PART 1 • JULY 21, 2015

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COUNSELORS AT LAW

How to Make Law Firm Mergers Work: It Starts with Culture

In recent years, mergers have arguably become the preeminent agents of change and growth in the legal industry, culminating in the first quarter of this year, which saw a record number of firms joining forces.

The goals of nearly all of these combinations are similar: broadening client relationships, gaining depth in important practice areas, expanding geographical reach, and leveraging back office functions to forge the strengths of each firm into a more powerful combined entity.

When a firm goes hunting for a merger partner, examining business and financial factors alone may reveal many promising candidates. But to narrow the field and to raise the likelihood of a successful combination, firms should look as hard at culture as they do at financial metrics and client rosters.

Culture matters in every industry, of course, but in deals between law firms, it's paramount. When law firms merge, no money changes hands, typically, and no propriety assets are transferred. The power of a law-firm merger lies in human capital. If the lawyers of one firm aren't compatible with the lawyers of the other, then combining the two, no matter the business case, makes little sense.

The first question firms should ask before entering into any merger deal, therefore, should be something like this: Will the combined firm result in a cohesive and unified organization, or simply a larger confederation of lawyers? Getting an answer is easier said than done, of course. Ask a managing partner to describe his or her firm's culture and you'll likely hear words like "collaborative," "collegial," "entrepreneurial," "client-centric" and so on. These are commendable characteristics to be sure, but too vague to be insightful.

Instead, I'd recommend seeking the answers to specific questions. I've found that posing the following eight queries can produce tremendous insights into a firm's true culture.

1. What does firm stand for, and what are its core values?
2. Does firm leadership and the remainder of the partnership embody those values?
3. What is firm's reputation in the communities it serves and with its clients?
4. What is the overall quality of the firm's work — is excellence a constant, active pursuit?
5. Does the firm prioritize teamwork or does it operate in silos?
6. Is there camaraderie or cutthroat competition — how do the partners treat clients, each other and subordinates?

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7. What criteria are used to determine partner compensation — is it "eat what you kill?"
8. What is the firm's attitude toward and track record on pro bono work, diversity and charitable giving?

The dialogue in discussing these and other matters relating to cultural compatibility should occur in the early stages of a deal. These meetings should start with leadership, and then extend to practice group leaders and other important partners.

If however the preliminary discussions pass muster, the next logical step is to start pounding out a term sheet or letter of intent that defines most of the deal structure. This gives both sides an additional, important opportunity to observe each other under stressful working conditions. If the back-and-forth becomes too acrimonious, or results in multiple stalemates, it is likely a signal that the cultural fit is less than ideal. ■

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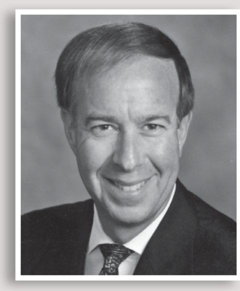
- *Article One:* How to Make Law Firm Mergers Work: It Starts with Culture
- *Article Two:* How to Make Law Firm Mergers Work: Dealing with the Finances
- *Article Three:* How to Make Law Firm Mergers Work: The Business Case
- *Article Four:* How to Make Law Firm Mergers Work: Integration



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PART 2 • AUGUST 3, 2015

BLANK ROME LLP
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How to Make Law Firm Mergers Work: Dealing with the Finances

Last week I wrote about how a merger of law firms can only be successful if each firm's culture aligns compatibly with the other. But as important as culture might be to creating a unified and focused firm, none of it matters unless the combined firm gains an economic advantage from the combination. In most cases, this beneficial financial impact drives the merger discussion.

For that reason, working out the financial business case should commence early in any merger process. Combinations can be accomplished with various financial constructs. The acquiring firm could receive the other firm's work-in-progress ("WIP") and accounts receivable in return for capital credit and other considerations (such as guaranteed compensation). Or the acquired firm's partners could keep their WIP and receivables, and contribute a portion back to the acquiring firm as capital. There are a number of ways to structure a deal, but whatever the construct, it should be modeled at the outset.

And in any financial model there will be a multitude of inputs. These represent some of the most critical building blocks in any merger analysis. Again, these will vary by situation, by model and by construct, but some of the most important considerations are:

- What are the compensation levels for partners, other attorneys and staff?
- Will compensation guarantees exist? If so, for how long and subject to what milestones, if any? (e.g., revenue and hours)
- What expenses will be assumed by the acquiring firm? (e.g., leases, existing contracts)
- What level of tail insurance coverage will be sought and who will bear the expense?
- What will the integration costs be?
- Will there be a physical move? What will the cost be?
- Will the transaction be accretive or dilutive to the acquiring firm's partners in year one? In the following years?
- What redundant costs can be eliminated?
- What capital will be contributed and when?
- Is there a broker and if so, will that fee be expensed or amortized?
- Will billing rates change?
- Will there be reduced billable hours during the transition?

