SEVEN COMMON MISTAKES IN SELECTING AND MANAGING OUTSIDE COUNSEL IN THE MORTGAGE BANKING INDUSTRY

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INTRODUCTION

The job of in house counsel is extremely difficult. Counsel is often forced to balance the demands of heavy case loads, differing demands based on the geography of the cases that they are handling, competing and often unreasonable internal clients, and concerns driven by shrinking budgets and profit margins within the company. Against this backdrop, legal departments in the mortgage banking industry are not viewed by the business people running their companies as profit centers, but frequently as a necessary evil -- a place to call when there is a problem that cannot be solved solely by the resources of the caller, as a place for confirmation of the caller's desire to take certain action and to protect themselves in the process, or as a place to simply prevent a problem which is bleeding the company of profits from becoming a hemorrhaging ulcer. One of the major realities, and major frustrations, of national lenders (which by their very definition conduct business on a national scale) requires that they use outside litigation counsel from around the country. Most often, in house counsel has never met, and may never meet, their outside litigation counsel in order to evaluate them. How then does in house counsel evaluate whether outside counsel will perform well and satisfy the company's needs and goals? How will in house counsel be better able to manage outside litigation counsel? And, most importantly, how can in house counsel better control the cost of outside litigation counsel, thereby reflecting well on the company's legal department from an internal business perspective?

Below I have highlighted seven mistakes which are made in selection and management of outside litigation counsel. At the end of my discussion, I have offered certain suggestions and conclusions.

COMMON MISTAKES

I. RFP'S ARE THE ANSWER TO GETTING THE BEST FIRM FOR THE LEAST MONEY

It seems axiomatic that, if a company seeks RFP's for legal providers, market forces will work to create a situation in which the company is able to select the best firm for the least money. The thought process being simply to collect all of the RFP's, analyze the qualifications of the respective firms, and select the most qualified and cheapest firm. This sounds logical enough especially given our comfort in believing that free markets generally produce better and cheaper goods and services.

However, how do you know the RFP's are true estimates of the firm's ability to perform the work quoted? Isn't it human nature to assume that, in a highly competitive environment, firms will underbid the work in order to appear more economical for the purpose of obtaining the work? The answer to these questions is something I would refer to as the "Contractor's Dilemma".

The "Contractor's Dilemma" is an analogy from the construction industry which is worth noting. It is not uncommon for construction companies in a highly competitive marketplace to underbid (artificially deflate) the cost to perform a job by cutting out all or most of their profit (and even in some instances initially agreeing to perform the project at a loss). Why? Because the companies know that project owners do not have a good grasp of what it takes to construct a building. Once the contract is awarded, the successful construction company may then assume that it will be able to recoup its otherwise lost profit by claiming that the owner has requested changes to the project, or the project is more complicated than initially thought, which additional work may only be performed at an increased (inflated) price.

In the alternative, the construction company has calculated its price by assuming it can cut corners with its subcontractors or suppliers, i.e. by using cheaper or different materials than those originally quoted, or by hiring less

experienced or lower quality subcontractors in order reduce the contractor's cost to perform the job thereby making a profit while staying within its quoted price. Similarly, professional legal services, like construction services, are enormously complex and varied and are as unknown a commodity as the labor and materials necessary to construct a building. Though we may have a general idea of what it takes to construct a building, or what it takes to handle a lawsuit, how do we really know what's going on in the field, or in the offices of local counsel, unless we are there?

When presented with an RFP, as with the construction company presented with a bid proposal, it is the temptation of the law firm (even well meaning) to cut its otherwise normal rates with the belief that "they will make it up in volume." However, when the law firm later realizes that profits have not been recouped based on volume due to the complex and non-routine nature of all but the most simple pieces of litigation, something has to give. That something will inevitably manifest itself in the firm (if it wants to keep the work) just as it does with the construction company, i.e. the firm will cut corners by failing to perform those tasks or level of analysis which the firm would normally do for a full-rate paying customer, or by forcing the work down to the most inexperienced (cheaper) professionals in the firm in an effort to perform the work within the firm's quoted price structure, thereby making the work more profitable.

II. ECONOMIES OF SCALE ALONE WILL HELP CONTROL COSTS

Some companies believe that, if they agree to give the entirety of their volume of work within a single geographic marketplace to one professional legal provider, the company will successfully obtain the services of a higher tier law firm at below market prices. As with RFP's, the same principles apply. Because highly specialized professional services, unlike paperclips, are not fungible, inevitably firms that have cut their billable rates (at least to a substantial degree) to perform the work will eventually realize that their time is better spent on full-rate customers. Lawsuits in the mortgage banking industry tend to be of myriad variety with many small twists and turns. This variety (as discussed below) requires creative thinking and often does not lend itself to a rote formula of litigation. Therefore, these cases are "labor intensive" both in terms of time and intellectual effort. As such, it is difficult (especially for higher tier legal providers) to create a true production line method of handling large volumes of mortgage banking litigation which fits within the firm's overall structure and makes the work profitable.

