

The Risks of Ignoring Future Uncertainty: Scenario Planning for Law Firms

A workshop presented at the Senior Marketers Program, April 1, 2009
 23rd Annual Legal Marketing Association Conference
 Gaylord National Resort, National Harbor, MD
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Summary of the Four Scenarios

We have prepared four scenarios for use during a scenario planning workshop for senior legal marketers on April 1 at LMA's 23rd annual conference. Each scenario describes a possible future for the legal industry intersecting somewhere between two dimensions: (1) timing of economic recovery (early 2010 vs. 2011-12) and (2) legal services delivery models (aggregated vs. disaggregated). The scenarios are summarized below:

		<i>Legal Services Delivery Model</i>	
		<i>Aggregated</i>	<i>Disaggregated</i>
Economic Recovery Begins	<i>Early 2010</i>	The Great Pretenders	Shattered!
	<i>2011 or later</i>	The Big Chill	Davids vs. Goliaths

The Great Pretenders describes a world where economic recovery begins in early 2010, the earliest anyone now hopes for. Global M&A activity, one of the earliest indicators of the recovery, surges as market-leading companies and those with large cash reserves acquire competitors and suppliers weakened by the recession. The strong are eating the weak and getting even stronger.

In this world, law firm leaders feel they have made it through the tough times and look forward to life as they once knew it. The recession was tough, but it encouraged necessary discipline and weeded out the weak. 2010 promises to produce the most law firm mergers and acquisitions ever recorded.

Shattered! describes a legal industry dramatically altered by a perfect storm of events that created a PR nightmare for BigLaw. In this possible future, the recession's impacts on the legal industry pale in comparison to other events that also grabbed the public's attention. Inside BigLaw, the survivors of the 2008-09 layoffs still suffer from depression and guilt. In 2009, a runaway bestseller and a summer HBO TV series set the stage for a

Wall Street BigLaw disaster fueled by debauchery and hubris. One of America's most respected law firms has been brought very low, rocking New York society and BigLaw to its core. Law firms may never be the same.

As a result, the legal industry is reversing its bigger-is-better trend. Dozens of start-up law firms, prospering mid-sized and regional firms, mega-networks of telecommuting lawyers, and new legal vendors leap into the breach. It's possible the growing economic recovery will allow BigLaw to repair its embattled reputation and rule again, but one thing *everybody* understands is that for the first time in a long time BigLaw has many serious competitors.

The Big Chill is a future where the hoped-for 2010 recovery has not appeared and does not seem imminent. All governments and economists now agree the recovery will not appear until 2011 or later. Federal stimulus plans have dramatically slowed home foreclosures, but failed to thaw banks' lending practices. The only bright spot in the corporate legal services market comes from the huge corporate M&A deals being struck in pharma, transportation, real estate, and energy at enormous fire-sale prices.

Corporate legal clients have much smaller legal budgets, but still face an overwhelming burden of legal issues, including bankruptcy, financing, litigation, and regulatory changes. In response, all firms survive by cutting costs to the bone and learn to compete on price. The largest companies discover they have no energy to deal with scores of smaller firms. The exchange of large amounts of commodity work for law firms and the BigLaw promise of safety for corporations becomes the two-ingredient glue that keeps big companies with big law firms. It is a painful time, particularly for legal vendors. Competition becomes cut-throat, pitting firm against firm—and in a surprising twist, some firms against some clients.

In the **Dauids vs. Goliaths** future, corporate legal clients are having a radically different response to the continuing economic deep freeze. In a world already full of risk, they see little extra risk in moving from one law firm to another. All relationships are up for grabs. Some clients cancel their convergence programs, turning to procurement agents or consultants to deliver the best combination of price and expertise on each matter.

The legal industry is rapidly disaggregating. The fiction that big firms could develop and benefit from economies of scale is now seen for the naked emperor it always was. In BigLaw, some of the biggest rainmakers decide they'd rather not share their pie, and form their own boutique firms. In fact, new firms of all kinds are sprouting up all over. Technology vendors reorganize to provide turnkey services and compete directly with firms. Many law firms outsource everything but their most core legal services. Clients are buying legal services directly from India and China. The only certainty is that this is a time for pragmatists, not purists. Everyone who hopes to survive this era is now brutally scrutinizing their beliefs, styles, processes, and goals.



The Great Pretenders

		<i>Legal Services Delivery Model</i>	
		<i>Aggregated</i>	<i>Disaggregated</i>
Economic Recovery Begins	2010	The Great Pretenders	Shattered!
	2011 or later	The Big Freeze	Dauids vs. Goliaths

Spring, 2010 – The global recession ended at 2009 year-end, and 2010 ushers in a global economic recovery that offers both corporate kingpins and average citizens much-needed emotional relief. Optimism rebounds rapidly in proportion to the lows everyone experienced during 2008-09.

Banks have finally begun lending again, which provides a jump-start to small business, resulting in new hiring. Consumers slowly start buying more than the essentials. Large companies start hiring as well. Manufacturing output rises. Real estate sales and prices rise steadily, although certainly not to pre-recession heights. Global M&A activity, one of the earliest indicators of the recovery, surges even more as market-leading companies and those with large cash reserves acquire competitors and suppliers weakened by the recession. The strong are eating the weak and getting even stronger.

