Law Firm Finance: Is it Really a New Normal?

Mile High Chapter – ALA
Presented by Stephen M. "Pete" Peterson
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Favorite legal movie quotes; selected lines

- "Here's a dime. Call your mother. Tell her there's serious doubt about your becoming a lawyer."
- "Somewhere, inside, in the dark, the firm is listening."
- "Everything that guy just said is bullshit. Thank you."
- "I hate lawyers; I just work for them."
- "You don't want to quit me. I'm your dream client. I'm the most fun, I'm rich, and I'm always in trouble."

Today's agenda

- Current and anticipated future trends affecting firm economics
- Budget considerations for 2013
- Keys to better profitability

- Why is it called the New Normal?
- In most business cycles, many of the "old ways" may no longer work and firms need to become more entrepreneurial and flexible to take advantage of the new economy.
- Well, this line of thinking isn't new.

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Challenging times for the profession

- Business model
- Firm economics
- Compensation structures
- Competition; disruptors
- Wag the Dog
- Succession issues
- War for market share/free agency partners
- Law firm failures

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In law firms….

- Economic success (however defined) creates complacency
- "If it ain't broke, don't fix it."
- "Our model has worked brilliantly for generations; why change"?

Business as usual

"We're ready to begin the next phase of keeping things exactly the way they are."

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"Things may come to those who wait, but only what's left behind by those that hustle."

Abe Lincoln

Intolerable Cruelty (excess capacity)

- Too many:
- Law school graduates
- Associates-given what clients will pay for
- Of-counsel and non-equity partners, challenging the advancement of associates
- Equity partners, if judged on strict performance criteria or amount of profits to go around

Wag the Dog

Clients forcing innovation

Clients forcing innovation

- How we bill
- Legal project management
- Predictive coding

Alternative fee arrangements

Pfizer Inc., which spends more than $500 million a year on legal matters, says it expects to reduce its domestic law-firm spending by 15% to 20%, largely through flat-fee arrangements.

"I have told firms you cannot make your historical profit margins" on Pfizer work, said the pharmaceutical giant's general counsel, Amy Schulman.

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Points of Law: Unbundling Corporate Legal Services to Unlock Value

HBR article July-August 2012

Opportunities for other firms.

Fee alternatives--litigation

- Under what circumstances might each of the following be the right choice
  - Associates review docs at rack rate?
  - Use staff associates with rates 50% less?
  - Use temp-agency attorneys and pass along cost (or cost plus) as client disbursement at roughly 25% of associate rate?
  - Offshore LPO at roughly half the temp agency cost?
  - Rely entirely on software tools?
    - Predictive coding, etc.

POINTS OF LAW: UNBUNDLING CORPORATE LEGAL SERVICES TO UNLOCK VALUE

How Cisco Decides Who Does What

Cisco's general counsel, Mark Chandler, sorts legal activities by looking at two factors: whether they will pose a high risk if performed poorly, and whether they will contribute to competitive advantage. (This approach is borrowed from Geoffrey Moore's *Dealing with Darwin*, 2005.)

	NOT TIED TO COMPETITIVE ADVANTAGE	TIED TO COMPETITIVE ADVANTAGE
HIGH RISK	**WORK CLOSELY WITH OUTSIDE FIRM** High-stakes litigation Reputation Compliance HR policy	**HANDLE INTERNALLY** Product design, build, and sell Intellectual property strategy
LOW RISK	**OUTSOURCE TO A VARIETY OF PROVIDERS** HR cases Smaller litigation Real estate	**MANAGE VIA SELF-SERVICE, AUTOMATION, OR OUTSOURCING** Routine transaction processing

NOTE ADAPTED FROM CISCO SYSTEMS INTERNAL DOCUMENT

The Economist; 50 ways to leave your lawyer

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Industry disruptors; start of the New Normal?

clearspire

LawVest

Cometh The Hour by Riverview Law

axiom
law redefined

NOVUSLAW
The Measure of Certainty

Rocket Lawyer
The easiest way to make it legal.