For example, unlike insurance defense firms that, at their core, are designed to cater to insurance carriers (which pay legal providers at an artificially low rate because of the promise of volume business) from the software they use, to their accustomed methods of client reporting, to the firm's time keeping practices, to the pay structure of their employees, the higher tier firms attempting to cater to the mortgage banking industry are not set up to service one type of client, nor are they set up to service (on a regular basis) clients that are paying rates which are otherwise below the firm's normal billable rates. These firms have significant hierarchy and over-head, high pay structures for their employees based on the rate of return for their full-rate customers, and have a plethora of clients running from multi-national manufacturers, to pharmaceutical companies, to mortgage bankers -- most of which pay the firm's normal rates. Accordingly, once these firms discover they cannot create an economical production line approach to handling mortgage banking litigation, corners will again be cut, the work shifted to the lowest cost professionals in the firm, or the work will be abandoned in order to use the firm's resources to perform work for full-rate clients.

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In addition, by awarding all of the company's work to a single source provider within a geographic marketplace, the company may actually end up paying more for services in the end. Comfortable in its position that it "has the work locked up", the professional service provider may become complacent, thereby becoming susceptible to "heavy" billing practices in order to "make up ground" for otherwise performing lower rate work.

III. A SINGLE "BIG" FIRM WITHIN A GIVEN GEOGRAPHIC AREA IS BEST TO HANDLE ALL OF A LENDER'S NEEDS

If I hire a single large firm within a geographic market to service all of my company's needs, my personnel will have familiarity with the firm and vice-versa, the firm will be conversant in our issues, the firm will have the depth and breadth of expertise to service all of the company's needs, and efficiencies will be gained. It is true that a single large firm will have the requisite expertise and depth of talent to handle all of the issues that litigation in the mortgage banking industry can throw at it. It is also true that using a single large firm to perform all of the company's work in a geographic area will create certain efficiencies by virtue of the fact that the firm will come to know the company's personnel and the company's hot button issues.

However, there are additional realities with this scenario driven by the multitude of variety of litigation in the mortgage banking industry. The depth and complexity

of litigation in the mortgage banking industry runs the gamut. At one end of this spectrum, litigation takes the form of sophisticated class actions which challenge an aspect of the application or underwriting processes with national implications for the company and may have far reaching and substantial economic consequences for the company (I refer to this form of litigation as "Top Tier"). These Top Tier cases are complicated, may require vast legal resources for the proper handling of such cases, and carry enormous risk to the mortgage lender in terms of public perception and actual monetary losses.

While Top Tier litigation is very important to a mortgage banker, it constitutes a small minority (in terms of volume) of the lawsuits which are filed by or against the company on an annual basis. The vast majority of cases fall into 2 other categories which I refer to as "Mid-Tier" and "Lowest Tier" litigation, respectively.

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Mid-Tier litigation can take numerous forms, but tends to have certain common features including: (1) the lawsuits involve a single transaction which is contested by a single plaintiff, thus limiting its consequences to the transaction at issue; (2) the lawsuits may be brought in pro per (often by plaintiffs who will file multiple lawsuits or multiple appeals simply trying to delay action by the mortgage banker for as long as possible), or may be brought by smaller law firms who believe there is some legitimate challenge to be made with an eye towards leveraging a settlement; (3) the lawsuits raise issues with a reasonable level of complexity including allegations of fraud or violation of regulatory statutes in the loan application and underwriting process, allegations of a title defect triggering title insurance coverage, assert constitutional challenges, assert claims designed to stop or delay the foreclosure process, or involve unique fact patterns.

These Mid-Tier cases have a level of complexity which require substantial expertise and strategic thinking to resolve (especially quickly and cost effectively). These cases also demand sophisticated and competent counsel to obtain results the company will deem acceptable. However, the amounts at issue are not substantial (typically with exposure being $500,000.00 or less). For example, depending upon the rates of the firm retained to perform the service, defense of a $60,000.00 mortgage could cost $100,000.00 in attorney fees. Why not simply settle the case at the outset? The simple answer is that often the case is not susceptible to a quick settlement for a myriad of reasons which require the litigation to move forward, i.e. plaintiffs are in pro per and cannot be dealt with as effectively as if they were represented, plaintiffs may be represented by small but aggressive law firms which understand the financial dynamics and will push the case forward until they obtain a desired settlement, business departments within the company do not understand the dynamics (or cost) of litigation and wish to "stand firm", plaintiff's positions are baseless and the company will not pay as a matter of principle or because the company does not want to gain a reputation of being a "push-over", or the company may need discovery simply to understand the plaintiff's case to better evaluate its settlement position.

