The Outsourced GC Model: An Alternative Solution to Legal Staffing

Since its inception in 2019 Corvus Group has provided outsourced General Counsel services to managers operating in the venture capital and private equity industry ("**PE/VC Mangers**"). Although there are numerous benefits to utilising the outsourced General Counsel model, especially for emerging and lower to mid-market PE/VC Managers, PE/VC Managers have traditionally been hesitant to adopt the model, with a preference instead for relying on non-legally trained internal resource, external law firms and/or secondees to cover their day-to-day legal needs before making permanent legal hires.

Given the potential cost savings and flexibility afforded by the outsourced General Counsel model, we thought it beneficial to explore in this article PE/VC Managers' traditional approach to legal staffing, the implications of the traditional approach and the advantages that the outsourced General Counsel model has to offer – in particular for emerging and smaller managers.

Introduction

In this article we explore the pros and cons of the traditional legal staffing solutions deployed by PE/VC Managers, the practical and cost implications of those solutions and the numerous benefits of the outsourced General Counsel model, in particular for emerging and smaller managers.

The traditional approach to legal staffing

One of the idiosyncrasies of the private equity and venture capital industry is that all PE/VC Managers face, broadly speaking, the same legal challenges irrespective of their size and AUM. The ever-evolving and increasingly complex legal and regulatory environment in which PE/VC Managers operate makes little distinction between a start-up manager and a well established, scaled advisory business. Furthermore, many of the general legal needs of PE/VC Managers are the same as those faced by any business – for example, corporate establishment, corporate actions, on-going governance, commercial contracts, property leases, IT licences, employment matters, insurance, data protection and financing. As a result, in any given week a PE/VC Manager will face a diverse range of legal issues, a number of which will fall outside the more industry-specific areas (such as fund and tax structuring and M&A-related work) in relation to which external counsel are usually engaged.

Whilst there really is no substitute for specialist external counsel when it comes to handling more complex or time and resource heavy legal matters, PE/VC Managers often face a resourcing dilemma when dealing with more generic day-to-day legal work.

Unless emerging and smaller PE/VC Managers have someone with relevant and up-to-date legal experience among their staff pool, legal work is often handled in one of three ways, at least initially:

1. It is allocated to an investment team member (with or without prior legal experience).

2. It is allocated to a senior operations team member (such as the CFO or COO).

3. It is outsourced to an external law firm.

As a PE/VC Manager scales, it is not uncommon for them to enter into secondment arrangements with their external lawyers. The typical secondment arrangement involves a trainee, junior or mid-level associate being made available to provide full time legal coverage to the PE/VC Manager, with the secondee usually relocating to sit with the PE/VC Manager's team for the duration of the secondment. A secondment is intended to be a temporary measure and is usually a precursor to the PE/VC Manager making its first full-time legal hire, which itself is often the first step on the road to building out a full in-house legal function.

Drawbacks of the traditional approach

Each of the solutions for dealing with day-to-day legal work outlined above has a number of associated benefits and drawbacks.

1. Allocation to investment team members, CFOs or COOs

The obvious benefit to this approach is cost saving. Given the typically high cost of experienced lawyers and the time it takes to establish a stable PE/VC advisory business, emerging and smaller PE/VC Managers will be all too aware of the impact that a permanent legal hire will have on their cost base and burn rate. As a result, there is a great financial incentive to have an existing investment or operations team member deal with day-to-day legal issues.

The main downsides to this approach are risk exposure and inefficient allocation of human resource. Without current and relevant legal experience, there is always an inherent risk that legal matters may be inadvertently mishandled, exposing the PE/VC Manager to liability. For example, failure to register regulatory, tax, corporate and property returns in time can expose PE/VC Managers to fines and censure, inappropriately drafted or negotiated contracts can result in unforeseen consequences, litigation and potential liability exposure and the mismanagement of data protection matters can lead to significant fines.

Furthermore, allocating legal work to investment and operations professionals is simply an inefficient use of their time and skills. Legal matters will be an ongoing distraction for these individuals, who will expend material time and effort focussing on legal issues rather than on the work they have been hired to do.