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The Five Forces That Shape Industry Competition

Source: Michael E. Porter

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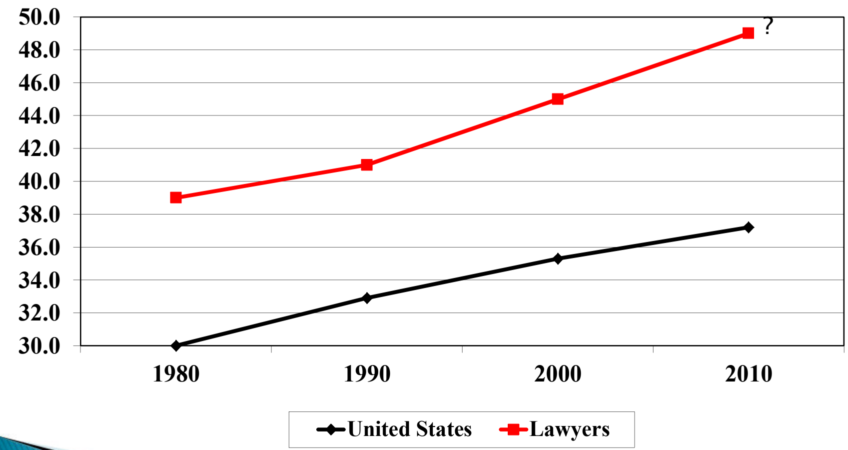
Succession Challenges

The future has already happened.

Median ages
Source: U.S. Census, ABA



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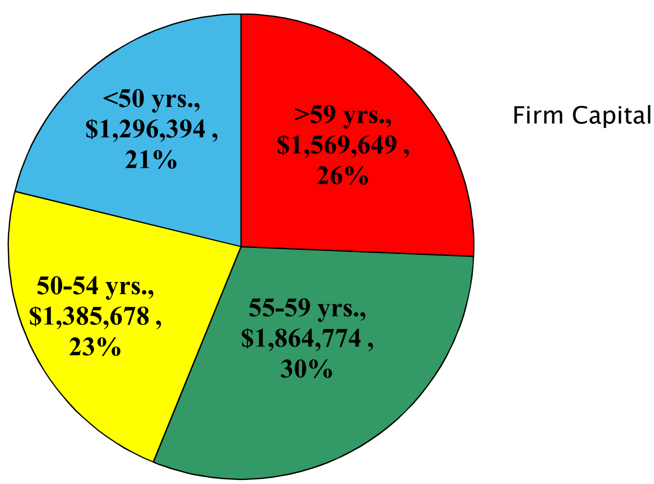
Many financial considerations; example



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"For whom the gods would destroy, they first grant 40 years of business success."
~Peter Drucker

What would happen if 10-15 firms failed in Denver next year?

Law firm failures

BROWN DREW & MASSEY LLP
ATTORNEYS AT LAW
Strength from heritage. Success through dedication.

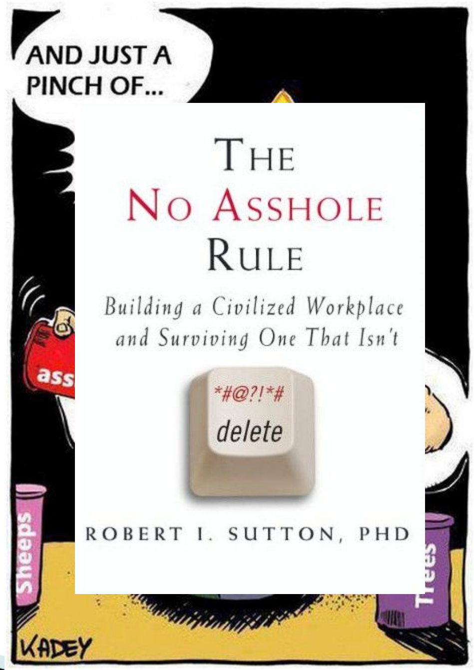
DEWEY & LEBOEUF

CLARK, THOMAS & WINTERS
A PROFESSIONAL CORPORATION
:: Austin
:: San Antonio

Mansfield Tanick & Cohen P.A.
ATTORNEYS AT LAW

Law Firm Consultant Predicts 'Absolutely' More Layoffs and as Many as Five BigLaw Dissolutions

What about 800 pound gorillas?



