Stark Choice for Lawyers— Firms Must Merge or Die

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By JENNIFER SMITH

Business is slow. Clients demand discounts. And top partners are being poached by rivals. For many law firms, these factors have created a stark choice: Merge or die.

After a hiatus during the recession, tie-ups between law practices are back as firms vying for a piece of the $100 billion global corporate-law industry seek to grow.

A least 60 mergers occurred in the U.S. and abroad last year, the highest level since 2008 and a 54% jump from 2010, according to legal-industry consulting firm Altman Weil Inc. Industry experts expect the figure to rise this year.

No longer can law firms boost profits simply by raising billing rates, as firms did in the years leading up to the recession. Clients gained the upper hand during the downturn, forcing many firms to offer discounts or increase their use of alternative-fee arrangements.

"It's now a buyer's market, not a seller's market for the first time in 20 years," says Bill Brennan, a principal with Altman Weil.

By joining forces, small law firms hope for access to more-lucrative deals and to retain existing clients. For larger firms, combinations offer ready-made regional offices or expanded practices. Building new practice areas within a firm is too costly these days, legal experts say. And hiring individual partners has had mixed results.

"Little by little, our ability to service our clients' needs has been limited by our smaller size," says Randall H. Miller, who as managing partner at Denver-based Holme Roberts & Owen LLP helped engineer its acquisition by Bryan Cave LLP. Now he runs the Denver office of the new 1,100-lawyer Bryan Cave, which has roots in St. Louis.

Firms that in flusher times might have rebuffed suitors now are courting them.

"Leading partners are tired of referring their hard-earned clients to law firms in other parts of the world, or to regulatory law firms in D.C., or to the Brussels office of another firm," says Peter J. Kalis, chairman and global managing partner of K&L Gates LLP, a nearly 2,000-lawyer international firm formed through a series of mergers over the past decade or so.

While law-firm profits have been inching up since the recession, earnings haven't returned to double-digit growth. And the gap between the wealthiest and lesser players is expanding.

Profits per partner increased last year at 70% of the 59 major U.S. firms surveyed by consulting firm Hoffman Alvary, with the gains averaging 4.4%. Revenue growth was the highest at the most profitable firms, according to Hoffman Alvary's report, which is expected to be released Friday.

That gap could be a factor behind an uptick in domestic mergers since the recession, as small firms seek the protection of firms with 100 lawyers or more and midsize firms consolidate to form even larger ventures.

Ed Wesemann, chairman of consulting firm Edge International, says conversations with his clients indicate that the coming year could bring 50 major mergers or more. He says at least a quarter of the firms ranked among the top 200 in gross revenue by American Lawyer magazine, have embarked on merger talks.

To be sure, many firms have avoided mergers. Some boutique firms with strong litigation practices or established specialties, such as Wachtell, Lipton, Rosen & Katz, rank among the most profitable despite their relatively small size. The New York merger-and-acquisition specialist has about 240 lawyers.

Law-firm combinations are complex, risky propositions. The costs of integrating new employees, real estate and computer systems might not offset hoped-for gains from increased billable hours, access to more business, or economies of scale. Alliances also can founder over how much partners are paid or which lawyers will hold the reins in the new firm. Partners peel off for greener pastures, sometimes taking clients with them, after a merger. Conflicts between clients can emerge when the rosters of two law firms are combined.

Nasty surprises can lurk. A few years back, Altman Weil consultant Mr. Brennan attended merger-integration talks between two firms that had reached a deal.

"To the surprise of the other party, the acquired party had a huge unfunded partner-retirement obligation that they had assumed would be picked up by the buyer," he says, estimating that the obligation was 5% to 10% percent of the acquired firm's annual revenue. When Altman Weil advises on mergers it makes sure such revelations occur beforehand, he says.

Nevertheless, a flurry of deals has gone through in recent months. In January the Canadian wing of the global Norton Rose Group teamed up with a Calgary-based firm specializing in energy to create a 700-lawyer enterprise with offices in all three major Canadian markets.

This week, McKenna Long & Aldridge LLP, which is based in Washington, D.C., said it would acquire a San Diego firm. The combined practice will have 600 lawyers and a stronger presence in California to handle real estate and litigation for national clients. The deal is expected to close in March.

March also will bring the formation of King & Wood Mallesons, a novel Pacific Rim alliance between a leading Australian firm and a top Chinese practice.

Getting bigger is not a panacea, warns William J. Perlstein, a partner at Wilmer Cutler Pickering Hale & Dorr LLP who served as co-managing chairman when the firm was created in a 2004 merger. "Operating a world-wide law firm 24/7 is a very expensive undertaking," he says. "As you get bigger, you end up with many more conflicts.... You end up with the costs, whether it's videoconferencing or travel."

But Frank Burch, global co-chairman of DLA Piper, says factors such as globalization, the rise of Asia and consolidation among clients are forcing more firms to consider marriage. "More people now appreciate that there are real benefits of scale."