Finally, (without any intent to denigrate the last category) we have Lowest Tier litigation. Lowest Tier litigation is that litigation which includes residential mortgage foreclosures, residential evictions, and consumer bankruptcies. These cases do not involve the same complexity as Top Tier or Mid-Tier matters. They typically involve constantly repetitive fact patterns and finite legal issues. However, the volume of these cases is massive. The only means to handle such cases in anything approaching a cost effective manner is based on a production line model. These cases are often handled by "foreclosure firms" which employ a handful of junior attorneys, numerous paralegals, and foreclosure technicians designed to process thousands of cases a time. Because of this mix of personnel, and the commonality of the issues, these cases can be handled by the foreclosure firms at a flat fee or otherwise at an artificially low cost.

Is the single "Big" firm best suited to manage this wide range of litigation? The answer is no – no more than the foreclosure firm is suited to handle this same range. Most mortgage bankers have already made this distinction between firms that handle the Top Tier litigation and the Lowest Tier matters having both a "Big" firm and a foreclosure firm performing services in a geographic market. However, are these two types of firms best suited to manage all forms of the mortgage banker's litigation needs? The answer (as noted throughout this article) is no.

IV. MANDATING REGULAR REPORTING FROM OUTSIDE LEGAL PROVIDERS WILL CONTROL COSTS

Like insurance companies have for decades, mortgage bankers are beginning to require regular and systematic reporting from their outside counsel concerning the status of matters. Certainly, it cannot be argued that regular communication from outside counsel is essential to the mortgage banker's general counsel to understanding the case and managing costs. However, the emphasis tends to be on *regularity* in

reporting, rather than focusing on the *type* of reporting.

In house counsel for the company are often (and justifiably) overwhelmed by the volume of cases that they handle at any given moment. With the shear number of residential loans exploding over the past decade, the amount of litigation generated from such activity has similarly exploded. Thus, in house counsel may be responsible for supervising dozens if not hundreds of matters.

With this background in mind, the regularity of reporting may be as much a curse as a blessing for in house counsel. While in house counsel is kept informed about the case, he or she is also inundated with reports that they must quickly digest to get an understanding about where the case sits and where it is going.

It is in this context that the type of reporting to counsel becomes key. Many reports from outside counsel are prepared by junior associates who are merely trying to recite the facts of the case and its procedural posture. What is missed is the need to report in a strategic and suggestive manner. This includes mapping out what the potential courses of action are, where each course of action may take the case in terms of results, suggesting the course of action which outside counsel believes is most prudent and why, and recommending options which may result in cost savings to the company.

This is the kind of reporting that in house counsel desperately need to assist them in moving efficiently and effectively through a large amount of matters. In house counsel are given and explained options which can then be selected or discarded by them – but the issue of where the case should go has been brought to a head, discussion will occur, an option selected, and the case moves forward to conclusion. In the basic recitation model of reporting, the onus is put on in house counsel (who is trying to manage numerous matters all over the country) to suggest and develop the potential courses of action. While certainly capable, this is a heavy burden on in house counsel which also does not move the matter forward quickly because general counsel is forced to suggest or ask for suggestions from outside counsel. Accordingly, much more "back and forth" communication, more time, and additional cost will be necessary to select and execute on a proposed plan of action for the case.

V. FAILING TO SET GOALS

The statement that you need to set a goal or specific desired outcome for a piece of litigation sounds so obvious that it is often forgotten. When a new litigation matter first comes to the mortgage banker, as with any large organization, the company is frequently already "behind the eight ball" in terms of the time to respond to the complaint. The complaint has taken time to wind its way from service corporations to the company to the appropriate person within the company designated to handle such matters – all the while the "clock" on the time to respond keeps ticking. Accordingly, there is a rush to get the matter assigned to outside counsel to ensure that the case is being handled.

On the other side of the equation, outside counsel is excited to receive and evaluate the file (as it is a new piece of business), and may find themselves up against immediate deadlines which must be addressed. In this context, goals for the litigation (other than the obvious – get the case dismissed in the shortest possible time and for the least possible expense) may be overlooked.

