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LAW FIRM MANAGEMENT

Trading Spaces

Law firms that respond quickly and decisively to the changing legal landscape will avoid many of the mistakes their competitors made in 2002. **By Sandy Lechtick**

In the Chinese language there is a well-known symbol with two distinct meanings - danger and opportunity. For many law firms, 2003 poses huge risks and great rewards. Avoiding risks and seizing rewards requires that law firms plan for their future. And business trends suggest that this year will be similar to 2002.

Law firm fragmentation, practice group acquisitions and mergers will remain on the legal landscape. Partners, particularly under-performing ones, again will face increased scrutiny and will be asked to leave. Consolidation and compression at some firms, while expansion and diversification at others, will continue.

Partner Defections

During boom times, rising tides lift all ships and well-paid partners overlook cracks in the dam. Today's recession and fight for clients, however, has lowered the water level at many firms to expose jagged rocks, including lower profits. Partners with a healthy practice will evaluate opportunities. This is especially true for rainmakers who feel penalized by nonproductive partners or management missteps, such as the hiring of top-dollar, big-ego lateral partners who do not perform.

Moreover, rainmakers feel penalized by the law firms that still operate as an "old boy fraternity," not as a business. Longtime partners who might have been productive 10 years ago continue to draw high salaries, even those billing 1,400 to 1,500 hours a year. Some partners also complain about firm leaders who signed expensive leases at the height of the real estate market. This dissatisfaction has fueled numerous partner

defections.

Last year, for example, defections by leading rainmakers at Los Angeles-based intellectual property boutique Lyon & Lyon added to the partner coffers of firms like Jones, Day, Reavis & Pogue; Fulbright & Jaworski; Perkins Coie; and Holland & Knight.

Minneapolis-based Oppenheimer Wolff & Donnelly's missteps in California, including compensation inequities and lack of support from firm headquarters, seeded intellectual property groups at McDermott, Will & Emery and Greenberg Traurig.

Internal bickering over firm direction, and extremely pricey real estate leases at San Francisco's Brobeck, Phleger & Harrison provided firms such as Clifford Chance and Dewey Ballantine with many great lawyers. Like last year, partner hemorrhaging will seed practice groups at more dynamic, profitable firms this year.

Rate Pressure

Hourly billing rates for partners will remain important this year. Rates are a key barometer of a firm's fortunes, big league status and ability to attract high-powered talent. However, as large law firms continue to raise rates and emphasize practice areas that command in excess of \$400 an hour for a partner's time, many hard-working lawyers will be faced with a tough decision: raise rates and lose key clients or keep rates stable and move their practice to smaller firms. This trend emerged last year.

Last February, five real estate partners left Pillsbury Winthrop's Orange County office to start their own firm after clients balked at Pillsbury Winthrop's premium rates. In April, senior real estate partner Pamela Westhoff at O'Melveny & Myers in Los Angeles moved her leasing practice to a 20-lawyer Santa Monica firm because she could charge her clients 20 percent less. Expect the trend to continue this year. Rate pressure will impact practices that traditionally command lower billing rates, such as real estate, insurance, trusts and estates, and labor and employment. The number of big firm lawyers moving to smaller firms will increase - especially in these practice areas.

Effective Management

Lyon & Lyon, a 101-year veteran of intellectual property law, closed its doors four months ago. Too many leaders, each with a different agenda, played a role in the firm's demise. Each of its five offices operated as a separate fiefdom controlled by a feudal land baron. There was no centralized management formulating and executing one strong vision for the firm. There was neither a cohesive marketing plan nor a cohesive financial strategy. As a result, Lyon & Lyon couldn't adapt quickly and effectively to changes in the business environment. For instance, it wasn't until seven months before the firm closed that it hired a marketing professional to teach the lawyers how to generate new clients and cross-fertilize existing clients. Addressing marketing well after the firm was in financial trouble was too little too late. It was like rearranging the chairs on the deck of the Titanic.