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Economic trends

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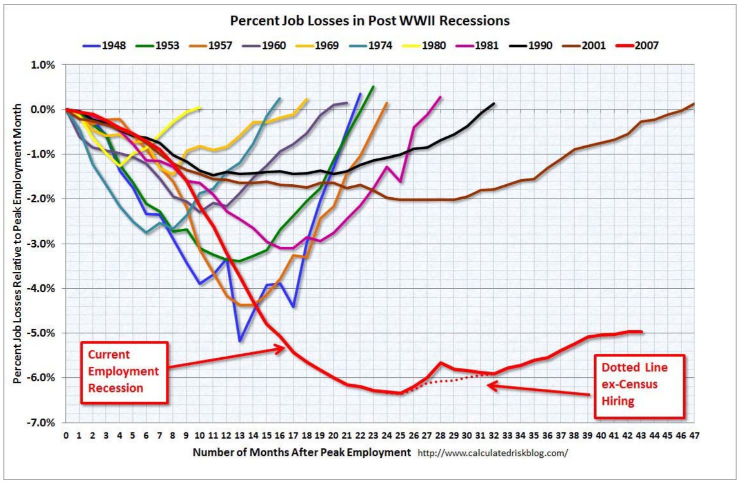
Recessions and period of time to job recovery



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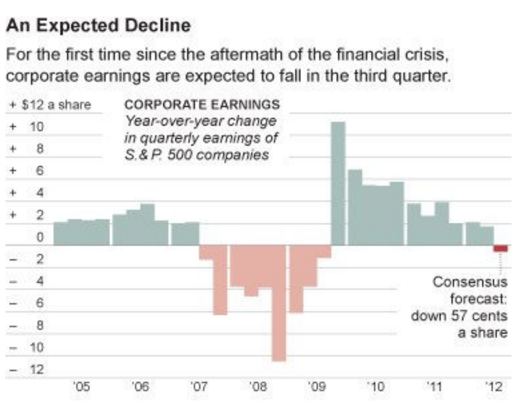
"Earnings in United States Are Beginning to Feel a Pinch."



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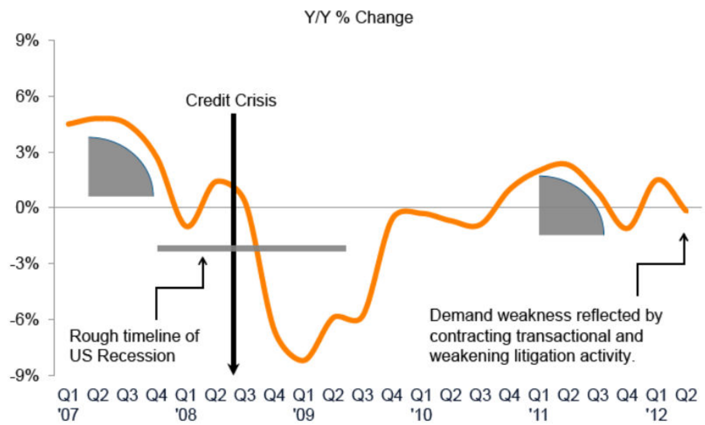
5-Year Pattern for Demand Growth



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*All timekeepers [4]

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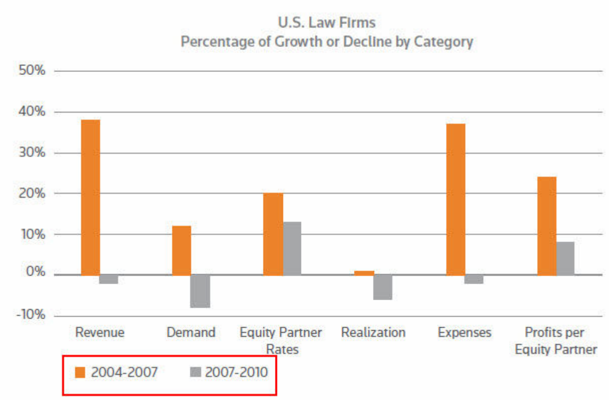
Impact of the Market Downturn



