For Successful Law Firm Mergers, Allow for These Critical Factors

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THE LAST SEVERAL YEARS have been boom times for law firm mergers, and 2015 is looking like more of the same, including reports of a megamerger involving Atlanta-connected McKenna Long Aldridge and UK-based Dentons. Not too surprisingly, some of the same factors for success or failure that apply in the case of these behemoth deals are equally applicable regardless of the size of the merger or other practice acquisition.

I believe there are five critical factors that should come immediately to mind and be thoroughly vetted when considering any type of law firm combination: people/culture, practice systems, compensation structures, facilities and clients/conflicts.

People/Culture

This factor of success or failure is critical but often difficult to assess before it's too late. The front line negotiators for both constituent firms tend to be the "face men" or women of their respective groups, so it is only after the combination has been consummated that the true chemistry is revealed as either a palatable recipe or a witches' brew. A single particularly strong personality in the mix can make all the difference for good or ill.

Accordingly, the more meaningful the exposure each firm has to the other firm's lawyers during the due diligence period, the better.

With a little effort, including inquiries within the legal community regarding the reputation of the prospective merger partner, bad mistakes can be avoided. The smaller the merger, especially when just a handful of new partners are being "acquired," the more critical this factor becomes.

Having practiced in a large-, small- and medium-sized firm, in that order, I have observed how corrosive an effect just one or two highly energetic—but totally self-centered—practitioners can have upon the group dynamic. In many cases, the issue may not be the personality, but rather the productivity (or lack thereof), of one or more individual partners.

In either case, once the marriage knot is tied, it can be extremely difficult—yet critically important—for the firm to extricate itself from the bad apple or apples.

Practice Systems

As law firms have become increasingly computerized, whether the constituent firms have practice systems that will blend well takes on enhanced importance. This factor can have a significant—sometimes even devastating—impact on the success or failure of the combined operation.

One painful example comes to mind. During my small-firm life, we tried to bring a PC practitioner into our Mac-networked firm, resulting in extreme unhappiness both for the PC devotee and the rest of the lawyers and staff who loved their Macs.

Despite our IT person's best efforts, due to system incompatibility, everybody's "machine" was freezing up often and at the most inopportune times. Ultimately, this was the principal factor in the new lawyer and his team moving on, but not before the entire firm's collective blood pressure had been dangerously elevated.

Factors like these are even more pervasive in a true merger context, where each constituent firm is likely to be enamored with its own legacy computer, accounting, timekeeping and billing systems, favorite vendors, etc.

Compensation Structures

A collective buy-in to a common system of compensation and benefits is a must in any successful law firm merger or acquisition. I have experienced both thoroughly subjective systems in which an all-powerful committee makes every compensation call, as well as primarily dollar-driven systems where objectivity supposedly controls. The former is usually not as opaque and subjective as it seems, nor is the latter as objective.

Significant challenges are in store for the surviving firm that must incorporate lawyers who are accustomed to living under one of these regimes and must now accommodate themselves to the other. Even more problematic is combining a contingent fee-based practice with one where the billable hour rules.

My current firm, where I've practiced happily since 1997, tends strongly to the objective side of the spectrum, and I am convinced this compensation structure has permitted us to more smoothly incorporate the several practice groups and lateral hires we've brought on over the years.

Facilities

Usually the respective firms' facilities lease or facilities ownership arrangements will not be a significant impediment to a smooth combination. In some cases, however, this factor can be a major negative.

For example, the acquiring firm may place such a high premium on physically combining the operations of the two firms that undue financial sacrifices are made to accomplish that objective. In such a case, the combined firm may have to take on or buy out an existing lease, creating a financial burden and source of continuing resentment for the legacy firm.

In a situation where the firm's quarters are owned by fewer than all of the partners, further opportunities for conflict and resentment exist. Those partners who are excluded from facility ownership may not feel fairly treated, and those who do participate can be distracted from their primary roles as practicing attorneys. There are more than a few local examples of firms in which the real estate tail wagged the law practice dog, to the ultimate detriment of all concerned.

Obviously, these issues should be carefully worked through before the deal is finalized.

Clients/Conflicts

I was talking to a lawyer friend recently who described how his firm's merger with a much larger national firm had lasted only a few months because of a conflict between his firm's best client and a major client of the acquiring firm. In retrospect, he realized that his focus on the exciting prospect of becoming a partner in a fine, national firm with many opportunities for cross-selling and other synergies had resulted in his giving less than full attention to the possibility of such a conflict.

The other factors discussed above can usually be resolved in a mutually acceptable manner if enough time and effort are applied, but conflicts between major clients are often not subject to resolution and can render the new marriage irretrievably broken from the start. Identifying and resolving such conflicts up front may be significantly complicated by ethical restrictions on divulging client identities and confidences.

More Art Than Science

The law firm merger/acquisition is a complicated thing. If you don't believe me, just Google "Checklist for Law Firm Merger" and run through the myriad moving parts involved. Most of these considerations will be at play, to a greater or lesser extent, regardless of the size or structure of the transaction.

In all cases, the complexity, and certainly the challenge, results in large part from the fact that the "target" being "acquired" consists primarily of people and their capacities to perform complex legal tasks, manage other people, keep clients happy and find new clients and sources of business.

Although beyond the scope of this article, I would be remiss not to allude to considerations of professional ethics in this area. Suffice it to say that the rules are not always intuitive and that special care must be taken to faithfully observe them (compare Rule 1.17 of the ABA Model Rules of Professional Conduct on sales of law practices and Bar of City of New York Formal Opinion 1999-04 on law firm mergers).

While the task seems daunting, giving particular consideration to the factors discussed above is bound to enhance the chances for success in an endeavor that ultimately is more art than science.