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FIRM GUIDANCE

A Shifting Paradigm

By: Sandy Lechtick

As I was watching a speedboat zip across the crystal clear Cabo San Lucas harbor, in the distance was a huge ocean liner slowing slugging its way into view. By the time it reached port, the speedboat was long, long gone. Thinking about the present state of affairs in Law Firm America, it occurred to me that many law firms – especially larger ones continue to move like tankers and fail to realize that much of what is happening today will be deeper and longer lasting then many realize.

Changing inflection points will affect law firms from top to down – leverage, billing rates, compensation, partnership prospects, possibly the whole business model. It seems like yesterday when Steven Brill, founder and former editor of American Lawyer, pronounced with conviction and fervor, that mid-sized law firms were clearly on their way out. He reasoned they would soon be joining the Dodo Bird, uttering that pronouncement about 15 years ago.

While Brill's predictions were to a large degree accurate – especially during much of the 80's, 90's and 2000 to 2008, the pendulum has been slowly swinging back in the other direction and a chunk of the action is being captured or reclaimed by well-managed small and mid-sized firms. The operative word is "well-managed."

About five years ago, I moderated a "mid-sized law firm" panel discussion for the National Association of Legal Search Consultants in L.A. and selected prominent partners from a few of the top mid-sized firms: Morgan Chu (Irell & Manella); John Gamble (Allen Matkins Leck & Gamble); Adrian Prietz (Quinn Emanuel) and Jeff Rosenfeld, (managing partner of DLA Piper).

The first three affectively articulated the plusses of the mid-sized firms. Most were major boosters for that business model and why their partners were better able to control their destiny vs. being micro-managed by mother-ship 3,000 miles away. It seems that that pitch is resonating with many lawyers today.

Consider that the very attributes that made many large firms so profitable and so formable has been their bench strength, highly leveraged pyramid, national and global reach; significant and well-developed infrastructure; ability to handle huge pieces of major litigation and large extremely sophisticated transactions, superb branding and of course, deep relationships with corporate America.

For many years, General Counsel and other buyers of legal services gave their high priority and in many cases lesser important matters to their chosen vendors – large well-established firms in a “one-stop” shop format. After all, if someone screwed up or the results were not super terrific, no one could second-guess the referral source since the matters were given to this first tier albeit high-rate firm.

Today, more buyers are factoring in price and bang for the buck, like never before. There is less “cover your ass.” Small and mid-sized firms are getting matters that not too long ago would have been almost impossible to get. They were simply not invited to the table. “Legal services” as John Welch, chairman of Burke Williams & Sorensen, told me, is not a business generator. In this market, he noted more companies are reaching out beyond their preferred list of high rate law firms and looking more closely at results as well as cost. More G.C.’s are asking about alternative billing arrangements, results oriented bonuses and top down rate reductions.

Today more buyers of legal services are asking – and increasingly so, “Why should we pay fifth or sixth year associates $350-$450 an hour on many matters, when we can hire a partner with 20-plus years of experience at a fine albeit smaller firm for $400-$500 an hour with perhaps the judgment, industry knowledge and track record to handle in one half of the time that which the mid-level to senior level associate would have taken?”

In addition, more purchasers of legal services are increasingly resistant to subsidizing the training of first-year and second-year associates earning $165,000-plus a year. In fact, some feel the same way about second, third and fourth year associates too. Therefore the pushback will either cause law firms to hire less first year associates, drop salaries (perhaps 15 to 30 percent), put off hiring or ask partners to do more. The question is, how will this all play out? I suspect that at some point, there will be a shortage of well-trained junior to mid-level associates – especially in the general corporate and real estate transactional areas.

Many buyers of legal services will continue to watch their dollars more closely and not be excited in moving matters back to partners billing in $600 an hour range when they’ve been getting good results and excellent service from partners at small firms billing $400-$550 an hour. In the labor sector for instance, partners will find it very challenging to charge $550-$650 rates – especially on single-plaintiff matters when some very fine employment oriented firms and middle market firms can make a buck charging $325-$475 an hour.

Historically, some top firms – especially the larger ones have had what some could characterize as an arrogant “our rates are justified” attitude. After all, they reason, most of their partners (and associates) are highly credentialed and almost all came out of the top law schools. Historically they have the biggest and the best corporate clients. They have generally handled the largest and most sophisticated matters and highest exposure litigation. Most make a compelling argument that their work product is clearly superior

and consistently of higher quality. While I generally agree (but not completely), the question remains, how much of that work should command $600-$700 an hour rates?

Once small and mid-sized firms demonstrate that they're every bit as capable on some matters as the Big Boys, and often more responsive, they will capture more business. Therefore larger firms will have to either charge less, staff their cases more effectively, and/or demonstrate that their work product or extra service justifies higher rates – especially "middle-market" clientele. And many will have to come to grips with the notion that having a Park Avenue address is no longer rational justification and in some cases, a liability.

While many partners like the depth and breadth and critical mass of the larger firm we are seeing small and mid-sized firms increasingly attracting talent (partners and associates) from mega-firms. In some cases it's rates. In others it's shrunken books of business and overall platform. Two of our recent partner placements at a small firm came from two large national firms including a Harvard Law School top litigation partner who took his practice from a prestigious East Coast law firm.

What lessons can be learned from this changing paradigm? How can large firms with significantly higher cost structures compete not just for Fortune 100 to Fortune 1000 company work, but middle-market companies? The last time I checked, California is a middle-market town. How can small and mid-sized firms continue to compete effectively when things gets back to normal?

At the end of the day, the business environment will improve significantly and much will get back to normal. But, 2009 or 2010 normal is going to be a lot different than 2007 normal and a lot more like 1992 normal. The top-tier firms will continue to be more bullet proof than others. The question is, how well will large firms compete effectively with more nimble smaller law firms on middle-market work – especially if a lot of the highly leveraged high-rate work does not return?

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