2. Outsourcing to an external law firm

The main drawbacks to outsourcing day-to-day legal matters to an external law firm are primarily cost and practicality.

Private practice lawyers are typically expensive, which is reflective of their highly specialised skillsets. The issue for PE/VC Managers is that day-to-day legal issues are typically multi-faceted, resulting in the need for input from multiple partners, often supported by their respective associates and trainees. Given that each individual lawyer involved will be recording time as a general rule, it's easy to see how legal costs can spiral.

The upshot of using external counsel is that the advice received will usually be comprehensive and technically accurate. The flip-side of this coin is that legal advice is often difficult for PE/VC Managers to digest and put to practical use, being so technical and/or heavily caveated that non-legally trained professionals struggle to meaningfully utilise it.

In the majority of cases, PE/VC Managers want to be advised in simple and clear terms as to what they should (or should not) do and/or to be provided with a document or other practical output which can quickly and easily be put to use in their business with minimal disruption to their BAU. Utilising external specialists who are not necessarily abreast of a PE/VC Manager's internal processes, risk appetites and business drivers is often a costly and impractical way to achieve this.

3. Utilising secondees

A secondment arrangement can provide a PE/VC Manager with a full time legal resource at a fraction of the cost of a full time legal employee or external law firm. The secondment solution is not without its drawbacks, however.

A secondee is (often but not always) a trainee, junior lawyer or mid-level lawyer. As such, there will inevitably be gaps in the secondee's knowledge and experience. The best case scenario is that the secondee is aware of their limitations and confident enough to flag this to the PE/VC Manager and seek support from their law firm as needed (although this will likely result in the PE/VC Manager receiving a bill for time spent by the law firm). The worst case scenario is that the secondee is not aware of a knowledge gap or is over-confident in their abilities, resulting in them issuing erroneous advice or missing key issues entirely.

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Whilst a secondee may be a more senior lawyer, irrespective of their experience secondees will be drawn from a particular team within a law firm. As such, secondees will (to a greater or lesser extent) be area specialists who will inevitably turn to external counsel with respect to matters outside of their typical practice area, giving rise to the escalating costs discussed in section 2 above.

Finally, secondments are intended to be temporary. Although it is far from uncommon for a secondee to join a client to whom they have been seconded (subject to the client navigating the inevitable non-solicitation clauses in the secondment contract), that is not always the case. PE/VC Managers utilising secondees are therefore likely to have to deal with a lack of continuity as secondments end and new secondees are brought up to speed, and face uncertainty as to whether their new secondee will be as successful as their previous one.

4. Permanent hire

There are many compelling reasons for making a permanent legal hire. Having an 'on-demand' legal resource which is fully embedded in and attuned to your business needs will ensure that non-legally trained staff are freed up to focus on their respective areas of expertise whilst ensuring your legal matters are given priority and immediate attention. An in-house legal resource can also be perceived to add legitimacy to PE/VC Manager's business, helping to demonstrate good governance, scale and substance.

That said, in-house lawyers are an expensive resource. With ever-increasing salary and bonus expectations being driven by the larger law firms and PE/VC Managers, many emerging and smaller PE/VC Managers may find themselves priced out of attracting senior lawyers with the breadth of experience required to deal confidently with the range of legal issues that the manager will face.

As an alternative to traditional salary/bonus pay structures, PE/VC Managers may instead consider offering allocations of carried interest and/or success-linked bonuses. Aligning more closely with the remuneration packages of front-office teams can alleviate some of the immediate financial pressure of a full time legal hire and can help to instil a 'stakeholder' mindset in a function that can at times (rightly or wrongly) be perceived as a barrier to doing business. However, allocating carry dilutes the carry pool available for investment and investor focussed staff and success-linked bonus structures could compromise the impartiality of in-house counsel with regard to their risk management function – indeed, a PE/VC Manager would need to be confident that offering material financial incentives to 'get the deal done' would not cloud their in-house counsel's good judgment.

