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REACHING NEW HEIGHTS

MIDSIZE LAW FIRMS CLIMB INTO BIGLAW'S TERRITORY

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March 12, 2014

TheRemsenGroup
727 Kirkwood Avenue - Atlanta, GA - 30316
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March 2014

A Publication of Law Bulletin Publishing Company

Chicago Lawyer®

Volume 37 Number 03 • chicagolawyermagazine.com

REACHING NEW HEIGHTS

Midsize firms climb into Big Law's territory

Good things come in midsize packages

Josh Leavitt

Smaller firms find path to success by attracting Big Law partners and clients

By Roy Strom

With investment returns flat-lining about two years ago, a private equity group turned its cost-saving scalpel to its legal-services budget.

Deals are the lifeblood of private equity shops; this group in particular has closed more than 300 of them. And when each passing buyout, carve-out or spinoff can result in a seven-figure Big Law legal bill, savings can be vital.

Much Shelist was one of the firms interviewed to land a slice of work from the private equity group. The firm's chairman, Mitchell Roth, said the entity previously sent all of its legal work to "one of the top law firms, if not the top law firm, in the country, especially in private equity."

Today, after representing for roughly two years the dealmakers that he said he could not name in public, Roth's midsize firm is doing deals "left and right for these guys."

"Have we put a dent in large firms' revenue? I doubt it. But they don't like having us around, that's for sure. Any time you bring another law firm into a huge relationship, and we start chipping away at it, there's risk, right?" Roth said.

"We do a great job on a deal for 40 percent less? Maybe we get the next one. Or maybe we keep going bigger and bigger on these deals. And over time, we'll start taking their market share."

Roth had a similar experience with an aerospace client that has traditionally been serviced by some of the nation's largest law firms.

"We're doing millions of dollars of work for this company, and we weren't even relevant four years ago," he said.

Roth and Much Shelist's experience is representative of industry reports that say smaller firms have already been growing their slice of the pie relative to the nation's biggest firms — a change often credited to an increasing price sensitivity among general counsels nationwide.

A LexisNexis report in October made headlines when it put numbers on a trend that those in the profession had long felt: Sophisticated legal consumers are becoming less fixated on the brand name atop their memos and more concerned with the number at the bottom of their invoices.

The share of U.S. legal fees going to firms with 201 to 500 lawyers grew from 18 percent three years ago to 22 percent in the 12 months ending in June 2013, according to the report based on an analysis of $10 billion in legal fees. At the same time, the largest 50 firms — those with more than 750 lawyers — saw a drop in market share to 20 percent from 26 percent.

Perhaps more striking was the report's finding that the biggest matters were most likely to be shifted from Big Law to what some consider midsize shops. For U.S. litigation matters that generated $1 million or more in outside legal fees, firms of 201 to 500 lawyers had 41 percent market share in the latest year of the study. That was up from 22 percent three years ago.

While that national trend has resulted in a flurry of Big Law partners joining smaller firms in Chicago, those who have made the jump stressed that anybody considering a similar leap should approach the ledge cautiously. Those lawyers leave behind Big Law hourly rates that can start at $650, while midsize firms can offer rates that range from $200 to $450.

And there are still risks for midsize firms in a legal market that continues to consolidate.

A trend reversal

Today's stories of midsize success are a stark contrast to reports of those firms' demise in the run-up to the Great Recession.

Over the last decade, as national players planted their roots in Chicago by acquiring long-standing midsize offices, the narrative for smaller firms often went something like this: Merge, slowly lose partners or accept a plateaued role in the legal business as the world "went global." Or worse.

Yes, the world went global. And it is true that one tactic general counsels employ to save costs is to leverage their purchasing power within one firm — and usually a large one. And for the biggest and most important deals, even the leaders of midsize firms say they aren't right for the job.

But it appears that other forces have proved wrong the thinking that midsize firms are of a bygone era.

Raymond Werner, chairman of Arnstein & Lehr, said his 150-lawyer shop and firms like it generally offer rates that, depending on the matter, can be about 60 to 70 percent lower than the advertised rates at Big Law firms — which continue to rise as many double down on a strategy to target a portion of the market where they can command premium rates and, in turn, boost their profitability.

Yet as top-down belt-tightening continues in corporate America, general counsels such as Century Aluminum's Jesse Gary have increasingly opened up to the idea that Big Law does not have a monopoly on talent.