The modeling should include, at a minimum, a pro-forma combined income statement and balance sheet for the year of the transaction and the following year, a cash flow

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analysis for the same periods and key financial metrics, including Revenue Per Lawyer, Profits Per Partner and Profits Per Equity Partner, and a dilution analysis.

Invariably, one of the most sensitive financial considerations in any law firm merger will be compensation for the acquired firm's partners. An important guidepost is how and where these new partners fit into the acquiring firm's compensation structure. Straying too far from those benchmarks will likely create friction among the acquiring firm's partners, even if there is a business case for doing so.

Although law firm mergers don't come with the kind of paydays that owners of non-principal-service businesses might experience, the partners of the acquired firm often receive some kind of financial benefit in the form of goodwill. The goodwill can take different forms, including cash or capital, but whatever the form, it will come at the expense of the acquiring firm's profits. Some of the hit can be mitigated with creative ways of providing capital. For instance, a "golden handcuff" approach may be employed, by providing that capital in the merged firm vests over a three to five year period.

Finally, the financial modeling needs to clearly show how a merger will prove accretive for both sides in the long term. Some initial dilution of profits and perhaps revenue might be expected, especially where the acquired firm has greater profit margins. There will always initially be redundant costs and one-time deal expenses. However, once operations have been fully integrated, and redundancies eliminated, the model should benefit from economies of scale. ■

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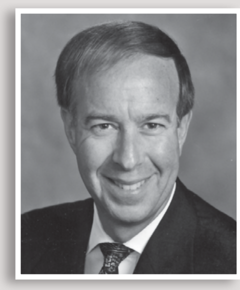

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PART 3 • AUGUST 11, 2015

BLANK ROME LLP
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How to Make Law Firm Mergers Work: The Business Case

In the past few weeks I've written here about two crucial early steps in the law firm merger process. For these deals to be successful, it's critical to establish a cultural fit and to align the firms' financial interests. But as important as these steps might be, law firm mergers are most often conceived for business reasons. While it may seem obvious, it's imperative to develop a compelling business case — it defines the long-term shape of the combined firm, and articulates the plan to enhance performance.

A strong business case for a merger should address three major components: combining complementary areas of expertise and enhancing depth, both within professional disciplines and geographies; cross-selling new services to each firm's clients; and filling in practice area gaps. Firm leaders must build a comprehensive business case that encapsulates the merger's benefits and synergies. This should be presented to each firm's leadership and important stakeholders to build consensus and a unified vision of the combined firms' evolution. The business case should be balanced, which means addressing downside risks as well. Being candid with all partners and stakeholders on every aspect of the deal will help build goodwill — an invaluable commodity whether or not the merger is consummated.

Consider an independent consultant

Assuming both sides perceive the business union to be compelling, having an independent industry expert validate the business case could be valuable. Getting a third party's perspective can help neutralize emotional or personal biases and create enthusiasm for the deal. This process must be closely managed to achieve all expected goals. A "go/no-go" decision will be much easier to make once this step is completed.

Hire outside counsel

Mergers tend to be transformative for all parties. For partners, they're life changing events. With so much at stake, it's advisable, especially for the acquired firm, to seek outside legal counsel. While it might seem redundant to hire yet another set of lawyers when combining two teams of attorneys, it's well worth considering, especially for firms with limited law firm mergers-and-acquisitions experience. Keep in mind Abraham Lincoln's famous remark: "He who represents himself has a fool for a client."

Check for conflicts

Any due diligence analysis must start with both firms' top clients. These should account for between 50 to 75 percent of each firm's revenue. Conflicts or redundancies amongst these keystone accounts must be identified early on, as one major roadblock can subvert even the best-looking deal. Just as with any business combination in any field, the search for conflicts should be exhaustive. After the biggest clients have been examined, the process should move on to second-tier clients, some of whom may be growing quickly and represent major growth engines for the firms. This

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process should continue through closing, as each firm adds new clients to its roster. Lastly, focus on business conflicts as well, such as one firm representing generic pharma, and the other representing brand pharma.