PE/VC Managers who are cost sensitive may think of looking to mid-level or junior lawyers for their first legal hire, although these lawyers are by no means inexpensive. Given the rise in salaries across the legal profession, it can be argued that mid and junior lawyers actually represent the poorest value for money, given the size of their pay expectations and their relative lack of experience.

Irrespective of their level of experience, all in-house counsel will be required to outsource elements of their legal work to external specialists at some point (for example, during fund structuring/establishment and during investments/divestments). Although an in-house lawyer may be able to add value by alleviating some of the pressure placed on investment and IR teams during intense periods of activity (for example, by acting as a filter/firewall between external counsel and front office teams), there will of course be a multiplication of legal costs where both in-house and external counsel are working on a given matter.

Unlike external counsel, who only charge if there is work to do, an in-house lawyer is a fixed overhead which must be paid irrespective of utilisation levels. During periods of greater activity (for example, when first establishing legal and governance policies and processes, making regulatory applications, during fundraises and during deals) an in-house lawyer is likely to represent good value for money, depending on how much of the legal heavy lifting they are able to undertake. However, an in-house lawyer will not be fully utilised all of the time and there are likely to be quieter periods during which a PE/VC

Manager may begin to question the benefit of having a permanent, material cost on their payroll.

Finally, in-house legal hires can also be expected, after a time, to petition to grow a team. This can be driven by a desire to bring in extra resource to deal with an increase in workload, to bring in specialist knowledge or simply as a means of reallocating responsibility for legal work that has become formulaic/mundane. Whatever the driver may be, given the cost of legal hires, building out an in-house legal team will inevitably lead to a material increase in staff costs.

The outsourced GC model

For PE/VC Managers looking for an alternative solution to dealing with their day-to-day legal needs, Corvus Group offers an outsourced General Counsel service via its Corvus Advisory business.

As the name suggests, the outsourced General Counsel service entails a lawyer from the Corvus Advisory team acting as a client's in-house counsel, albeit on an outsourced basis. Clients can elect to pay a monthly retainer if they have an indication of the level of monthly legal coverage they require, or pay an hourly rate if they do not. Pricing is fully flexible and can be adapted over time to suit each client's legal needs as they develop.

The fundamental aim of the outsourced General Counsel solution from a client service perspective is to ensure that there are no perceived barriers between a Corvus Advisory lawyer and the client. To that end, Corvus Advisory lawyers can attend client offices on a regular basis to embed themselves with key team members and can utilise client email addresses and infrastructure if a client prefers. Response times and coverage will be exactly the same as a permanent legal hire would provide. Over time, the Corvus Advisory lawyer will become fully embedded in a client's corporate culture and fully attuned to their business drivers and risk appetites, appearing to both internal team members and external parties to be a full-time member of the PE/VC Manager's team to all intents and purposes.

The outsourced General Counsel model, although a departure from the traditional approaches to legal staffing outlined above, has proven over the past four and half (plus) years to be successful, with a number of clients having utilised the model both as a temporary measure and a permanent solution.

For clients, the benefits of the outsourced General Counsel model include:

1. Gaining access to broadly experienced, partner-level GCs with sector-specific experience.
2. Hourly rates that are substantially below those of City and US law firms.
3. The ability to ramp legal utilisation levels (and therefore associated legal costs) up and down in line with work demands.
4. A solution that can be as temporary or permanent as required.
5. Lawyers who become truly embedded in a client's business over time, developing a deep understanding of business drivers and risk appetites and operating in exactly the same way as a permanent in-house lawyer.
6. No expectations or demands of material salary increases, bonus payments, carry allocations or the allocation of further resource to grow an in-house legal team.

Conclusions

Since 2019 Corvus Advisory has supported its clients by providing in-house legal solutions on an outsourced basis. The outsourced General Counsel model, although a departure from traditional approaches to dealing with legal staffing, has proven to be successful and we firmly believe that the outsourced General Counsel model is a compelling option for emerging and smaller PE/VC Managers looking to manage their legal needs in a robust yet cost-effective manner.

If you would like to discuss any of the points raised in this article in more detail or explore how Corvus

Advisory can assist you, please feel free to contact us using the details below.

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