Captive LPOs: The Right Type of Subsidiary for Your Law Firm?

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Law firms, in response to the more-for-less value challenge posed by buyers of legal services, are exploring different organization models. The win-win goal is to provide services of equal or better quality to clients at a lower cost while at least defending, if not improving, law firm revenue and profit. Models range from network affiliations and combinations with law and other professional service firms to unbundling and re-bundling of services through multidisciplinary platforms, and everything in between.

Here, we discuss why law firms might choose to create one such model: the "Captive LPO" (LPO stands for legal process outsourcing). A Captive LPO is a subsidiary wholly-owned by a firm, created to handle legal process work (think: repeatable work which can be performed efficiently, effectively, and less expensively through the application of streamlined processes, project management, and technology). There are many types of work LPOs can handle; here are a few examples: document review, contract extraction, IP management, and company formation and maintenance.

What Are the Pros and Cons of a Captive LPO?

By separating the practice of law from legal process work into two separate entities, these different types of work can be optimally managed, priced, and delivered under different business models. Some reasons a law firm might want to create a Captive LPO:

- For processing high volume, repeatable work;
- To benefit from labor arbitrage and other cost savings;
- To test a new business endeavor without risking the firm's brand integrity; and
- To visibly demonstrate to clients a dedication to right-sizing workflow and providing value.

Creating a Captive LPO does have challenges and the firm should proceed with care when going down this path. Setting up a Captive LPO can be expensive in terms of time and money, especially if the Captive LPO is set up in another country as a foreign subsidiary. In addition to potentially complex management challenges, they can sometimes be more difficult to wind down than to create.

This model may not be well suited for many small and midsize law firms unless those firms have a strategy for scaling the LPO to serve many clients beyond the parent law firm, or unless the law firm has another business case for setting up a Captive LPO. For this size of firm, "white-labeling" a pre-established LPO company with the firm's brand may be a more manageable and less-expensive solution.

A wholly owned Captive LPO will be more closely tied to the strategy and culture of the parent law firm. By creating a separate entity that is affiliated with but not wholly owned by the firm, the entity can receive outside investment and have more freedom to experiment.

A Captive LPO is not the only model that can address the goals and provide the benefits of having a law firm subsidiary. Other types of subsidiaries can be valuable, too. I spoke with three different leaders about the types of subsidiaries their firms chose to create (two chose a captive model, one did not).

Captive LPO

Matt Burnstein is the Managing Partner of Waller Lansden Dortch & Davis, LLP, a firm of about 250 attorneys headquartered in Nashville, Tennessee, with other offices in the Southern United States. Within the past decade, his firm acquired a Captive LPO called Clear Diligence. Although it is equipped for and solicits work for other clients including law firms other than Waller, Clear Diligence has been invaluable in serving Waller's top dollar-volume clients. According to Mr. Burnstein, this LPO can serve almost as "a concierge service to enhance and deepen relationships with its M&A clients."

Chris Boyd, COO of Wilson Sonsini Goodrich & Rosati, a law firm with approximately 900 attorneys across three continents, spoke with me about the firm's wholly-owned software subsidiary, SixFifty, which was launched in early 2019 as a new go-to-market channel for the law firm's expertise. SixFifty combines product design and technical skills with Wilson Sonsini's legal expertise to create tools for businesses to solve complex legal problems as well as free tools for individuals who can't afford an attorney. Initially, SixFifty focused on privacy compliance, with CCPA and GDPR solutions. By 2020, SixFifty was producing paid and free tools to help businesses return to offices while continuing to support remote work, as well as free tools to help people affected by the pandemic avoid losing their homes. Chambers ranks SixFifty in Band 1 for Law Firm LPOs.

Partly Owned Technology Subsidiary

Rudy DeFelice, CEO of Keesal Propulsion Labs ("KP Labs"), explained to me why KP Labs did not choose the Captive LPO model. KP Labs was spun out of California law firm Keesal, Young & Logan. "All the scholarship on new business development in the corporate world has demonstrated that you shouldn't try to develop a new business under the umbrella of the established entity. The growth rates, capital needs, and operating philosophies of established businesses and new businesses are vastly different. If the new business is treated as a department or practice area within the established business, the objectives of the established business tend to overwhelm the new business. We've seen that frequently in legal."

"The best practice is to incubate an idea internally, support it, and set it free. This model was particularly appropriate for KP Labs because we're not an ALSP (we're not doing things law firms do but with different cost and staffing structures). We built a true technology company to provide digital transformation services to corporate legal departments, to help them become better versions of themselves through technology and automation. We needed the freedom, capital structure, and runway to build a company in the Silicon Valley model, so we spun the company out as a separate entity, with its own P&L, ownership structure (the law firm retains a significant stake), growth objectives, and incentive systems. The entities share expertise and they partner on engagements at times, but each manages its operations and finances."

"The separate-but-related structure has enabled KP Labs to grow rapidly while giving the law firm access to technical capabilities and a reputation as a tech-savvy law firm. Also, as a large shareholder in a technology company, the relationship has given the firm a financial stake in the fastest-growing segment of the economy while using a structure that maximizes its chance for success."

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