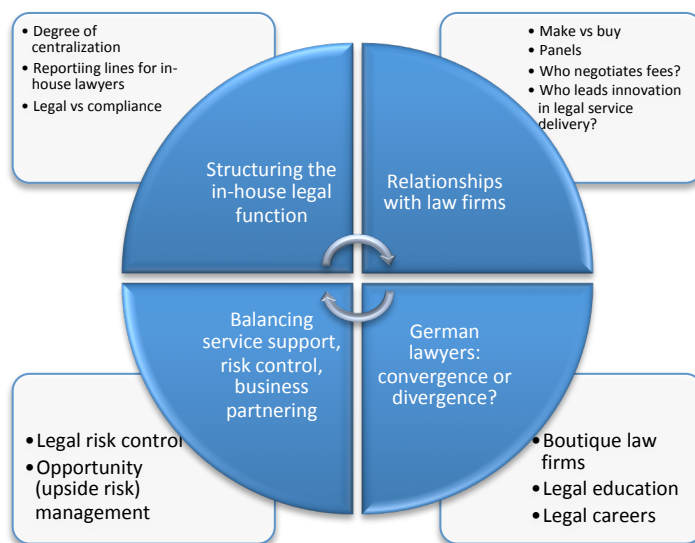
In-house lawyers have three roles to play, namely service support, risk control, and business partnering. In Germany, this study found that risk control has become more important among the three roles in the 2010s. It is arguably the most important trigger that has enhanced the power of the in-house legal function in Germany. By contrast, the other two roles are being played out in a variety of ways. Some German companies have appointed a chief operating officer for the legal department to promote efficiency in service support function, but others have not. Some German companies have a CEO and top management teams that expect the general counsel to play a business partnering role, while others do not. This variety is likely to persist. A brief overview of DAX30 companies’ Executive Boards supports this view of persistent variety, as different types of directors (CEOs in some cases, directors with legal expertise but typically not a general counsel in other cases) are held to account for Legal & Compliance.

Chapter 6: Conclusions

This report discussed what general counsel in particular and in-house lawyers more generally do to structure their legal department (Chapter 2), manage relationships with law firms (Chapter 3), and relate to top management teams at the corporation they work for (Chapter 4). In Germany, as elsewhere, the in-house lawyer role used to be narrowly defined, and the status of being in-house had been inferior and subsidiary to working in law firms or the judiciary. However, over time, the power of in-house lawyers has risen, as they became more closely aligned to business and contributed more to business strategy. The power of in-house lawyers derives from balancing the mix of roles that they are expected to play in service support, risk control, and business partnering. This study reveals that in Germany, it is the need for better risk control that has triggered the enhancement of the role of the general counsel.

Whilst much of the practices gleaned from the interviews in this study are in a state of flux, I wish to conclude by highlighting some key issues (summarized in Figure 4) that are worthy of further consideration by in-house lawyers who are in positions of influence to drive future changes.

Figure 4: Cluster of Issues for In-house Lawyers in Germany



The first cluster of issues concerns the *structure of in-house legal departments*. As noted in Chapter 2, mature German companies are centralizing their legal function to obtain a better traction in risk control and legal budget control. However, the perspective from German subsidiaries of some multinational companies reminds us of the importance of preserving a country or regional focus in legal work. Thus, while the reporting lines for in-house lawyers may privilege preserving the integrity of the legal function, there remains a real challenge in creating the right mindset and processes to navigate the tension

between maintaining a centralized legal function and ensuring close interaction of in-house lawyers with business and geographic units. Separately, it seems worthwhile giving more thought to how compliance and legal relate to each other.

The second cluster of issues concerns *corporate legal departments' relationships with law firms*. In systematizing the relationships, panels of law firms are likely to spread. However, there remain some yet-to-be-settled issues. First, while the corporate legal department has won the battle against business units to manage the procurement of legal services from law firms, in-house lawyers have yet to endorse the involvement of procurement professionals, as they believe that *'we are lawyers, so we know how to buy legal services best'*. If the finance function does not have the sole authority to select audit firms, why should the legal function not share its authority to appoint law firms with the board or the procurement department? Second, who – in-house lawyers or external lawyers – would drive future changes in how legal services are delivered? As one GC stated confidently: *'In the past, external lawyers did interesting work and in-house did standard work; now, it's the reverse with in-house doing strategic work.'* Will corporate legal departments also lead in the provision of legal services in alternative ways, or will they share such initiatives with law firms and alternative legal service providers (ALSPs)?

