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NEWS

  **Stroock's Merger Talks Face Pension and Accounting System Hurdles**

 The New York law firm has been in talks with Squire, McGuireWoods and Steptoe. But the firm's pension program and its accrual accounting system could complicate a merger.

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 Law Firm Mergers



Patrick Smith



- As Stroock seeks out a merger partner, the firm's accounting system and unfunded pension could add additional barriers to a deal.
- Merger experts say that while those elements add an additional level of complication to merger talks, it doesn't mean a deal can't be done.
- The firm has explored a merger with McGuireWoods, Steptoe and, most recently, Squire.

Stroock & Stroock & Lavan, beset by partner exits in recent years, has been in merger talks with multiple Am Law 200 firms, but the law firm is facing some challenges to a combination, including its pension program for retired partners and its accrual accounting system, according to sources familiar with the matter.

In particular, Stroock has been in discussions with McGuireWoods, Steptoe & Johnson and, most recently, Squire Patton Boggs, according to a source. Representatives for these firms did not return messages seeking comment on merger talks.

In a statement, the law firm declined to comment on specifics of any merger talks but acknowledged that “operations systems” and pension obligations may be points to address in “sizeable law firm mergers.”

“We are always working to strengthen our business in line with our long-term strategy to grow independently and fairly evaluate new opportunities as they arise. We do not comment on rumors or speculation,” said a Stroock statement to Law.com, adding: “It is common knowledge that sizable law firm mergers are typically complex, and while operational systems, compensation systems and pension obligations of the parties involved rarely dovetail perfectly, many still find a way to close.”

Stroock’s merger talks follow years of falling head count and some unwanted partner exits. In March 2022, Stroock lost a 43-attorney bankruptcy and restructuring group to Paul Hastings. And Stroock, like several other firms, recently made attorney and staff layoffs, Law.com reported in January.

The firm’s accounting structure has been a merger impediment for some time, according to a source. Stroock uses an accrual system—which may consider revenue from work in progress and accounts receivable before it is received from clients. The firm also keeps a fiscal year that ends in September.

Most U.S.-based firms follow a calendar fiscal year and use cash basis accounting, often collecting upward of 30% of their revenue for the year in December.

## **Pension Predicament**

Meanwhile, the firm’s pension program, according to sources, could pose challenges related to a combined law firm’s obligations post-merger. Stroock’s pension obligation, at one point, was around \$40 million annually. However, sources have confirmed that the firm has reached out to its retirees on at least one occasion to ask them to consider a reduction in benefits to make the firm’s financial position more palatable for prospective merger partners.

The pension obligation is tied to the revenue of the firm, which means retirees evaluating whether to take more of a hit on their benefits need to make a decision: Do they accept less now in hopes that the firm can find a merger partner, or do they hold firm and try to keep what they have?

One potential question for the merger participants is whether Stroock factors in the revenue of the newly combined firm when assessing pension benefits or whether the firms will need to keep that separate.

While a pension could be a potential impediment in any merger talks, it doesn’t necessarily scuttle talks between the right firms, said Peter Zeughauser, principal at Zeughauser Group and a veteran of several major law firm mergers.

“When firms are in the merger market or are thinking about it, they are usually focused on paying down the plan as much as they can to position themselves better for a deal,” he said.

Zeughauser added that the motivations can vary for the parties involved on whether this is a good decision.

“If a firm is in trouble, then keeping the pension obligation low is better than having nothing if the firm goes under,” he said. “Something is better than nothing and you don’t want the double whammy of losing the plan entirely.”

It’s not clear whether any of Stroock’s merger partners also have unfunded pension programs.

But generally, a merger between a firm that has an unfunded pension and one that doesn’t can create two classes of partners, said Zeughauser, including those from legacy firm A that have the pension and will continue to receive the benefits from it after retirement, and those from legacy firm B that will have to pay into the pension but not receive its benefits. He said that while certainly a hurdle, that doesn’t necessarily mean a deal can’t be struck.

“Some firms are more comfortable with two classes of partners,” he said. “All pay in but only the legacy partners will get the benefits. There have been some deals that have done that.”

While a few decades ago, unfunded pensions were more prevalent, especially for New York-based firms, most firms at this point don't carry one, said Brad Hildebrandt, another veteran consultant of law firm mergers.

"Now, they are either gone, being phased out or have seen significant reductions," he said. He agreed with Zeughauser that a two-tier system can cause issues during merger talks, but also agreed that these are "solvable problems" for two firms that want to make a merger work.

## **Another 'Solvable' Hurdle?**

Stroock's accrual system is another point of discussion for its merger partners. While common in Europe, an accrual accounting system is far less common in the United States, making merging the books more complicated.

"Most firms are not excited about adopting an accrual base system," Hildebrandt said. "It creates new income and tax issues for them, and those are two significant issues. Are they solvable? Yes, but it takes a good understanding of whatever direction the firm [being acquired] is heading. If it is a positive one, there can be a compromise."

Zeughauser said that a merger between two different accounting systems could cause some initial undesirable side effects.

"It can trigger an additional year of payment as a makeup payment for the firm that is a year behind," he said. "And that can be an issue in getting a merger vote out of the firm partnership."

Both consultants said these issues, while adding complexity to the merger discussions, are not deal breakers.

What was a deal killer, said Hildebrandt, was a "lack of flexibility." The question is how flexible Stroock and its merger partners are going to be.

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