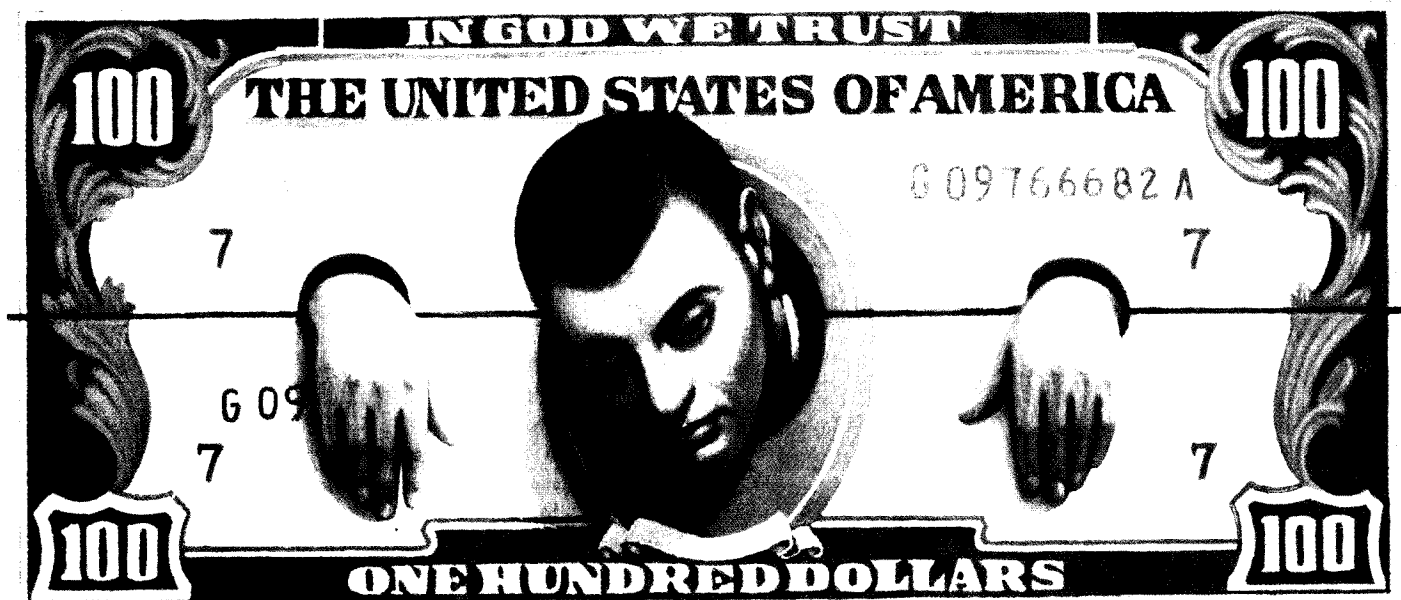




CHEAP MONEY HAS DRIED UP IN THE WAKE OF THE US SUB-PRIME MORTGAGE CRISIS AND SOLICITORS NEED TO ADDRESS THE POTENTIAL IMPACT ON THEIR FIRMS OF DECLINING BUSINESS CONFIDENCE. POLLY BOTSFORD REPORTS

Feeling the crunch?



Every market creates winners and losers, and the effect of the current credit crunch on law firms will be no different.

For proof, one needs only look to the US – some lawyers there are being kept extremely busy by the 278 sub-prime-related law suits filed in federal courts recently. At the same time, other lawyers are out of work after law firms such as Clifford Chance and Cadwalader Wickersham & Taft had to make a number of lawyers redundant. Here in the UK it is not surprising, therefore, that firms are anxious about what 2008 may bring. Some, however, see it as a challenge rather than a disaster.

First the bad news: there is no doubt that lawyers are concerned about the current fiscal climate and thinking hard about what impact a downturn will have on their clients, and, therefore, on their business. And rightly so. Only last week Rachel Lomax, the Bank of England's deputy governor, voiced fears of the largest ever peacetime liquidity crisis. As David

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Gordon, who runs DG Law, a boutique corporate and commercial practice in south London, says: "There's a lot of talk, a lot of nervousness."

The worst hit are lawyers involved directly in structured finance, but all sorts of transactions are also under threat because lenders are tightening their belts on their lending criteria. Paul Marsh, Vice President of the Law Society, says: "People are anxious because solicitors are one of the engine rooms of economic growth. If there are changes in the pattern of growth, solicitors are affected by that."

But the picture is patchy. Gordon says some clients are seeing more work come through, not less. But deals are slowing down, which means fees are too.

"One client, which provides mezzanine finance [part private equity, part loan], has a stuffed order book because the doors are being shut in other places," he says. "But on the whole, deals are taking longer. We had one buyer in a deal

who was dragging his heels because he was having difficulties getting the loan. The deal finally went through, but it took a lot longer."