Source: Citi Law Watch

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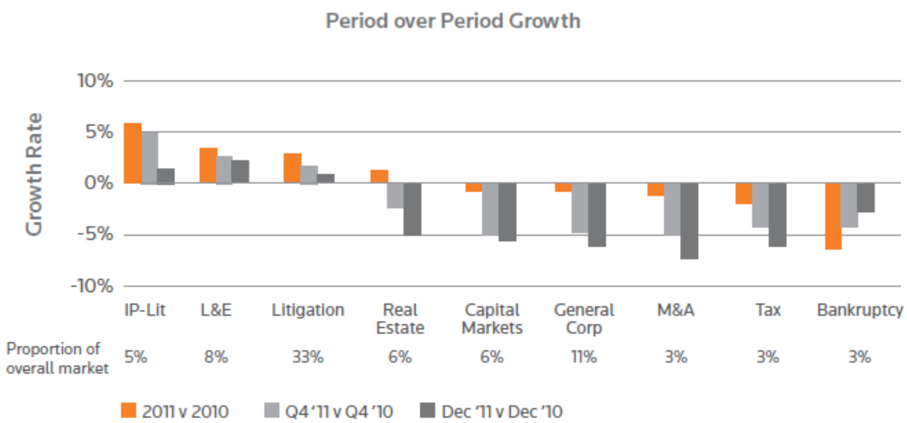
Practice trends–2011

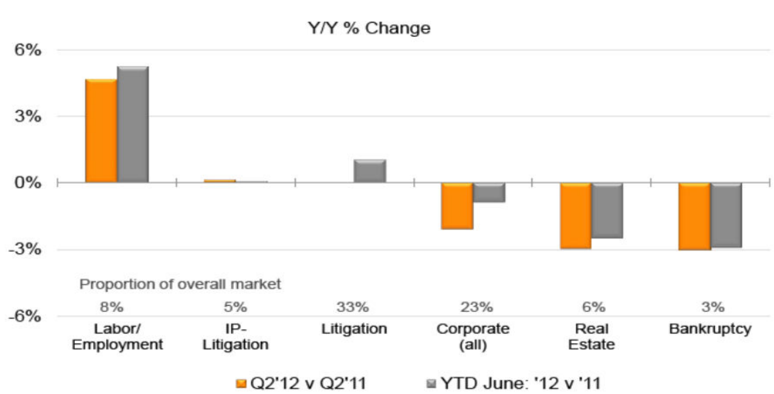
Demand Growth by Practice: All Firms



Source: Thomson Reuters Peer Monitor

Practice trends–Q2 2012

Demand Growth by Practice: All Segments



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*All timekeepers 5

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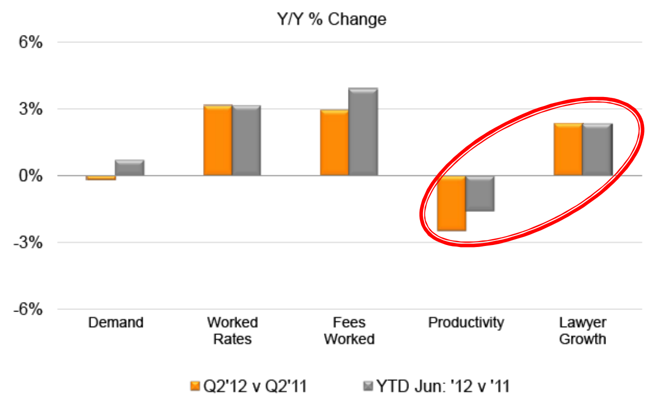
Key Performance Measures: All Segments



