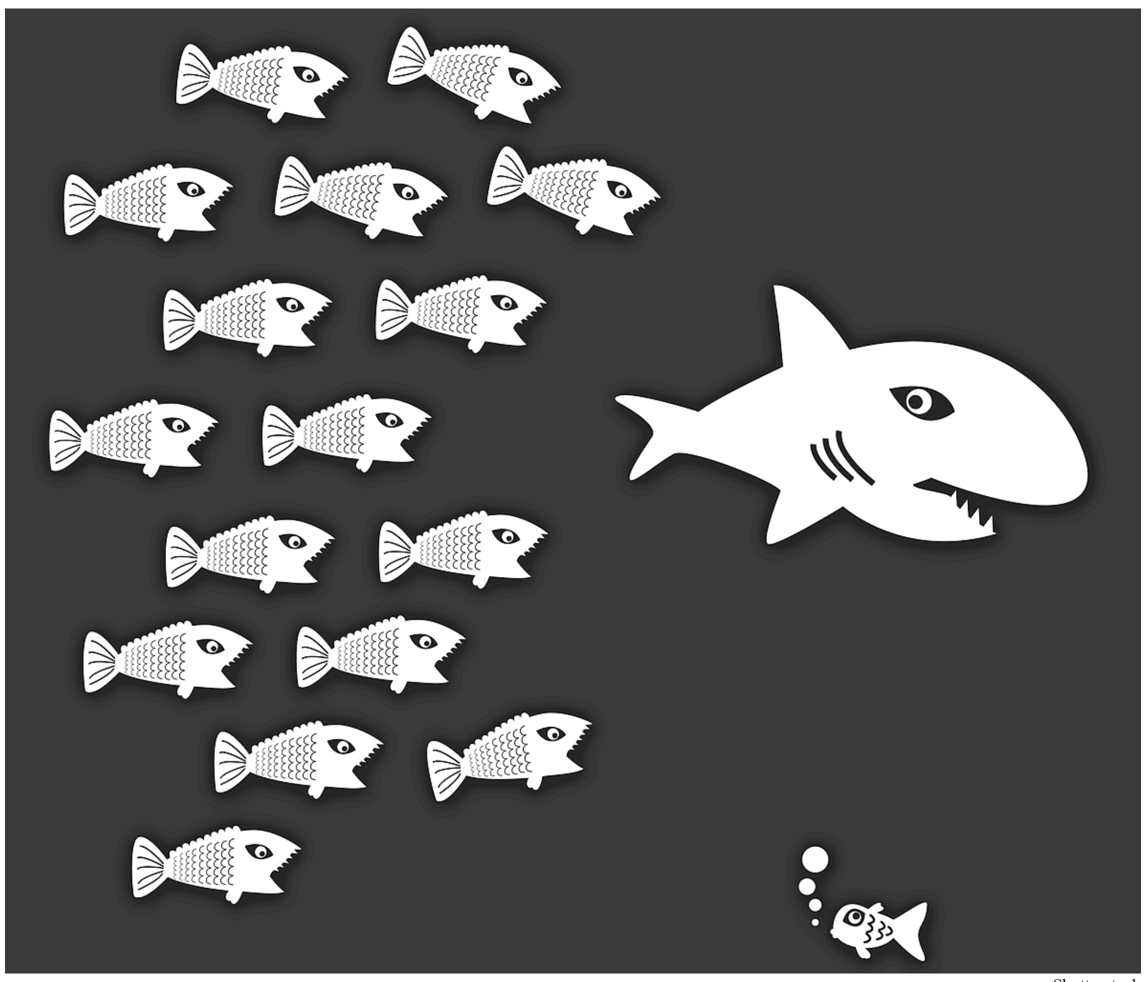

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Year in review: law firm mergers

By Edwin Reeser

A surprising thing about the record 91 reported "mergers" in 2015 is not that there were so many combinations, but that there were so few lawyers involved in them. The "mergers" referenced in the recent report released by Altman Weil Inc. on law firm combinations had a tiny impact on the legal market overall, though in a few cases, we observed that they did have a significant impact on the individual lawyers involved.

Forty-three deals involved five or fewer lawyers, and 70 of the reported combinations involved 20 lawyers or fewer. Eight deals were cross border verein tie-ups, and those are more like offshore franchise sign ups than mergers, so we may exclude those when looking only at the U.S. market. That leaves only 13 deals in the U.S. involving a firm of more than 20 lawyers.

Now, let us look at the headcounts involved.