Strong fiscal management and ability to execute will separate the winners from the losers. This year, successful firms will compensate a partner based on merit (hours, revenue,

leadership) rather than seniority; strip equity from partners who act as employees, not owners; and accelerate the partnership tract for superstar associates. They also will divest themselves of costly office space.

Also law firms with streamlined executive committees that make quick decisions and have partner support will thrive. Leadership has never been more important as mistakes prove costlier and costlier - law firms, for example, laying out millions of dollars to acquire expensive lateral groups and open a foreign outpost.

Firms with leaders such as Bob Dell at Latham & Watkins; Bob Lewis at Lewis, Brisbois, Bisgaard & Smith; Pete Kalis at Kirkpatrick & Lockhart; Ralph Baxter at Orrick, Herrington & Sutcliffe; Bruce Jeffer at Jeffer, Mangels, Butler & Marmaro; John Quinn at Quinn, Emanuel, Urquhart, Oliver & Hedges; and Morgan Chu at Irell & Manella will continue to grow their firm and the bottom line. These firm leaders devote significant time to conduct due diligence before hiring a lateral partner, looking at the partner's entrepreneurial spirit as well as his or her lawyering skills. They also hire lateral partners who have practices that directly tie into the firm's strategic objectives.

Mergeritis

Last year, there were numerous law firm mergers nationwide. The mergers included Oakland's Crosby, Heafey, Roach & May with Pittsburgh's Reed Smith; San Francisco's McCutchen, Doyle, Brown & Ensersen with Boston's Bingham Dana; Washington, D.C.'s McKenna & Cuneo with Atlanta's Long Aldridge & Norman; and San Francisco's Lillick McHose with New York's Nixon Peabody. The merger trend will continue this year with regional firms looking to go national and national firms looking to go international.

Two contemplated mergers are already in the works: Philadelphia's Morgan Lewis & Bockius with Brobeck Phleger and Palo Alto's Cooley Godward with New York's Pennie & Edmunds.

Ultimately, more firms will merge to expand their client base or geographic reach. Mergers add key practices that bring in more business from existing clients. They also jumpstart practice areas that would take several years to recharge through home-grown talent. How long this merger mania will last depends on the number of small to midsize firms that have the client base and rate structure to support a bigger, acquiring firm.

Diversification

As with 2002, law firms with too many eggs in too few baskets are at risk of failure. Reliance on a small group of clients can lead to disastrous results. A key partner leaves and 30 percent of the firm's business walks out the door. An important client goes belly up. Another one outgrows the firm and moves to a national firm with greater litigation support. A case keeping 20 litigators busy settles, and there is nothing in the pipeline. Smart leaders establish a firm client base with no one client generating more than 3 percent or 4 percent of the business. With diversity in clientele comes steady cash flow. Take, for example, the former high-flying firms of technology's heyday. Wilson Sonsini Goodrich & Rosati; Cooley Godward; Gunderson, Dettmer Stough, Villeneuve, Franklin & Hachigian; and Brobeck Phleger focused almost entirely on technology clients and the

corporate work those clients generated. With the technology industry now in a slump, these law firms have been forced to lay off idle attorneys and likely will continue to do so this year.

One law firm that caters to technology clients but has weathered the downturn in corporate work is Orange County's Stradling Yocca Carlson & Rauth. The firm did so through diversification. In the past two years, Stradling Yocca has hired quality lateral partners such as litigator Todd Gordinier from Orrick Herrington to expand the firm's litigation and intellectual property practices. This year, expect to see firms follow Stradling Yocca's lead and add more practice areas to their mix.

In all, this year will offer the same danger and opportunity as 2002. Law firms that respond quickly and decisively to the changing legal landscape will avoid many of the mistakes their competitors made in 2002 and will reap the rewards accordingly.

Sandford "Sandy" A. Lechtick is president and founder of Esquire, Inc., a Los Angeles based legal search firm specializing in partner placements, law firm mergers and practice group acquisitions. He can be reached at sandy@esquiresearch.com.