What is particularly striking is that this is the first bad news for the top echelon in a while, as a recent report of 96 of the UK's leading law firms by Smith & Williamson, the professional practices business adviser, shows. It found that in 2007 "business confidence declined for the first time in six years".

But the bad times have not really hit yet. Law firms here have not seen significant redundancies – the effects have only been felt by a few firms and in very particular practice areas. Olswang, for example, admitted it was possibly looking at ten redundancies in its real estate department in November 2007. But in 2008, firms may start to use a combination of redundancies, cut backs on external recruitment and internal promotion to reduce their fixed cost base. As Smith & Williamson's report states, "firms anticipate appointing fewer new partners".

Giles Murphy, head of assurance and business services at Smith & Williamson, says staff cutbacks are not something to shy away from if that is what it takes. 'I can see redundancies happening,' he says. 'Firms are worried this might affect their reputation, but actually redundancies show that a firm is being seen to deal with a problem. For me, it shows strong management.'

One way to counteract a fall in fees and profits could be for firms to merge or acquire particular departments. However, this appears unlikely, as Smith & Williamson's report emphasises: 'The main reasons for seeking a merger or an acquisition relate to developing growth potential for the business rather than increased profits or security.' Some believe that merging two firms that are in financial difficulties for similar reasons will only make those difficulties worse.

Colin Rodrigues, who runs the corporate practice at Midlands firm Hawkins Hatton, says: 'Perhaps a firm wants to merge to get economies of scale, to get cost savings, but if two firms are both doing the same type of work in a practice area which is not doing too well, then the merger just compounds the problem.'

Though it is clear that, at the moment, only certain practice areas such as conveyancing, securities, and merger and acquisitions work are directly affected, this may well change. As Gordon warns: 'We have yet to see the effect when companies do their budget reviews and decide that this contract or that project is going to be abandoned, or wound down.' So it may be that those isolated areas will not be so isolated as 2008 runs its course.

Now for the good news: because law firms have counter cyclical practice areas that tend to do well in otherwise downbeat times, there should be more work for litigators particularly financial litigators and insolvency lawyers, as there has

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been in the US. Across the Atlantic, everyone is suing everyone else the figure of 278 federal law suits is high enough, but that does not include state court cases, arbitrations and any disputes that may have settled, so the actual figure for civil disputes that a law firm could be involved in is probably much higher.

Also, some of the biggest household names in banking are getting involved. In December 2007 Barclays Capital sued the Wall Street investment banking and securities trading firm Bear Stearns over hedge fund losses. Just last week, HSH Nordbank, the major German lender, announced it was intending to sue UBS for its sub prime losses. It is also the case that the US expects government investigations to start and regulations to flow from the sub prime crisis. Such activity, if replicated in the UK, is all potential work for the profession.

Nor is there much doubt that this activity *will* happen in the UK. It is just a question of when. Andrew Durant, a managing director of Navigant Consulting, the forensic accounting and business advisory firm, has extensively analysed the 278 US federal cases. He says that 'we are waiting for the tsunami of cases to hit the UK, probably in six months' time, in the third or fourth quarter, and particularly in the insurance and hedge fund areas'. There will, of course, be differences between the UK and US experiences, not least because many of the suits in the US are class action cases by borrowers – the UK has not yet acquired the same appetite for these types of actions.

It remains to be seen of course how well UK law firms learned the lessons of the last serious downturn in the late 1980s and early 1990s, and whether they will prove better at staying the course this time if the pessimistic pundits are proved right. Murphy says that in the last recession, law firms were accused of

doing nothing and hoping that the situation would improve, and suffered as a result. 'This time round,' he says, 'they are better managed, so they will react quicker.'

Firms are now talking more about practice diversification and redeploying staff, as Peter Grindley, a principal at expert witness company LECG, who specialises in evaluating law firms, explains. 'It is about how much firms can re-focus within the firm away from areas that are weaker, and shift people around to offset losses,' he says. 'Can they re-focus in other parts of the world, for instance, because [the credit crunch] is not a global problem?' He does not believe firms are burying their heads in the sand. 'As we speak, they are making plans and forming strategies for what they can do.'

Firms should have a bit more faith in their survivability, says Marsh. 'I've seen crises like this before. The firm is 100 years old – we have survived world wars, even Margaret Thatcher. We have every reason to be confident.'

Grindley says law firms are something of a special case because there is, even in the worst economic downturn, always work for lawyers. 'There is much underlying legal work which is independent of economic cycles,' he says. This would include much legal aid work.

Rodrigues agrees, saying legal aid is 'fairly recession-proof'. Finally, then, some good news for legal aid practitioners.

For those firms who are negatively affected, Marsh advises a measured approach: 'If you are having a quieter period, then react to this in a businesslike way. Use this opportunity to take a good look at your business, your premises, your IT systems; all those things which you never have the time to consider when the phone is ringing every five minutes.' Sound advice indeed.

Polly Botsford is a freelance journalist



Marsh: common sense



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