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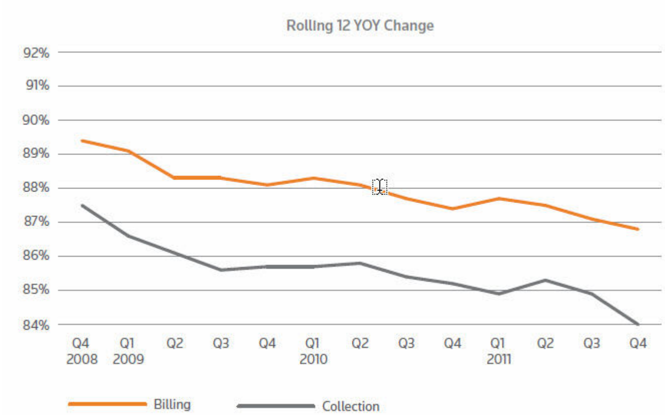
Collected Realization Rate against Standard: All Firms



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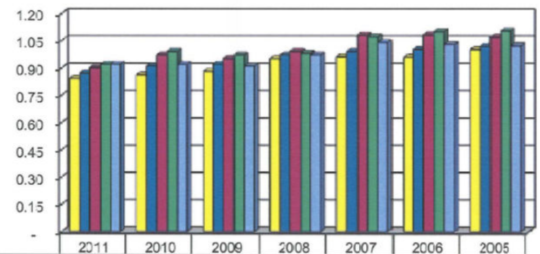
Administrative Employees per Attorney



	2011	2010	2009	2008	2007	2006	2005
National - <50 Attorneys	0.84	0.86	0.88	0.95	0.96	0.96	1.00
National - 50-150 Attorneys	0.87	0.91	0.92	0.97	0.99	1.00	1.02
National - 151+ Attorneys	0.90	0.97	0.95	0.99	1.08	1.08	1.07
National - 151-300 Attorneys	0.92	0.99	0.97	0.98	1.07	1.10	1.10
National - 300+ Attorneys	0.92	0.92	0.91	0.97	1.04	1.03	1.02

McGladrey

All Non-Client Service Personnel (Sec, HR, IT, Acct, Mktg) / Number of Attorneys
(Paralegals are not included)

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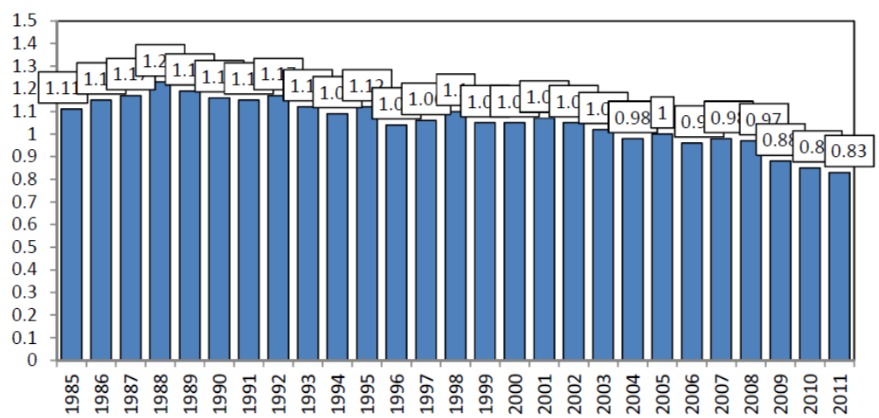
Ratio of staff to lawyers



Source: ALM Survey

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No country for old practices

"We can't solve problems by using the same kind of thinking we used when we created them."

A. Einstein

Law as a business: from Cohen & Grigsby's website

- All of our partners are expected to be productive, both in terms of billable hours and origination of business. There are no unproductive partners dragging down profits, nor is it a concern that the retirement of any senior director will jeopardize profitability.

BigLaw woes

- Recent survey conducted by Wells Fargo's Legal Specialty Group

- Results through June 30, 2012
  - Revenues increasing 3% YOY
  - Expenses increasing 6.5% YOY
  - Hourly rates up 3.7%
    - Net 2.9% (erosion)

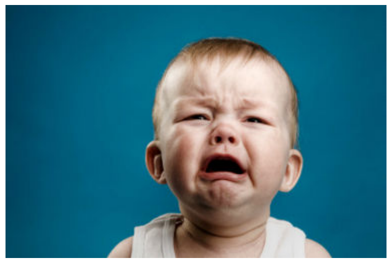
BigLaw woes (cont.)