In addition, general counsels are less likely to find the price stability offered by alternative billing structures at the largest firms. The LexisNexis study found smaller firms billed twice as much under alternative billings over a 12-month period than the nation's 50 largest firms.

At Century Aluminum, Gary found high-quality lawyers at smaller firms in Kentucky — where the aluminum producer has some of its biggest operations — who can service legal issues such as employment matters at a fraction of the cost of the firms that previously handled issues out of offices on the U.S. coasts.

"The real thesis was: Can we find the legal talent we need in Kentucky that can do a lot of this work that we were doing on the coasts but for a real significant price difference?" Gary said. "We've been really pleasantly surprised by what we found in Kentucky. ... These are the same guys we all went to school with. They just went home instead of moving to New York or Chicago or LA."

Enough moves like that can reverberate through the profession. What do partners from the coastal firm do after losing out on a client (or multiple clients) due to a billing rate that is largely out of their control?

Frequently, they approach smaller firms that will allow them to offer clients a lower rate, said Michael C. Borders, managing member of Dykema's Chicago office.

"We see ... a lot of lawyers not seeing the opportunities at some (large) firms, and their belief is they can grow their practices and relationships with clients if they move to firms that have more flexible rate structures," Borders said.

"It's not rocket science, honestly."

A more well-worn path

Midsize firms sent out plenty of press releases in the last year heralding new partners who joined from Big Law firms.

Freeborn & Peters, a roughly 120-lawyer firm, announced the hires of partner Gary Jungels — a former Mayer Brown and Kirkland & Ellis lawyer — and Peter Steffen, who joined as senior counsel from Foley & Lardner.

The 110-lawyer Ungaretti & Harris hired seven lateral partners and three lateral counsels, including former Kirkland lawyer William Corey Spence and Jeffrey M. Friedman, who had previously practiced at DLA Piper and Drinker Biddle & Reath. David Tanner also joined from Drinker. In another sign of the firm's health, it hired 21 lawyers in total last year, including six first-year associates out of its summer program, its most in more than a decade.

"It was a very active year

J. Eric Guth

for us," said Tom Fahey, Ungaretti & Harris' managing partner. "We don't recruit that many people either as first-years or as laterals in a typical year. It was a year when a lot of things came together in terms of the firms' workload and opportunities in the lateral market."

Arnstein & Lehr, meanwhile, added John Gekas, a litigator who formed his own practice after working at Kirkland.

As evidence of the market turning to firms like his to handle bigger transactions and litigation matters, Arnstein & Lehr's Werner said the firm handled the national real estate portion of a multibillion-dollar divestiture, while the chief transactional firm was a large Wall Street shop.

Mitchell Roth

But Werner stressed that making lateral hires of former Big Law partners is a strategy that comes with its own set of dangers.

"They know themselves and their clients' needs better than anybody," Werner said. "They know whether they're going to really be able to move that business with them. Sometimes they fool themselves, and they're not able to move that relationship … But if they're looking for a more open environment, a more flexible rate structure and a place where they can continue to represent their client and bring young lawyers in the fold … firms like ours are just a wonderful home for those folks."

After considering many of those same things, J. Eric Guth decided to move last year from Barnes & Thornburg to Much Shelist.

A corporate finance partner, Guth said he was impressed by Much Shelist's broad resources, finding them comparable to those at Barnes & Thornburg. In addition, the midsize firm was well-known to his clients and the Chicago business community.

"When I made the switch and told clients that I had switched, no one has asked me to explain who Much Shelist is," Guth said.

"Anything that I ask for they're pretty much willing to provide. They're definitely committed to the success of their partners because ultimately it redounds to the benefit of the firm. And it's not just resources. A lot of it is a flexibility that (the firm's leaders) have. The answer is never 'No.' It's either: 'Yes.' or 'Why? And let's figure out a way to make that make sense.' "

Those considerations are on top of the more basic cost considerations that make his practice more appealing to more clients, Guth said.

"There aren't a lot of clients out there who will rule out a lawyer because they are not expensive enough," Guth said.

Not rocket science, but chemistry still involved

While the trend might seem to make simple sense from a macro perspective, career changes occur on the micro level. For the lawyer choosing to be uprooted after decades of walking into the same firm, it could not be a more personal decision.

Josh Leavitt, a Much Shelist partner, said it wasn't an easy decision to leave K&L Gates, where until last year he had worked for two decades. But he was ultimately persuaded by several factors at Much Shelist, including flexibility on fees; a strong focus on understanding clients' needs and business; and the firms' attorneys being eager to work together across disciplines.