Confidentiality: Take nothing for granted

Any merger exercise must include an undertaking of confidentiality on both sides. Premature disclosure can jeopardize the deal, tip off competitors and make clients anxious before the firms can talk with them and present the merger with proper context. Don't take anything for granted. I recommend using browser-based, non-company email accounts to handle merger communications, including due diligence, as well as using code names throughout all communications. In the case of a pre-mature leak, there should be an agreed upon plan in place early on, with a response agreed to by both firms. Acting quickly will ensure that the firms, not competitors or internet gossips, control the merger narrative.

Be transparent

During due diligence, which should be conducted by each firm, leaders should maintain an open dialogue and share historical and new information as it becomes available. Operating with as much transparency as possible will result in better decision-making and a better merger, if it is to happen, and it will also justify the considerable time and effort spent in due diligence, a detail that should not be overlooked. A comprehensive due diligence will also help validate the business case and facilitate integration, the subject which I will discuss in the next and final installment. ■

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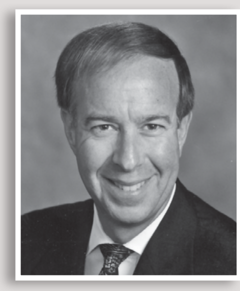

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PART 4 • AUGUST 21, 2015

How to Make Law Firm Mergers Work: Integration

In the past few weeks, I've covered the staple considerations that should lead discussion, planning and execution of law firm mergers. Once these critical factors have been resolved, the final element, planning for integration, must be addressed and tended to during merger discussions—and then for months following consummation of the deal. In a sense, the easy part is getting the deal done—the hard part is its execution.

The most successful law-firm mergers always implement comprehensive integration plans that combine painstaking attention to detail with thoughtful implementation tactics. Combining large groups of people in a work setting poses a myriad of challenges; the integration plan is meant to assure a smooth transition. The benefits of a merger—from back office efficiencies to greater combined legal competencies and business development prowess—will be realized more quickly when a thorough integration plan is successfully implemented.

The integration process should start as soon as both sides feel a high level of confidence that a deal will get done. A team should be assembled to lead the effort, and its members should include staff from finance, HR, technology, conflicts, billing and collection, facilities, and marketing. This group should meet every two weeks during the later stages of deal discussions, and then weekly as the closing date approaches, with meetings continuing for three to six months after closing, or however long leaders think it's necessary to achieve a seamless consolidation.

The integration team will coordinate all operational aspects of the merger, from which software programs will be retained, to how existing and new-client servicing will be enhanced. Two point people should be assigned to post-merger operations: one who handles systems and related staff issues, and another whose duties center on creating a welcoming environment for the lawyers of the acquired firm and dealing with lawyer and practice related matters.

Among the first things the integration team should examine are the IT systems at both firms. Often, the acquired firm will transition to the systems of the acquirer, unless the acquiring firm is looking to make an upgrade, which does happen. After the merger, redundant systems should be kept in place for a time while tech teams complete their transitions. This is especially important for billing, collection and finance functions. Computer assets—laptops, mobile phones and desktop machines—should see no down time. The goal is to keep the technical transition from interfering with the lawyers' work. To that end, computer training and orientation should occur as soon as possible after closing (or immediately before), preferably on a weekend, so the new lawyers can make as seamless a shift as possible, with

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as little down time as necessary. The goal is for the merger to have as little effect as possible on the firm's primary product: billable hours.

The acquired firm's lawyers should be supplied with a who-to-contact list, so that all questions are easily and quickly handled by the right person on the acquiring side. Again, creating a welcoming atmosphere is key; mergers with rocky transitions can create morale issues that can translate to lower billable hours and less than optimal client service.

Perhaps the top priority throughout all integration processes: avoiding the loss of business or confidence from any client. Timing and client messaging is critical, as well as an articulated plan regarding billing rates. It's not acceptable for clients to hear about the combination through the press. A careful and precise plan to inform each client of the merger should be executed before the union is formally announced; firms should be prepared to answer questions about whether billing rates will change.

When some time has passed after closing, key members of the transition team should gather for a post-mortem to discuss which parts of the integration went well and which ones can be improved upon in the future. For growing law firms, mergers offer a powerful avenue for growth. Executing them smoothly is an acquired skill that creates a competitive edge. ■

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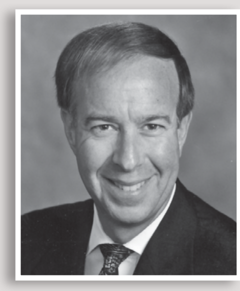

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