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# Law Firm Mergers

## Advice for getting the deal done and making it work

The trend toward consolidation in the legal services industry continues unabated. "Law firms want to match the geographic footprint of their clients," says Bruce MacEwen, author of the widely read *Adam Smith, Esq.* blog on law firm economics. "As the Fortune 500 and Financial Times 100 are increasingly global, so must be the top-tier firms that serve them."

Firms merge in pursuit of a global footprint, but firms merge for defensive reasons as well. During the mid-1990s, the New York office of my former firm, San Francisco-based Thelen, Marrin, Johnson & Bridges, was critical to the firm's construction and project finance practices. But in the highly competitive New York market, it was difficult to grow the office beyond 20 lawyers — who were all vulnerable to poaching by other firms. We couldn't grow, but neither could we afford to lose, the office. So we decided to seek a New York-based merger partner.

The decision to merge triggered a lengthy and complex process. First, we engaged outside consultants to help us identify potential merger partners. Once we had narrowed the field to one candidate, New York-based Reid & Priest, we encountered — and then overcame — numerous obstacles to completing the transaction and then operating the new firm.

This isn't the entire story of the merger that created Thelen Reid & Priest. That would take too long to tell. But our experience is useful to understanding what it takes to bring two large firms together and operate them as one.

### Making the deal

The first step in any merger is developing a strategic argument — an analysis of your firm's strengths and weaknesses — and then forming a plan to make the firm stronger. At Thelen, Marrin we did just that. At an off-site meeting of key partners, we forged a consensus that drove the merger process. The consensus visualized the firm as national in scope, with what we called a "critical mass presence" (an office with at least 50 lawyers) in four important markets — the San Francisco Bay area, New York, Los Angeles, and Washington, D.C. — and with a balance between litigation and transactional practices.

Once we had decided to seek a merger partner, we systematically examined the New York market. We had preliminary conversations with several other firms, but our search eventually led us to Reid & Priest, which at the time had about 160 lawyers in two offices, New York and Washington, D.C. (By comparison Thelen, Marrin had about 200 lawyers practicing in four offices — San Francisco, San Jose, Los Angeles and New York.)

Combining two large professional services organizations is a complex undertaking involving many important steps, including:

- Preliminary negotiations and due diligence, including possible conflicts of interest. The conflicts examination is critical, because conflicts can and do derail law firm mergers. Fortunately, conflicts were not significant in our transaction, as most issues were resolved in a matter of weeks.
- Serious discussions and negotiations, and in-depth due diligence.
- Partner approvals, and closing.

Completing these steps takes time. Exploratory conversations between Thelen, Marrin and Reid & Priest first took place in

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April 1996, but serious discussions did not begin until the third quarter of 1997. Ultimately, partner approvals were obtained in March 1998, and the closing took place on June 30, 1998.

### Making the merger work

In bringing two firms together, it's critical to understand the difference between "change," which is the factual differences in life before and after the merger, and "transition," which is the emotional process that people experience in adjusting to change. Examples of change include new practice departments, leaders, governance structures, policies, partners, strategies, expectations, and firm name. Change is important, but it pales in comparison to transition.

Here are some examples:

**Firm governance model.** We put in place a transitional governance structure for two-and-a-half years after closing, with equal representation from the constituent firms. The purpose was to provide stability during the post-merger period and ensure that important partner constituencies were represented. These goals were achieved, but the price was a balkanized, representative structure that detracted from a one-firm philosophy and preserved preexisting divisions within the two firms. It's a price that I would not pay again.

**Firm leadership.** An eight-member merger committee comprised of partners from both firms decided who would occupy key firmwide, office, and practice group leadership positions. The advantage of this process was that decisions were made promptly; the disadvantage was that feelings were invariably hurt, and some partners with reduced influence in the new firm became problems for us in the post-merger environment.

**Partnership tiers.** We combined Thelen, Marrin's two-tier (equity and partial-equity, all voting) and Reid & Priest's two-tier (equity and non-voting salaried) partnership structures into what was, in effect, a three-tier Thelen Reid system. This reflected our wish to be fair to all partners by preserving existing partner classes. The downside was the added complexity and inefficiency stemming from too many different types of partners. We should have used the merger as an opportunity to create a simpler partnership structure, not a more complex one.

**Partner compensation.** Here, we adopted the principle that except in "extraordinary" circumstances, the profit participations of each partner would remain unchanged for 18 months after the merger. The advantage of this decision was predictability, allowing ample time after the merger for evaluation of individual partner performance. In hindsight, this was a significant error in judgment. We should have grappled with performance immediately. We failed to anticipate the large number of partners who considered their performance to be "extraordinary" within the meaning of the exception and thus qualified for advancement to a higher profit participation level.

## Key Areas of Concern in a Merger

1. **Firm governance and structure**
2. **Practice departments,** including practice group leadership
3. **Partnership issues:** structure (single-tier versus multi-tier), voting rights, capital contribution requirements, retirement, and benefits
4. **Partner compensation:** philosophy (including performance standards and expectations), manner of determination, individual partner profit participations, and draws and profit distribution policies
5. **Associates:** performance standards and expectations, work assignment systems, professional development and training, partnership track, and compensation (including incentive programs)
6. **Administrative:** departmental organization and structure, leadership, compensation and benefits, and personnel policies

### The unexpected

Any merger between two large organizations will produce surprises: The Thelen Reid merger was no exception.

- Although relatively less profitable than Thelen, Marrin before the merger, the Reid & Priest component became significantly more profitable immediately after the merger. This was due, in part, to the identification and correction of inefficiencies and underperformance during the merger process. While healthy for the firm overall, this change led to unexpected post-merger tension between partners from the two constituent firms.
- Pre-merger differences between high-value and mid-value Thelen, Marrin practices were exacerbated after the merger as mid-value West Coast practices suffered even more by comparison to the economics of high-value Reid & Priest practices.
- Unanticipated cultural differences surfaced after the merger, as East Coast partners demanded a higher level of personal contact with firm leadership than West Coast partners had historically required.

So expect surprises and be prepared to deal with them head-on.

### The bottom line

Making a merger happen takes a great deal of time and effort. And making a merger work is even more time-consuming — in a sense, it's an effort that never ends. But the correct merger, well-conceived and well-executed, will dramatically strengthen your firm and its ability to serve clients. I felt that way in 1998 about the merger between Thelen, Marrin and Reid & Priest, and continue to feel that way today. LFI