"The message is so much more than price competition," Leavitt said. "It's just not all about sending them a bill for their legal services. They know they're going to get billed and they expect the highest quality.

"But it's this other stuff that helps you to be a more effective negotiator; it helps you to be a more effective advocate. It's thinking about those things every day that makes the difference and in a collaborative fashion."

Greg Grove, another Much Shelist partner, echoed Leavitt's sentiment. But his story highlights another consideration for lawyers who may be interested in moving — the risk of building a practice outside Big Law.

Grove began his career in Palo Alto, Calif., at Wilson Sonsini Goodrich & Rosati, an international law firm with Silicon Valley roots that annually places near or atop the rankings of representing clients in venture capital funding.

After roughly 11 years, he moved from the West Coast to Chicago, where he was a partner at Kirkland from 2006 to mid-2009.

While at Kirkland, he believed he had a rare combination of experience that would allow him to capitalize on what he saw as a growing venture capital or startup scene in Chicago.

"I can mix tools from the buy side, the sell side, the venture capital tool kit and the private equity tool kit," Grove said, recalling his thinking before he moved to Much Shelist. "And then comes the moment where you say, 'OK, what am I going to do with the rest of my life?' "

When he committed to the idea that he would begin his own entrepreneurial practice at a midsize firm, he knew it involved a number of risks. For one, there was leaving the financial security provided by Kirkland.

"You only leave Big Law once," he said. "So when you leave, if you choose to leave, then it's important to make sure that you're moving into the right platform."

That was another risk, especially considering the investment — both in money and trust — that his desired practice would require from any law firm he joined.

The startup scene in Chicago circa 2009 was not the same hype-filled arena it is today. And it was November, roughly a year removed from the failure of Lehman Brothers that sparked the worst financial crisis in decades. And finally, he was proposing to represent startups, which by definition have little money to pay legal bills. He was asking the firm to take on "collection risk."

Greg Grove

"It was very, very difficult those first couple of years," Grove said. "But here's the key. Here's why I chose Much Shelist. (Roth and Chairman David Brown) looked me in the eye and I said, 'All my mentors tell me it will take three years to build my practice into something. And I need you to know that, because I'm betting my career coming here to you.' ... And they stood by me. They built the practice."

Today, Grove said he has a seven-digit venture capital practice based in Chicago and Silicon Valley.

"My natural business-development base is also my client base," Grove said. "And so I honestly think that if you want to be an originating partner, you have to find a law firm that values your natural client origination base. And while for some people, Big Law is actually exactly the right place for them to originate, for other people, their natural client origination base is not the highest priority, or perhaps even the average client, at Big Law."

Midsize or Big Law, similar pressures

Midsize managing partners have their own set of risks to consider when approaching Big Law laterals.

There could potentially exist a problem of adverse selection: The least capable Big Law partner may be the most eager to jump to a midsize shop. And it is a difficult fact of life that Big Law partners who have traditionally spent time servicing clients as opposed to originating work can often find themselves first in line for cuts at the largest shops.

"There's also a ton of laterals from big firms ... that have diminishing or no books of business that believe that if they went to a midsize firm and lowered their rate from $800 to $500 that they could build a book of business and grow a practice," Roth said.

"I think that's really, really hard and dangerous. Like anything else, you know, when you have a large practice, you can go anywhere you want. When you don't, it's tough to move. ... I don't hire those guys thinking I'm going to be able to help them grow a book. I don't think that's going to happen."

Roth said the sweet spot for lawyers he is looking for would have a book of business in the "high six figures" and believe they could adapt to and benefit from a more entrepreneurial practice of law.

"We've been really successful helping them grow their practices two, three, four, fivefold," Roth said.

But Roth said he faces his own pressures luring attractive laterals who increasingly view a law firm with a national presence as a requirement to grow their business. Roth said the firm handles matters across the country, but with only two offices — Chicago and Irvine, Calif. — a prospective lateral might have second thoughts.

So Big Law partners are sliding down to midsize firms and those same firms are looking to bolster their dowries with more offices.

"Midsize firms now are going either national or super-regional with, I would say, somewhere between 200 and 600 lawyers," Roth said. "So they now are almost like large firms of the past."

Clients — like that private equity group looking for lower legal bills — may hope midsize firms can keep their fees low amid the growth. ■

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