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Why is goal setting important and how does it relate to litigation cost? Goal setting is important because it creates a finish line for the case or a lighthouse to which to sail the ship. Once a goal is set, everything that is done by outside counsel should relate back to the goal, i.e. how does this action assist us in achieving the desired outcome. Without goal setting, litigation management tends to be more of a "stream of consciousness" approach where the case meanders back and forth until it ultimately (and often by accident) crosses the finish line. The effect on cost is evident – rather than each task having a calculated impact on the case, litigation tasks are conducted on a trial and error basis, thereby increasing the cost by engaging in unnecessary tasks.

Goal setting is also important for internal client satisfaction. Inevitably, in house counsel is responsible to business departments within the company that must account in their budgets for the gain or loss associated with a case. If goals are set and achieved, in house counsel is more likely to have a happy internal client.

Just as important as setting a goal is making the goal clear and achievable. If it is impossible to obtain an immediate dismissal of the case and incur no costs in the process (i.e. which is almost never the case), then reasonable goals must be established. Otherwise, both outside counsel and in house counsel (in terms of internal clients) will be set up for failure. Having a clear goal is as important as making the goal reasonable because it lets everyone know (and feel comfortable) that "we're done" once the goal is reached.

Finally, it is important to continually re-evaluate goals. Things happen in litigation that aren't expected or take you off course. Counsel, like the ship's captain, must continually look back to his/her compass to see if the case is off course, if so, put the case back on course, or if necessary, decide whether a new destination is required such that new goals must be defined.

VI. FAILING TO ENCOURAGE STRATEGIC THINKING AND PRACTICAL PROBLEM SOLVING

As noted above in relation to goal setting, once a goal is established, every action taken in the case should be calculated directly to reaching the goal. This approach is thinking strategically, rather than either randomly or routinely (i.e. this is how we always handle this type of matter) about a case. Simply put, your action plan is specifically designed to resolve the case and is created to avoid having a set of random actions taken by outside counsel because such action "just seemed good at the time", or if it doesn't work "we'll just try something else". It also avoids just looking at a case (which on its face appears similar to many others handled by counsel) and handling the case in a formulaic manner which in actuality may not be the best way to manage *this* case.

In addition to thinking strategically, outside counsel must be encouraged to think practically. While there may be black letter (or "by the book") approaches to solving a problem, there is no substitute for common sense such as picking up the phone and calling opposing counsel to see if the case may be resolved. Another example of thinking practically, is determining what your adversary wants (not what you think they want) and giving them what they want (if it makes sense to the company from a cost/benefit perspective) in order to quickly resolve the case.

Are their firms that are better at thinking both in a strategic and practical manner. The answer is yes. Thinking in this way is a product of experience. Experience in handling the same or similar matters. Experience in handling cases that are challenging and multi-faceted. Experience in the many mundane aspects of life. All of these create a well-rounded attorney capable of dissecting and solving a complicated case.

With regard to the Lowest Tier litigation work, the most senior counsel in such firms do satisfy this model (yet they do not work on the vast majority of cases). However, many attorneys in the firms performing the Lowest Tier work may not for one reason only—cost. In order to be competitive in handling the Lowest Tier work, these firms must employ very junior attorneys to perform the work. Although the junior attorneys in these firms may someday become the practical and strategically thinking lawyer, they are unlikely to do so early in their careers (no more so than junior attorneys in large or mid-sized firms will) while many end up leaving their positions for other opportunities several years later.

The attorneys needed for the task are clearly present in the firms performing the Top and Mid-Tier work. They tend to have had the range and depth of experience necessary for the job.

How are counsel handling the Top and Mid-Tier work to be distinguished? The answer is that there is little distinction between the senior attorney at the mid-sized firm performing the Mid-Tier work and the same attorney at the "Big" firm performing the Top Tier work. Both sets of attorneys tend to have wide-ranging experience and have the professional depth and breadth to handle almost any matter. However, beyond the top layer of counsel at each type of firm, there is a distinction in how matters are staffed. In the "Big" firm, the senior partner who is able to think strategically and move a matter towards conclusion in a systematic manner is also grossly more expensive than the Mid-Tier work warrants. Accordingly, in an effort to appear competitive in terms of rate structure (both to the external client and internally to the senior partner's other partners), the senior partner must minimize his/her role in case management of Mid-Tier work and is forced to ship the majority of work in "carrying the ball" to junior and far less experienced attorneys. It should be noted that this is not the case with Top Tier work because the substantial complexity and substantial exposure to the client justify a different fee structure and will warrant far more involvement by senior partners.

