

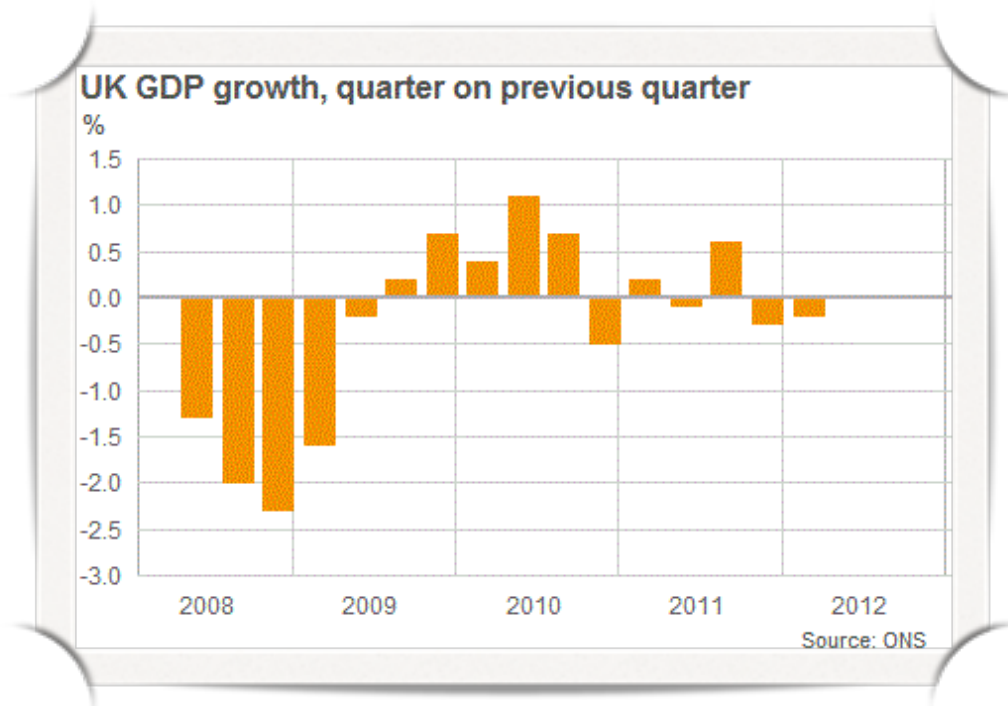
The impact of a double dip recession on UK law firms



John van der Luit-Drummond
16 May 2012

Introduction

There has been much speculation in the press over recent months that the UK was heading for a double dip recession. On 25 April 2012 the UK returned to recession after shrinking by 0.2% in the first three months of 2012. The question I will attempt to answer in this presentation is what impact might this have on UK law firms?¹



Recession 2008

Is the legal profession recession proof?

- It likes to think of itself as recession proof and, to an extent, it is.
- During economic boom, law firms will grow advising on large commercial transactions, mergers and acquisitions.
- During the “bust” times, law firms can profit from representing clients litigating over who’s to blame for their financial difficulties.

¹ 'UK economy in double dip recession' BBC 25 April 2012

The effect of the 2008 recession on law firms...

- The effect of the recession in 2008 was severe on commercial law firms.²
- Law firms with large property departments suffered as deals dried up. M&A and finance-related work also slowed dramatically.
- Some firms were able to reinforce their insolvency practices.
- The collapse of major institutions such as Lehman Brothers automatically resulted in a slew of legal work.
- The top British and American firms raked in millions in fees on large restructuring and insolvency proceedings.
- Those firms that had always focused less on transactional work and more on litigation held up reasonably well. An example of this is that it has been well documented in the press that there is often an increase in personal injury litigation during periods of an economic downturn.³

So did law firms have it all their own way?

Studies and the media⁴ have suggested that in the aftermath of the 2008 recession, many married couples found themselves unable to afford to divorce, as job loses, house prices and investments fell in value, and so couples stayed together contributing to a dramatic fall in divorce rates.⁵ Indeed, as the UK climbed out of recession, following the "green shoots" of recovery in 2010, there followed an equally dramatic rise in the divorce rate for the first time since 2003.⁶



² 'The recession and it's effect on the legal profession' by Chambers Student

³ 'Is the recession to blame for the surge in no win no fee claims' by Arti Vasoo on www.articlesnatch.com

⁴ 'Recession Reality Bites For Divorcing British Couples' by Fiona Wood, Family lawyer and Partner at Pannone LLP in The Huffington Post 9 December 2011

⁵ 'Divorce rates fall to 29-year low' by Harry Wallop The Telegraph 28 January 2010

⁶ 'Til debt us do part: recession blamed for rise in divorce' rate by Tom Peck in The Independent 9 December 2011

So what did law firms do to limit the effects of the recession?

Most firms sought to trim costs through relatively minor measures such as:

- deferring start dates on training contracts;
- bringing in four-day working weeks;
- and eventually some redundancies (albeit not in the same scale as other industries)

Will this be repeated in the current double dip recession?

It would be difficult to think that it will following three to four years of near-stagnant market conditions leaving many law firms severely weakened.

