# When Does A Client Become Too Big or Too Important?

*By Ward Bower*

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The Enron collapse raises many questions about the relationship between a large corporate client and its professional advisors, including its auditors, lawyers and consultants. Andersen LLP has attracted most of the criticism and is the subject of both civil and criminal actions based upon alleged derogation of professional duties. Observers also have questioned the role of Enron's outside counsel, especially with regard to its investigation of the nefarious partnerships commissioned by the Enron Board. Much of the criticism of Enron's outside auditors and lawyers is based on the influence of the large fees they collected on their professional independence and objectivity.

Consulting fees paid to Andersen by Enron in 2001 exceeded audit fees and in the aggregate they totaled over $50 million. Legal fees paid to Enron's outside counsel reportedly constituted 7% of the law firm's revenues. In 2000 that firm collected over $386 million in fees. Law firm management has reported that loss of Enron legal fees will not pose a financial hardship to the firm. That may be true given the firm's prominence and potential ability to replace those revenues with work for other clients. But replacement of over $25 million in lost fees is a big order for any law firm.

**How Much is Too Much?**

Most law firms would welcome the cash flow provided by a large client; the more the better. But what happens if a single client provides 50% of the law firm's revenues? Can the firm be truly independent in such a situation? What about a 30% client? 20%? 10%? What is the point at which concern should arise?

One might argue that a firm is critically vulnerable to the loss of a client when that might lead to partner defections to other firms linked to a reduction in profitability. The mere threat of such a scenario might apply pressure to a firm that could compromise its professional independence and objectivity.

**Captive Law Firms**

Law firms also might be vulnerable when the client effectively "captures" the firm. This happens when a firm concludes that the client is too big for the firm to afford to lose. Clearly that would be the case with a 50%, 30% or even a 20% client. Some would even suggest that it arguably becomes an issue at the point a client provides as little as 4% of revenues. Why? At a 40% profit margin, typical in large successful firms, a loss of 4% of revenues translates to a 10% reduction in partner incomes. A 10% reduction in net income is more than most firms could easily accommodate, even if some of that were to be made up by work from clients previously unavailable due to conflicts of interest.

Short of loss of a major client, how can a firm determine if it has or is about to be captured? One test might be the ability of the client to control the relationship — dictating strategies, staffing, rates and fees. In a captured state, there is intense pressure on the law firm to accede to client demands in these areas, some of which might affect professional judgment and independence.

**The Dark Side of Partnering**

Partnering is one vestige of the otherwise maligned TQM movement that actually provided benefit to many law firms and their clients. It represents the integration of the supplier (law firm) into the customer's (client's) value chain. Joint staffing and training, reverse seminars, electronic integration, alternative pricing and "convergence" or consolidation of legal work in a smaller number of law firms are all aspects of legal partnering.

A seldom-articulated concern with partnering is that consolidation of a corporate client's work increases the volume of work to beneficiary firms, creating the potential for "capture" and potentially detracting from professional independence. Law firms have to invest in the expanded relationship, adding staff and overhead to handle the increased workload but they risk financial

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disaster if the relationship ends. The legal risk, often ignored, emanates from the potential for compromise of the law firm's independence in an effort to secure the client relationship.

**Strategies to Avoid or Mitigate Capture**

What should a law firm do to reduce its vulnerability to a major client capable of its "capture?" "Firing" the client obviously is not a preferred solution. More feasible strategies might include growing other, existing clients faster than the major client; diversifying the client base by attracting new clients, either locally or through geographic expansion; adding lateral partners with client bases they bring with them; merging with another firm to dilute the relative influence of the major client; reducing fixed costs by servicing the major client with contract or temporary lawyers; "ratcheting up" the major client, vetting lower value work and accepting only work justifying higher rates and fees; or employing creative alternative pricing and reengineering work processes to improve margins.

The attraction, growth and development of major clients certainly is a desirable direction for most law firms. Being captured by a dominant client presents a host of problems for the law firm and maybe even for the client. Successful firms will employ strategies to enable them to grow client relationships while avoiding the downside of capture. Thoughtful firms will consider this as a planning and policy issue, even where a client provides as little as 4% of its revenues. ◆

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