In the Mid-Tier firm, however, because of the sizable difference in rate structure between mid-sized firms and "Big" firms, the senior partner is able to stay more firmly engaged in case management moving the matter strategically to conclusion. This is not because counsel in the mid-sized firm are better or necessarily care more about their clients than their counter-parts in the "Big" firm, it is because their rates are lower and more easily justified to the client (where the amount of potential liability is far lower than say, in a multi-state class action suit) and internally to the firm's partnership such that the firm does not have to take a big "hit" in terms of reducing its rates.

VII. ENCOURAGE CASE BUDGETS TO BE TREATED AS GOALS NOT SAFETY NETS

For a growing number of mortgage banking companies, outside counsel are being required to develop and submit case budgets. These budgets vary from lender to lender in detail, but at least one primary purpose is to provide the lender's legal department and business departments with a gauge on the potential litigation costs associated with each matter. Presumably this helps the lender budget for its legal department and control costs by permitting

the lender to engage in a cost/benefit analysis, i.e. is it going to cost more to defend the case than the potential liability associated with it.

Case budgets are undeniably a good tool from both the lender's perspective (as noted above) and outside counsel's point of view because the budget forces counsel to evaluate where he/she intends to take the case and what it will cost. If outside counsel proposes a case management budget of $50,000.00, and in house counsel accepts the proposed budget as reasonable, both parties should be pleased so long as the desired result is achieved for no more than $50,000.00.

However, there is something missing in this typical budgeting procedure. That something is a desire to be *economical* where possible. The client may actually be capable of being *saved* money from the quoted budget. Stated a different way, if it does not matter how or when a package is delivered, why not send it via regular mail rather than overnight delivery? Why not look for ways to leverage the case into early dismissal pursuant to a dispositive motion (if possible), rather than taking four (4) meaningless and unnecessary depositions prior to reaching the same result?

There is a link in this concept to the culture of firm handling a particular case. While most certainly an over-simplified statement, "Big" firms tend to have big clients willing, accustomed, and able to pay big fees. These firms do not need to educate their members on seeking out economical means to litigate cases. Many attorneys in these firms may not know how to "do it." Furthermore, the junior attorneys in these firms most certainly do not have a good grasp on economical litigation knowing only one way to litigate (i.e. full bore with all the bells and whistles) and may have no incentive to litigate in any other manner, i.e. they are still learning the ropes and want to stretch their "litigation legs."

In fairness to the "Big" firm performing Top Tier litigation, however, when potential liability is frequently, if not always, seven-plus figures in damages, cost-cutting or penny pinching may not only be an unnecessary strategy, it may be *unwise*. If one of these cost-cutting measures results in significant liability to the client, the law firm is certain to be second-guessed in that regard. Therefore, while budgets may be set for Top Tier litigation, given the potential liabilities involved, little attention may be paid to them so long as litigation costs are not absurd.

Different firm cultures often prevail in the mid-sized firm. Again, while this may be an over-generalization, these firms tend to have a few very large clients and many small and middle market clients. The small and medium sized clients are, by economics, required to take a different approach to litigation. These clients may not have litigation budgets, or one major piece of litigation (if poorly handled) may be the difference between a good and bad year (or worse) for a particular client. In this context, not every case warrants litigating with "all guns blazing", nor can this strategy be justified or afforded by the client. Strategic and economic thinking by counsel in these firms in order to achieve results is the rule, rather than the exception.

CONCLUSION

Below are some brief observations resulting from the analysis in this article:

1. Be wary of relying too heavily on RFP's. If a firm's typical rate structure does not reasonably fit the desired rates for a particular litigation niche, the firm is probably not a good choice to perform that type of work;
2. Recognize the variety of litigation in the mortgage banking industry. In choosing outside litigation counsel to meet your company's needs, do not try to squeeze a square peg in a round hole. One size firm cannot service all of the company's needs any more than dress shoes can serve all of the required needs of the wearer. A mortgage banker should have at least 3 firms (one each – Top Tier, Mid Tier, and Lowest Tier) in a geographic market to service the types of work available. If controlling litigation costs is the primary focus of a litigation niche (such as is the case in Mid and Lowest Tier matters), rather than controlling liability (as is the case in Top Tier matters), then pick firms with the structure and culture suited to controlling costs;
3. Consider using 2 firms within any marketplace and within each litigation niche. This will maintain familiarity between the mortgage banker and outside counsel, but will preserve an element of competition between the firms;
4. Require suggestive, rather than mere communicative, reporting from outside counsel;
5. Require outside counsel to suggest goals for a piece of litigation within 30 days of receipt of the case with periodic and regular re-evaluation required thereafter; and
6. Mandate that partners participate in certain parts of the litigation process, i.e. in the initial goal setting and periodic re-evaluation of such goals.

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