“Lawyers rely on activity. What hurts them isn’t boom or bust, but market paralysis”... a substantial number of firms are currently “hanging on by their fingertips”.

- Tony Williams, the former managing partner of Clifford Chance, who now heads legal consultancy Jomati in 2011.

So what can we expect?

Mergers?

The double dip would, at best, force struggling firms into a succession of mergers with each other, which would no doubt lead to job cuts. Research by the Law Consultancy Network suggests that a high proportion of small and medium-sized firms completed mergers in the first half of 2011.⁷



⁷ 'Law firms mergers trend to accelerate' by Catherine Baksi in the Law Gazette 4 August 2011

John Quinn, the founding partner of Quinn Emanuel, opined⁸ that the merger of US firm Squire Sanders and UK firm Hammonds was a case of “two rocks that think if they hug each other tight enough they won’t sink.”

It appears that many firms have decided that there is strength in numbers. For example, it certainly makes sense for two firms with similar practices to merge, thereby reducing overheads and creating a stronger combined firm. This exact scenario happened with insurance-focused firms Clyde & Co and Barlow Lyde & Gilbert in 2011.

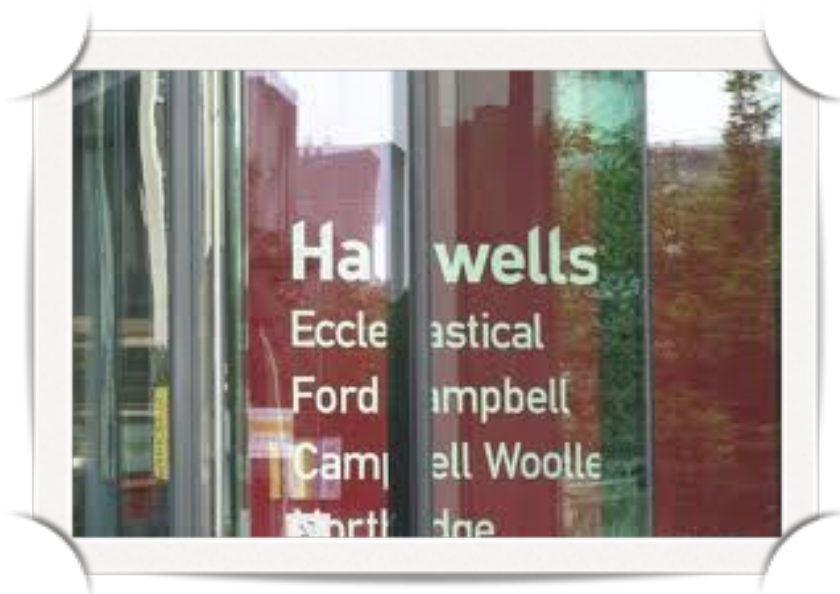
Worst case scenarios...

At worst, the double dip could see a whole host of firms being forced to close their doors such as in the case of Halliwells which remain the one major law firm to collapse so far. Halliwells was bringing in millions of pounds in revenue.

A logical and reasonable question to ask is: *Will every firm currently billing still exist in a year's time?*

In such an environment, can we really expect law firms to be:

- making trainee deferral payments,
- reduced-hour working schemes or;
- lavish redundancy packages for their staff?



⁸ 'Above the Law's Tweet of the Day: John Quinn on a possible Squire Sanders/Hammonds' merger 3 September 2010

The Graduate Market?

- Legal profession previously was seen as a safe option for a career but no longer the case.
- As a result of the recession many firms have noticed that many of the functions performed by lawyers can in fact now be dealt with by legal software.
- Those tasks that cannot be achieved this way and still require a human presence may not require a trainee at approximately £40,000 or even a paralegal at £20,000.⁹
- Law firms may be forced to rethink their trainee model which could well lead to an increase in the work of Accutrainee.

Accutrainee
Efficiency and Flexibility, Redefined

Redefining trainee resource management

About us | What we do | News | Trainee solicitors | Paralegals | Join us | Contact us

Organisations interested in

- reducing costs
- improving efficiency
- improving resource management
- an alternative to legal process outsourcing

Please click here

Receive a call | Contact us

Graduates interested in

- a truly unique training contract
- working for more than one firm throughout your training contract
- a fresh approach to trainee management

Please click here

Upload my CV | Contact us

The Accutrainee Model: The new, more cost effective, efficient way to manage your trainee requirements.

Accutrainee is proud to introduce this ground-breaking new model to the legal profession created to respond to the pressures facing law firms and general counsel in light of recent industry changes.

Our model offers substantial **cost reductions, improved efficiency and increased flexibility** in relation to your trainee solicitor needs. By innovatively redefining the traditional trainee model we deliver many benefits to graduates and those involved in the sourcing and training of the legal profession's most valuable asset.....our future lawyers.

As a SRA authorised training establishment, we recruit trainees and second them to law firms and in-house legal departments in accordance with their requirements. The result is we improve efficiency and flexibility for our clients and create greater opportunities for our trainees.

