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REGIONAL LAW FIRMS

Too big for their own good

Global firms' obsession with profits opens a competitive advantage for regional players.

By David T. Brown
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IN THE PAST YEAR, there has been continuous debate about the future of midsize and regional law firms and whether the megafirm trend is good for clients and the attorneys who serve them. The issue remains at the forefront of the legal industry due to a variety of developments centered around money and profits as the pre-eminent measures of law firm success.

In the prevailing environment, firms often feel compelled to discuss publicly their revenues and profits per partner, and arguably have sharpened their focus on these metrics. In addition, large firms find that the need to lure young talent has required higher starting pay for associates. Billing rates continue to rise. The problem is that none of these factors delivers additional value to clients, which are left to wonder where they fall on the megafirm priority list.

As the pace of mergers shows no signs of slowing—even in a down economy—the case for the middle-market or regional firm has gained considerable momentum since the last time *The National Law Journal* reviewed the status of these firms. David T. Brown, “Middle-market firms thriving in the land of giants,” *NLJ*, July 2, 2007, at S1.

The lack of focus on clients' concerns and needs calls into question the megafirm approach and its ripple effect on clients and attorneys. At the same time, it bolsters the argument for working with—and working for—regional middle-market firms.

In August 2007, the *Wall Street Journal* reported that some megafirm attorneys had begun charging \$1,000 per hour. Understandably, clients publicly criticized the move. Brackett Denniston III, the general counsel of General Electric Co., acknowledged that the company had paid \$1,000 per hour for “specialized” legal advice, but qualified his company's attitude by saying, “That's a line we'd

rather not see crossed.” Nathan Koppel, “Lawyers Gear Up Grand New Fees,” *Wall St. J.*, Aug. 22, 2007, at B1.

Even outside counsel reacted with disdain. One New York-based law firm partner said, “We have viewed \$1,000 an hour as a possible vomit point for clients.” And David Boies, the well-known trial lawyer, said, “Frankly, it's a little hard to think about anyone who doesn't save lives being worth this much money.” *Id.*

Thomas Sager, chief in-house litigation counsel for E.I. du Pont de Nemours & Co., is another outspoken critic of megafirm mergers, rising rates and es-

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calating salaries for first-year associates. During the past year, Sager has continued to speak out on these issues, in one instance agreeing to pay only a flat monthly fee instead of the \$1,000 hourly rate he was quoted by a New York lawyer. In the same *Wall Street Journal* piece, Sager was quoted as saying, “One-thousand dollars may be someone's choke point, but mine is actually a lot lower.” *Id.*

Sticker shock

In addition, Sager wrote in *NLJ* affiliate *Corporate Counsel* about how the concept of “value” is often offered as an excuse for overbilling, quoting one firm that justified associate salary increases by claiming that it had a “long-standing commitment to providing our clients with high-quality service from top-tier lawyers.” Sager's reaction: “If it takes a \$10,000 increase to attract or retain first-year associates, the firm must have little else going for it. What about the firm's culture, client base and work environment? Do those intangibles mean nothing?” Sager called the increase in starting salaries for first-year associates “appalling,” adding that it “makes in-house general counsel want to shout out the window like the frustrated anchorman in the movie *Network*: ‘I'm mad as hell, and I'm not going to take it anymore!’” Thomas Sager, “Not Going to



JOHN S. DYKES

Take It Anymore,” *Corp. Couns.*, September 2007, at 67.

At about the same time that Sager's essay appeared in *Corporate Counsel*, Wal-Mart Stores Inc. issued a memorandum to its law firms announcing a “moratorium on across-the-board rate increases” and declaring that the company would consider only “reasonable, individual requests for rate increases for those attorneys in your firm who are performing at an exceptional level.” Nathan Koppel, “Wal-Mart Memo to Law Firms: No More Rate Hikes!” *Wall St. J. Law Blog*, Nov. 2, 2007.

Profits-per-partner goals clearly are driving these trends despite client frustrations. The 2008 *American Lawyer* report on the country's 100 most profitable law firms brings the issue into sharp focus: “For the first time, the [AmLaw 100] firms showed five consecutive years of better-than-average growth in both revenue-per-lawyer and profits-per-partner, the metric that has turned law firm managers into contortionists.” The report went on to explain that this growth has been fueled by “surging demand for high-end legal services and unrelenting annual rate hikes,” as well as a concerted effort by some firms to reduce their numbers of equity partners. Aric Press and John O'Connor, “Lessons of the AmLaw 100,” *The American Lawyer*, May 2008, at 131.

Even layoffs have played a part in this complex profit-generating game. Sonnenschein Nath & Rosenthal recently announced that it was laying off 7% of its worldwide work force. In a front-page story in the *Chicago Tribune*, Sonnenschein blamed a lackluster economy for the layoffs. However, the

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article also noted that the firm had a strategy in place to raise its profits per partner from \$800,000 in 2005 to \$1.4 million by 2008—a 75% increase. Ameet Sachdev, “Profits Trump Legal Custom,” *Chi. Trib.*, May 29, 2008, at 1.

It is precisely this type of development that fuels the widening divide between attorneys and their clients. With many large law firms publicly setting forth lofty internal profit goals—while at the same time laying off associates and less profitable partners to make room for the wealth to rise to the top—it is not hard to see how some have lost touch with their clients and what is important in those relationships.

Whether directly tied to the profit motive or not, all firms raise rates and some have legitimate reasons for doing so. But the pace at which rates have been rising deserves a closer look. According to a study of corporate legal departments by the Association of Corporate Counsel (ACC) and Serengeti Law, legal fees have risen by 5% to 6% annually since 2001, a figure that far outpaced inflation.

