

Time to Hire In-House Counsel?

© 2001 Sandra L. Etherton
Etherton Law Group, LLC

Hiring in-house legal counsel can lower a company's legal costs, reduce turn-around time for getting answers to questions, and better manage the company's legal risk by enabling the company to proactively avoid liabilities instead of reacting to legal troubles after they arise. At some point in a company's growth it makes sense to hire in-house counsel. The question is, when is that point?

The timing of hiring an in-house attorney depends on a number of variables, and the timing will be different for each company. The major factors are the amount of revenue and the number of employees; the more money and people a company deals with, the more problems it is likely to have. Other primary factors include the company's plans to go public and the nature of its industry with respect to intellectual property.

Regarding revenue, the old rule of thumb is that a company should consider hiring an attorney as an employee when its annual revenue reaches about \$75 -\$100 million.¹ For slow-growth, privately-held companies, this number probably continues to be a good guide. However, for high-tech or fast-growth privately-held companies, the revenue factor is much lower. Those companies should consider hiring an in-house attorney when revenue reaches \$25-\$30 million. For companies that have no revenue yet but are backed by venture capital, the revenue factor can instead be evaluated using the cash burn rate. When a company with no revenue spends \$25-\$30 million annually, it should consider having in-house counsel. Other factors, such as headcount and plans for IPO, may weigh more heavily for such pre-revenue companies.

Regarding employees, historically companies have considered hiring in-house counsel when headcount has reached 250 employees.² Again, for slow-growth, privately-held companies, this is probably a sound guideline. However, for high-tech or fast-growth privately-held companies, the time to hire in-house counsel occurs when headcount is much less. The high-tech and Internet industries' practice of hiring many long-term independent contractors further changes the equation. While an employer usually avoids employer liability by utilizing independent contractors instead of hiring employees, contractors bring their own bevy of risks and problems. High-tech emerging companies should consider hiring in-house counsel when the sum of the number of employees and independent contractors nears 100.

If it is realistic that a company will make a public offering of its stock, the company should consider hiring in-house counsel at least a year before the planned initial public offering date. An IPO is a sophisticated financial and legal undertaking, and the volume of the work and the skill required to go public should not be underestimated. While outside counsel may handle the legal documentation necessary for an IPO, compliance with investors' due diligence and SEC requirements requires a knowledgeable hand inside the company.

Finally, companies that are in industries that rely heavily on intellectual property should consider hiring in-house counsel earlier in their growth than other companies. Early recognition of what a company's intangible assets are and acting proactively to protect them will place the company in position to leverage these assets against competitors, as opposed to defending them, possibly through protracted litigation. Whether these assets are protectable by copyright, patent, trademark, trade secret or leveraged by licensing, the company that acts first to register or otherwise

¹ Robert A. Major, Jr., *The Shrinking Pool of First Rate GC Candidates*, *The Executive Lawyer*, Vol 2., No. 6 (2000).

² Stephen E. Seckler, *Hiring Your First In-House Counsel*, <http://www.seckler.com>, February 21, 2001.

protect the asset has a distinct and powerful advantage over its competitors. Strong intellectual property protection helps strengthen licensing ability and avert litigation. Inside counsel with intellectual property knowledge can help spot these assets and take the right steps early to protect them.

The benefits of having in-house counsel are both economic and in peace of mind. The economic aspect includes the fact that the effective hourly rate of in-house counsel is usually 25% - 30% of outside counsel. Outside legal costs can be more tightly controlled, because the in-house attorney can spot waste more easily and question bills more authoritatively.

But out-of-pocket savings are only the easiest to see. Indirect savings are found in many places. For example, the time previously spent by the non-attorney employee to interface with outside counsel is eliminated, relieving that person to focus on his/her area of expertise. The biggest benefit of inside counsel is that risks can be better managed and future expenditures for legal costs can be minimized by laying the proper legal foundation for the business's future. Intellectual property is protected cheaply early instead of defended expensively later. Education about proper hiring and termination actions prevents employee and contractor complaints. Legal expenses for compliance with various regulations can be budgeted properly in advance, instead of spending money hurriedly, playing expensive catch-up and potentially even paying fines.

Finally, having someone trained and experienced in the law to handle legal aspects of the business just makes good sense. Like hiring experts in the areas of technology, finance and operations to make a business successful, hiring in-house counsel provides that legal expertise for handling day-to-day legal issues that would otherwise have no legal review, quickly responding to emergent legal issues, and contributing the legal perspective to company plans and management. Having in-house counsel can provide solid legal footing and give management peace of mind.