The third cluster of issues concerns *balancing the three roles that in-house lawyers are expected to play*. The three roles of service support, risk control, and business partnering are intricately intertwined in reality. For instance, even in service support, efficiency in delivery must be matched by effectiveness, which in effect implies that in-house lawyers *'don't act as policemen but more as a partner'* to facilitate business transactions. This morphs into what is essential in risk control, which should be about the management of both upside risks and downside risks. As one GC stated: *'we must be risk managers of course, but also opportunity managers'*. In other words, in considering how in-house lawyers add value to the corporation they work for, they may consider ways in which they identify new opportunities and endorse upside risk taking, as well as anticipating and preventing downside legal risks. Risk control and business partnering are closely intertwined when both upside and downside risks are taken into account.

The fourth cluster of issues may be in highlighting *German-specific trends* and questioning in what ways they may relate to global (albeit primarily US or British) trends. Will German in-house lawyers converge towards the US-UK norm, or would they remain distinctive in some respects? Here, the emergence of boutique law firms appears to be specific to Germany, counter to the US/UK trend of boutiques disbanding or merging with full-service law firms. Moreover, career patterns of German lawyers may, or may not be, converging to the US-UK norm. Doctorates in law see no sign of abating; legal education in Germany continues to focus on training for the judiciary; and major German corporations and financial institutions continue to look for a mix of legal recruits, some straight from law schools and others from law firms.

This study attempted to provide a systematic analysis of current trends and possible future directions in the role of general counsel and in-house lawyers in Germany. There is clear evidence that corporate clients led by the general counsel are becoming a force for change in legal services. It is hoped that some of the issues raised above give food for thought, if not concrete guidance for action, in turning this force for change into a sustainable one beyond reacting to a financial crisis or a corporate scandal.

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About the Author

Mari Sako is Professor of Management Studies at Saïd Business School, and a Professorial Fellow of New College, University of Oxford. Her areas of expertise include global strategy, comparative institutional analysis, outsourcing and offshoring, and professional services. These interests have led to consulting and research engagements in Europe, United States, India, and Brazil with a variety of companies and institutions, including English law firms. She is also member of the UK Legal Services Board Research Strategy Group, and member of the advisory board of Thomson Reuters Legal Executive Institute. She teaches Global Strategy for the Executive MBA and directs the Oxford Diploma in Global Business.

Professor Sako made a significant contribution to the understanding of the Japanese economy and Japanese firms. In the 1990s and 2000s, she was a researcher for the MIT International Motor Vehicle Program (IMVP), which gave her a valuable opportunity to be out in the field, observing and interviewing managers and workers at automakers and their suppliers in Japan, Europe and the USA. Insights from the fieldwork to understand lean production and quality control are also informing her more recent work on what professionals such as lawyers do. Her research has been published in the form of journal articles and five books: *How the Japanese Learn to Work* (with Ronald Dore) (1989), *Prices, Quality and Trust* (1992), *Japanese Labour and Management in Transition* (with Hiroki Sato) (1997), *Are Skills the Answer?* (with Colin Crouch and David Finegold) (1999), and *Shifting Boundaries of the Firm* (2006).

Professor Sako read Philosophy, Politics, and Economics at University of Oxford. She also holds an MSc in Economics from London School of Economics, an MA in Economics from the Johns Hopkins University, USA, and a PhD in Economics from London University. Previously, she worked as a researcher in a private research institute, and taught at London School of Economics. She also held visiting positions at Kyoto University Department of Economics, Tokyo University Institute of Social Research, RIETI (Research Institute of the Ministry of Economics, Trade and Industry in Tokyo), Waseda University, Tokyo, Ecole Polytechnique, Paris, and MIT Sloan School of Management, USA.

Appendix: Research Methodology

During November 2016 and February 2018, Mari Sako interviewed in-house lawyers at thirty-three companies, of which 21 were German companies (including five DAX30 companies) and 12 were German subsidiaries of multinational corporations headquartered in seven different countries (Finland, France, Japan, South Korea, Spain, Switzerland, and USA). Nearly all the in-house lawyers interviewed were group General Counsel or regional General Counsel, some also carrying the title of Chief Compliance Officer. Interviews were typically on the phone (a few took place face-to-face), and lasted one hour. In some cases, interviewees also provided further data and information by email.