"An innovative approach to solving the challenges law firms face in recruiting appropriate numbers of trainees and managing their cost"

- A recent survey¹⁰ shows that the number of support staff per fee earner decreased from 0.65 to 0.61, an average saving per fee earner of £821.
- The median spend on non-salary overheads per fee earner was £38,142 compared with £37,163 in 2010, an increase of 2.6 per cent.

⁹ 'The recession and it's effect on the legal profession' by Chambers Student

¹⁰ Now in its 12th year, the survey, which is produced in association with Hazelwoods LLP, a medium-sized, niche accountancy practice specialising in advising the legal profession, is widely regarded as the annual financial health check, particularly for the smaller end of the legal profession.

Diversify the work?

Farrer & Co, takes on ten trainees a year and is an example of a law firm in solid shape. Former senior partner James Furber says he would be “*very worried*” if Farrer only specialised in commercial property or banking work, as is effectively the case with many City law firms.

“Whatever happens in the world, people are still dying, still making wills, and still getting divorced. Happily, we’re positioned to benefit from that.”

In conclusion...

Reasons for law firms to be cheerful?

Broadly speaking, since the 2008 recession law firms have become more streamlined and have taken the steps to diversify their practices, and so they should theoretically at least be much better placed to withstand the double-dip.

New research from the Law Society's Law Management Section reveals that legal practices are continuing to show signs of growth.¹¹

- Practice fee income increased by 1 per cent in 2011, as practices continue to climb out of the hit from the recession.
- In 2009, firms saw a 6.5 per cent drop in fee income.
- Average net profit per equity partner increased from £112,549 to £114,853, a rise of 2 per cent.

Law Society President John Wotton commented:

“The LMS Financial Benchmarking Survey and the support that LMS provides to its members have had a key role to play in helping practices emerge from the recession through effective management. Now, with more competition emerging and more opportunities for practices as a result of the changes under the Legal Services Act, a robust management system is critical for any law firm looking to attract external investment or remain competitive.”

¹¹ Law & More: Law Firms Show Signs of Growth on Thursday 10th May 2012

Chris Marston, Head of Professional Practices at Lloyds TSB Commercial, agreed:

“2012 will be a pivotal year for solicitors. New entrants and external capital will undoubtedly bring change, but I firmly believe that this will expand the market for legal services and create opportunities for innovative, well-managed firms with strong leadership and effective financial management. Getting in shape now is therefore very important, and this year’s survey shows admirable resilience on the part of solicitors.”

- The legal profession is currently valued at £25.49 billion per annum (total turnover in 2010). - Legal Services Board press release

Are there still reasons to be worried?

Even if law firms do diversify and not specialise in only a few niche areas there are still fears that if the big banks and corporate entities lose confidence as they did in 2008, then the major transactions relied upon by many law firms will once again dry up.

Clients have taken stock of the fees charged by law firms, and as their own budgets become squeezed so they will look around for the best value for money.

Staying ahead of the curve...

Law firms may be forced to re-examine their business models through mergers or perhaps even being able to draw on outside investment by becoming an Alternative Business Structure.¹²

Smaller measures may include a change to their billing models whereby they charge a fixed fee for a conveyance or a matrimonial matter, rather than by the traditional hourly method.

Globalisation will allow many City law firms and national firms to outsource low-level tasks, such as document review or administrative work to countries such as India and South Africa and obtain cost savings as a result.

Law firms who are currently ahead of the rest of the legal profession include Eversheds and the Parabis Group. Catherine Baksi believes that outsourcing is 'key' to the survival of many UK law firms, but at present a lot of them are failing to act.¹³

¹² 'Private equity enters the law as Wagamama owner buys Parabis Group' in Legal Futures on the 6 February 2012

¹³ 'Many law firms remain 'reluctant' to outsource' by Catherine Baksi on 5 October 2011

Finally...

Has there been a realisation in the legal profession that the market for legal services has fundamentally changed in a world suddenly stifled by debt? Perhaps only time will tell.

In order to survive and prosper law firms will have to re-evaluate what they do, where, for whom and at what price. Law firms will need to be leaner and meaner than ever before.

As Alex Aldridge writes in the Guardian:

*'Of course, recessions, like riots, don't last forever. And when they pass, the survivors usually find themselves well-placed to thrive as the economy picks up again.'*¹⁴



The screenshot shows a web browser displaying a Guardian article. The page layout includes a navigation bar at the top with categories like News, Sport, Comment, Culture, Business, Money, London 2012, Life & style, Travel, Environment, Video, Apps, Offers, and Jobs. The article title is "Law firms fear double-dip recession" by Alex Aldridge, dated Thursday 11 August 2011 13:56 BST. The main text begins with "Legal profession weathered first downturn but redundancies are more likely if recession returns". Below the text is a photograph of a woman in legal robes. To the right of the article is a sidebar with social media sharing options (Share, Tweet, +1), a comments section, and a "soulmates" advertisement. The advertisement features the text "Find your perfect partner today at guardian.co.uk/soulmates" and a graphic of a couple walking on a path.

¹⁴ 'Law firms fear for double dip recession' by Alex Aldridge in The Guardian 11 August 2011