A mentality seems to prevail that this continued pace of increase is acceptable, as little has been done to stop the rate hikes. One legal industry consultant openly suggested that, because the 5% to 6% increase has been customary, it's perfectly fine to continue. Larry Bodine, “It's Safe to Raise Rates by 5 to 6 Percent for Corporate Clients,” *Law Marketing Portal*, Nov. 18, 2007. The attitude implicit in this assumption could be a dangerous one. One well might pose the question: At what point will clients reach a threshold on this issue? That time may be nearer than we think.

‘Serious mismatch’

Amid mounting frustration, clients are beginning to vote with their feet. In March 2008, BTI Consulting reported that 46.5% of corporate counsel surveyed said they had fired their primary law firm during the previous 18 months. David H. Freeman, “End Self-Deception, Excel in Client Service,” *Tex. Law.*, June 2, 2008, at 31.

In addition, a study by the London-based law firm Eversheds showed that clients are appropriately and actively questioning the value they receive from their law firms, and are calling renewed attention to the divide between client demand for value and attorney awareness of that expectation. Eversheds reported that 57% of clients polled mentioned controlling costs and achieving value as their key challenge in buying external legal services, while only 21% of firm partners thought providing better value and justifying costs to clients would be a major challenge in the coming decade. In a time when everyone is thinking about controlling costs, this seems to be a “pretty serious mismatch,” said David Gray, chief executive of Eversheds. Ron Zapata, “Cost-Cutting May Boost Smaller Law Firms: Study,” *IPLaw 360*, March 5, 2008, at <http://ip.law360.com>.

The Eversheds study included only U.K. respondents, but its findings seem highly relevant to the U.S. market. Commenting on the study in an interview with *IPLaw 360*, James H. Cheek, a senior partner at Nashville, Tenn.-based Bass Berry

& Sims, said that his firm has benefited from the trend of general counsel questioning the value they receive from larger firms. He reported that Bass Berry has received more opportunities in the past several years that traditionally might have gone to major-city law firms. “We have benefited from the fact I believe that we are a more efficient and less costly law firm,” he said. Zapata, *supra*.

Clearly, the results of a similar study focused on U.S. clients would be enlightening. In fact, perhaps

Middle-market firms focus more on client relationships.

it is telling that no one in the United States—a much larger legal market than the United Kingdom—has undertaken such an effort. Consider that Sager, who has been in-house at DuPont for 30 years, said that he “can't remember a time when so little attention was paid to clients' needs.” Sager, *supra*, at 67.

Law Firm Value Project

In response to the call for change from general counsel and corporate legal departments, the ACC in late 2007 announced plans to launch “The Law Firm Value Project.” According to the ACC, “long-time frustrations on this issue have exploded.” Susan Hackett, the ACC's senior vice president and general counsel, presented the initiative during a January 2008 panel discussion hosted by the Los Angeles chapter of the Legal Marketing Association. During the program, Hackett called for meaningful changes that will help close the gap between the costs and the perceived value of legal services.

The panel members confirmed that there is increasing interest among corporations in hiring regional law firms, many of which offer highly skilled, experienced senior counsel at a fraction of the fees charged by megafirms. In support of this conclusion, ACC President Fred Krebs said, “One of the most common things I hear general counsel say is that they can get the same level of quality at a much lower price at a regional or boutique firm. I would say many companies are moving in that direction.” Zapata, *supra*.

Middle-market firms have begun claiming their niche. The great middle-market firms make no apologies for their size. In fact, many are beginning to more aggressively assert their rightful position in the legal marketplace. For example, New York-based Pryor Cashman describes itself on its Web site as a “premier, midsized law firm” that is “bucking the 21st century's bigger-is-better evolution” with an approach that “eliminates logjams and avoids wasteful over-lawyering.”

In another example, midsize Goldberg Kohn in Chicago states on its Web site, “We're not the biggest or the oldest firm in Chicago, but we have a reputation for producing great work....Not surprising, then, that dozens of big firms have wooed us. But we're for hire, not for sale.”

Many other regional firms have held fast to their independence—even during the frenzied merger mania of recent years. As a result, their focus has been less on their own growth and more on their sweet spot: the bonds they have with their clients.

Middle-market firms typically focus more on client relationships, serving as trusted business advisers to their clients, often going the extra mile to achieve results and putting profit motives second. Some of the more in-touch firms even take the time to formally survey their clients on a regular basis to ensure the relationships are on track. These firms offer the kind of personal attention and culture that clients increasingly are seeking in their relationships with outside counsel.

Connoisseurship

The solution lies in being a smart connoisseur of legal services. Obviously, clients have choices when selecting law firms, and increasing numbers of corporate counsel are questioning their habitual loyalty to the company's “go-to” megafirm. According to the ACC's Krebs, “You are never criticized for going to a Magic Circle firm or a major New York firm. The question is, what are you using the firm for and can you get what you need from regional firms or boutique firms.” Zapata, *supra*.

In the end, most successful attorney-client relationships are based on great chemistry, teamwork and shared goals. In addition, the best middle-market firms offer extremely talented attorneys—many of whom came from larger firms and have chosen to practice in an environment that is focused on truly serving clients, rather than on meeting profit metrics.

“Relationships are the best competitive strategy,” wrote author Steve Yastrow. He explained that clients are certainly not interested in the amount of profit they generate for the firm. Instead, they care about how they are treated and whether their attorneys listen to them and understand their wants and needs. “In essence, they care about the quality of the relationship,” he concluded. Steve Yastrow, *We: The Ideal Customer Relationship 4* (2007).

Law firms would do well to take a lesson from Yastrow. Successful relationships are premised upon a constructive connection between the parties—an understanding of one another's needs. But in the professional services business, clients should come first. Firms' long-term success will be driven by how they meet the client's needs, not on how they boost profits per partner. **NLJ**

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