A total of approximately 1,900 lawyers moved in the 83 domestic "mergers." Looking from the top at the largest deals, there were seven deals of more than 50 lawyers in the acquired firm, with a grand total of 1,095 lawyers. The top two deals totaled 737 of those lawyers, and arguably those were both "*liquidating* mergers" for the acquired firms. That leaves five large deals taking a total of 358 lawyers.

The remaining 76 deals embraced about 875 lawyers, less than a dozen on average, the size of a decent practice group lateral move, or a geographic or practice group boutique "bolt on." Comparing those numbers to all of the lateral movements of lawyers from one firm to another throughout the course of the year, the lateral hire transactions were several times greater in the aggregate than mergers. (About 1,250 to 1,450 partners just in the AmLaw 200 move laterally each year over the past four years). Comparing these figures to the approximately 1.3 million licensed lawyers in the U.S., we have about 1.5 tenths of one percent of U.S. lawyers moving through "mergers." This type of merger activity displaces as much "financial water" as a starfish race across an ocean reef, especially when one has the temerity to exclude combinations of necessity as contrasted with combinations of opportunity, real or perceived.

What does it mean when this is the biggest year on record for law firm "mergers," apart from the obvious of "not a lot"?

First, there were perhaps a half dozen transactions that appear to be truly strategic and driven by a strategy to combine, with a size sufficient to have some market ripple. There were also some additions that were good opportunistic "buys" of practice expertise and some expansion into new geographic outposts that at first blush appear to be a benefit to both parties to the combination.

Second, the rest are a change of address, and in some instances just letterhead, shifting revenue to a new entity.

What we have is compression and consolidation, which is to be expected in an industry that is a mature market, with stagnant demand. In the legal industry with so much work being siphoned away into legal process outsourcing and performed by lower cost providers without the need for law licenses, there are numerous markets that are actually shrinking, exacerbating the problem of fierce pricing competition brought by oversupply of lawyers. The trend is well documented, sustained, and not slowing, so the financial pressures experienced for more than seven consecutive years on the lawyer side are unlikely to abate any time soon. We can expect more "merger" activity as long as there are buyers in the market place who are interested in the acquisition of revenue streams.

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Who are the sellers of these revenue streams? In many instances, they are going to be lawyers, typically smaller groups of lawyers, who have something worth selling. But why would they sell voluntarily if they have a good thing going? Typically because they have one or two fundamental problems associated with their sustainability as an enterprise. One is succession to leadership. Two, and perhaps more fundamentally, to continue generation of the revenue stream when one key partner retires.

A "merger" into a larger firm with an established operating structure and breadth of talent can help preserve that revenue stream. The pricing for such a move to a larger firm usually involves: (1) a compensation cut for the acquired lawyers, a function of higher overhead and thus lower operating margins in many larger law firms; (2) the need for a profit for the acquiring firm to be derived from the work and revenue generated by the new addition; and sometimes (3), a deal feature that allows the acquired lawyers to monetize and harvest some of the built up value in their firm that would otherwise be lost if they were to wind down.

The classic example is the small boutique that is brought on with terms that require them to satisfy all of their current obligations from their pockets, but in exchange keep all of their accounts receivable and cash inventory. That type of small firm "liquidating merger" usually generates a significant cash gain for the acquired firm. But the newly acquired lawyers immediately begin drawing compensation currently from the firm's profits just as a lateral partner addition would. They also they infuse capital, and often commit to a minimum term of years, say two or three, to help transition the business and clients to the new firm so they remain after the retirement of the small firm key relationship partner.

What is a different takeaway from the report? It is not how many firms are joining together. It is how that balances against how many new small firms are being born, especially with spin outs of new boutiques and specialty practices from larger firms. There may be more of that transpiring right now than at any time in the last dozen years as well, particularly in the area of intellectual property. Same lawyers, same quality work, lower price is a compelling pitch to clients these days. Same clients, same challenging work, better work life balance, control of my own destiny is a compelling pitch to some lawyers these days. Let's watch it this year and see where it goes.

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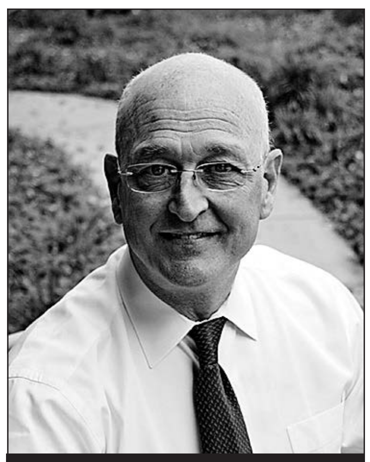

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