- Wells Fargo survey (cont.)
- Firms are strengthening balance sheets
  - Partner capital increased 7%

- One in three firms have unfunded pension plans (primarily for partners)

- Survey group; 115 firms in AMLAW200

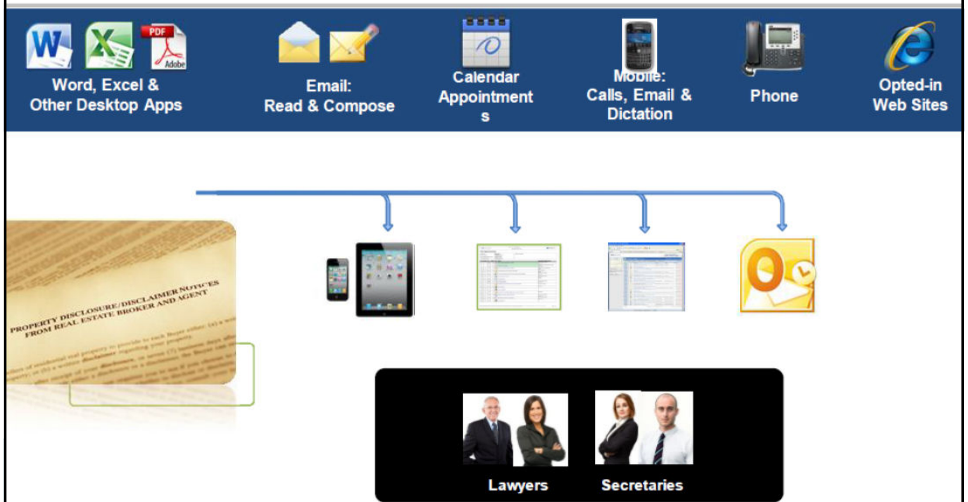
Firms with PPP below $2m taking the hardest hit!



Budget considerations

- Scenario plans
  - Further belt tightening
  - Loss of rainmakers
  - Loss of clients
- Impact from succession planning
  - Reduced productivity
  - Deferred income
  - Return of capital
- Lateral hires
- Consider tools like Time Builder

Time Builder: Capture, Classify, Review, Record



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Budget considerations (cont.)

- Zero based budgeting
- Increase budget for business development
  - Including training, coaching, sales programs
  - Track ROI
- Merger activity–many considerations
- Risk management
- Contingency line item
- What else can be outsourced
- Increase budget for internal controls

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Seeking lower cost solutions

- Offsite service centers

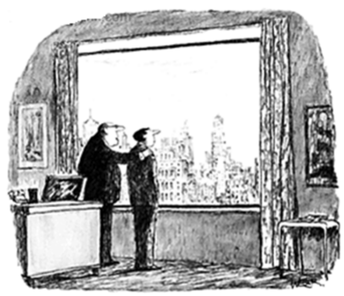
- Bingham (Boston) to Lexington KY
- Pillsbury (NYC) to Nashville TN
- WilmerHale (Boston/WDC) to Dayton OH
- Orrick (SF) to Wheeling WV

- Overseas based outsourcers have centers in Fargo and Dallas

Lack of internal controls

Next-former Mayer Brown CIO charged with embezzlement.

Keys to increased profits



Somewhere out there, Dean, is the key to increased profits. I want you to find that key, Dean, and bring it to me.

1. Get the work
2. Do the work
3. Bill the fees
4. Collect the fees
5. Return to step 1

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Keys to increased profits (cont.)

- Revenue
- Utilization
- Leverage
- Expenses
- Speed

- The New Normal?

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Other helpful (?) advice

- What law firms can Learn from organized crime.
- What Steve Jobs can teach law firms about marketing.
- What law firms can learn from my disappointing experience at Del Frisco's in New York.
- The 'Moneyball' lesson for firms.
- Risky Business: What law firms can learn from airlines and hospitals.

Wanna get away?

"He is in, but according to security cameras he's shimmying down the drain pipe outside his office window."

Questions/comments