Amid Law Firm Merger Boom, 'Transformational' Talks on the Rise

New York Law Journal
By Christine Simmons
December 13, 2017

While 2017 is already a record year for law firm mergers and acquisitions, the biggest action may be taking place below the surface.

An ever-increasing number of large law firms are entertaining merger discussions, according to several industry experts, driven by heightened competition and stratification in the legal industry.

“I can’t remember any time in our consulting experience that as many firms that are fairly large are willing to take up talks for larger deals,” said Altman Weil principal Thomas Clay, who said his consulting firm has been in high demand to evaluate potential combinations involving partners of equal or larger size.

While many have not been consummated and never will be, several instances of merger talks between large firms have already come to light this year. Others, however informal, have remained under the radar.

For instance, two sources with knowledge of O’Melveny & Myers said the firm has been exploring growth options, including through a merger or a large group acquisition. One knowledgeable source said O’Melveny & Myers had brief, preliminary merger discussions with Willkie Farr & Gallagher in the last year, but the discussions never went far. Both firms, in statements, denied they had merger talks with any firm.

And while Andrews Kurth Kenyon’s mergers talks with Hunton & Williams are now well known, the firm previously spoke with Winston & Strawn for a deal, according to sources briefed on the talks. Both firms declined to comment on any specific talks, while a Winston leader said the firm doesn’t plan on merging.

Legal industry observers point to several factors driving enhanced interest in Big Law mergers. Those drivers include a widening gap between the most profitable law firms and the rest of the Am Law 200; the perception that laterals and group hires are not enough to grow; the dilemma over aging rainmakers and succession planning; and increasing competition for sought-after clients and lawyers.

Deals already completed this year between large firms include Norton Rose Fulbright absorbing Chadbourne & Parke and Henry Davis York; Womble Carlyle Sandridge & Rice combining with Bond Dickinson; Ballard Spahr combining with Lindquist & Vennum; and Saul Ewing tying up with Arnstein & Lehr.

At least three other major deals have also been in the works in recent months, including Bryan Cave and Berwin Leighton Paisner (BLP); Hunton & Williams and Andrews Kurth Kenyon; and Foley & Lardner and Gardere Wynne Sewell.

Publicly, law firms typically stay mum about any merger talks until they are far advanced.

An O'Melveny spokeswoman said, "We have not had any merger talks and don't comment on rumors or gossip."

A spokeswoman for Willkie said, "We have not engaged in merger discussions with anyone."

Bob Jewell, the managing partner of Andrews Kurth, said in a statement, "Growth is part of our strategic plan, so naturally we talk to other firms from time to time. We do not comment on speculation or confidential matters."

Some firms say even considering a merger isn't in the cards. "We're not involved in any merger discussion, it's not part of any plan we have," said Michael Elkin, vice chairman and managing partner of Winston & Strawn's New York office, noting that the firm wouldn't comment on merger discussions in any case. Elkin said the firm's preference is to grow through adding large groups of lawyers.

'Flipped' Switch

According to Altman Weil's MergerLine figures, at least 95 law firm combinations have been announced so far in 2017, already beating an earlier high of 91 in all of 2015.

While many of those were large firms gobbling up smaller practices, Clay, of Altman Weil, points to a "switch that flipped" in 2017 that has prompted larger firms to become interested in "transformational" combinations involving firms of equal size or larger.

Echoing Clay, Kent Zimmermann, a law firm management consultant at Zeughauser Group, said there are more preliminarily conversations and announced combinations now in which both firms are in Am law 100, Am Law 200 or Global 100.

"Preliminary conversations between firms are becoming more routine," said Zimmermann, who has advised on multiple law firm combinations this year, including some in progress. "If you look across Am Law 200, more firms are open to those conversations than aren't. It's the exception that a firm would say we don't want to have any preliminary conversation."

Historically, most firms have grown their bench strength by hiring laterals and groups, but increasingly firms are putting all options on the table, even a combination, to beef up practices, Zimmermann said.

“A lot of chairs are coming to the conclusion that (growing by laterals and small groups) is a slow, expensive and error-prone path, and as a result, a growing number of firms are saying ‘We’re not going to limit ourselves to laterals and groups’,” he added.

It’s not just firms that are out of good options that are open to deals, Clay and Zimmermann said. Firms with high-quality practices and “with good brands’” are also open to merger talks, they said.

And in a market where demand is soft, increasing competition for sought-after clients and lawyers are also driving merger talks. One way firms can distinguish themselves for talent and clients is to add depth and quality in their areas of focus by joining forces, Zimmermann said.

Widening Gap

Michael Blanchard, an advisor to law firms and a partner at GLC Law Firm Consulting Group, said firms with 150 to 300 lawyers and regional firms are perhaps most open to mergers. They are large enough to have Am Law 200 competitors but have steep discounts and often “don’t have unique differentiators that set them apart,” he said.

“Anybody outside the top 30 law firms is looking and open to opportunities, either for leadership succession purposes or they feel they’re not able to compete for premium work,” Blanchard said, adding those firms find they either have to get bigger or get more focused in order to be the “go-to” firm for a high-quality practice.

Leadership succession planning and the need to cope with aging rainmakers are also driving firms to the merger market, said Blanchard.

“I don’t know anybody who isn’t actively willing to engage” in merger talks, he said. “There’s this fear out there that any one or two (departing) clients or partners can put a firm in a real difficult bind.”

Meanwhile, many large firms sense they have to keep up with peers further up the ladder. They may feel they can’t catch up in profitability and revenue, said Larry Watanabe, a legal recruiter and partner at Watanabe Nason & Schwartz. “A lot of firms are trying to make up for that by merging, gaining critical mass, acquiring a firm,” in order to grow their market share, he said.

Zimmermann said the gap in profits between some firms widens each year, even if firm profits grow by the same percentage, due to the benefits of compounding profits. “It’s like ‘we’re never going to have a prayer of catching up if we just build brick by brick’,” Zimmermann said. “The space between each rung is growing and it’s getting harder to climb and that’s partly why firms are putting all options on the table.”

Consider O’Melveny. The firm said it hasn’t been courting a merger, and its financials last year were healthy: it generated $725.5 million in gross revenue, up 5.2 percent over 2015, although it was still below the record-high revenue of $818.5 million the firm reached in 2012.

But over the last decade, O'Melveny has not caught with some of its peer firms in some financials. For instance, from 2006 to 2016, O'Melveny's profits per partners have increased 20 percent. Some of its peer firms founded in California have soared higher in the same period: Latham & Watkins' equity partner profits have increased 65 percent; Paul Hastings, up 62 percent; and Gibson Dunn & Crutcher, up 87.1 percent, according to an ALM analysis of the last 10 years.

Announced combinations between Hunton & Williams and Andrew Kurth and between Foley & Lardner and Gardere would allow the firms to leapfrog above their peers in revenue. While each firm is now out of the Am Law 50, the combined firms' revenue could result in each landing in the Am Law 50.

Firms want to increase their resilience in a highly competitive market and in the face of any upcoming market turmoil, consultants said. With a merger, they can accelerate growth in practices that command higher rates.

The upshot? There are few reasons to expect the pace of formal and informal merger discussions to slow down in 2018. And if even only some of them end in a deal, next year may break records once again.