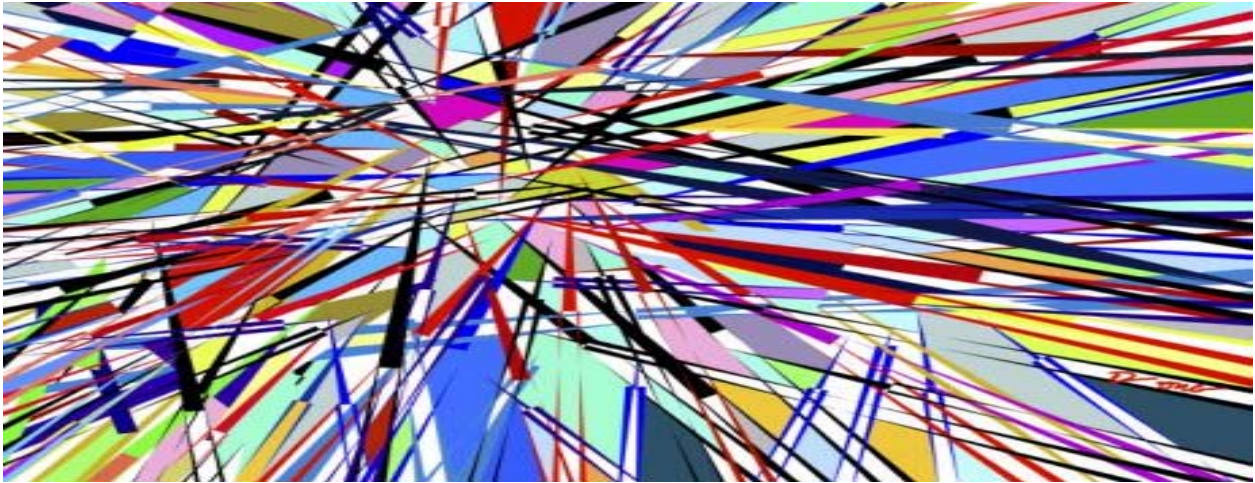
As the recovery continues, corporate legal clients are almost overwhelmed with legal issues. They face not only the increased regulation that resulted from the recession, but the new pressures of the recovery—M&A deals and attendant antitrust issues, recession-related litigation (employment, shareholder, antitrust), continuing bankruptcy and restructuring issues, etc. Distracted by so many legal issues, they prefer to deal with large firms that offer a broad array of services. Gains that law departments made during the recession to contain legal costs are visibly slipping away, as top outside firms once again gain the upper hand on fees.

Law firm leaders feel they have made it through the tough times and look forward soon to life as they once knew it—when law firms had plenty of work and associates kept their heads down, grateful to have jobs. In fact, many equity partners are almost grateful for the recession as it allowed them to cut non-performing de-equitized partners whom the firm had been supporting for too long. Firm leaders are feeling lean and definitely mean. Associate hiring picks up, and lateral partner movements are seen. The best and brightest lawyers scan the horizon to find their new, best affiliation prospects following the recession.

Although most law firms suffered and some were badly damaged by the downturn, others managed to remain fairly unaltered. 2010 already promises to produce the most law firm mergers and acquisitions ever recorded. In the legal industry, the strong are also eating the weak.

The recession taught BigLaw some tough lessons about the perils of permanent overhead (high associate and income-partner leverage). They expand their use of temporary lawyer employees, primarily by building their own temporary employee subsidiaries that supply lawyers and paralegals when extra help is needed. Some firms even acquire legal tech vendors, particularly those that support E-discovery, to gain competitive advantages these tools offer them. Many firms now follow Orrick's early lead in relocating back-office functions to less expensive non-metropolitan areas.

Law firm leaders, partners, and business development professionals continue to cannily mirror ACC's "Value Challenge" language about alternative pricing, re-engineering the practice of law, etc. But most law firms' styles, services, and pricing arrangements continue pretty much the same, with 80% of Am Law 100 billings being priced on an hourly or reduced hourly rate basis.



Shattered!

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But in Big Law land, unexpected events have precipitated changes no one would have predicted a year ago. Throughout 2009, a “perfect storm” of unfortunate events converged to create a public relations nightmare for BigLaw, with dire consequences for some.

By mid-2009, layoff survivors in big law firms were exhausted. Trust became a rare commodity even inside firms that had been highly respected for 100 years or longer, firms where the ranks of staff, associates, and partners were decimated by as much as 25%. Those still employed, especially associates, still suffer from depression and survivor guilt. When they describe last year, they sound like plague victims who lived, but are now scarred for life.

During 2009, David Lat, the founding editor of www.abovethelaw.com, graduated from online notoriety to full-fledged media stardom. Now he is interviewed frequently by Jon Stewart, Charlie Rose, and Anderson Cooper. He has appeared on the cover of *Vanity Fair* and been a guest on Oprah.

2009 also saw John Grisham's latest novel, *The Associate*, climb to #1 on *The New York Times* Best Sellers List. By the end of August, everyone from bloggers to parents to bureaucrats enjoyed hating BigLaw, too. New terms entered popular parlance, e.g., "Don't pad that bill!" (*translation: refrain from drinking to excess when splitting a bar tab with friends*) and "I've met my minimum billable" (*translation: I've had enough to drink*).

"Sullivan & Moore" premiered on HBO's summer Sunday night lineup and was an instant hit. Based on characters in www.bitterlawyer.com's Webisodes, the new show followed "associates who descend the humiliation ladder to partnership." A character greatly resembling David Lat has a recurring role.

But by far the worst blow to BigLaw's reputation came in September 2009 when three summer associates at the very profitable Wall Street law firm X&Y filed a sexual harassment complaint against the firm and five of its biggest rainmakers. The women had recorded with their cell phones explicit photographs and videos of the five partners' behavior, which they posted on their new blog, www.biglawpartnersarepigs.com. Overnight, the site attracted new content posted by other BigLaw associates and staff. After a few frantic days, X&Y settled the women's claims by firing the five partners and paying an undisclosed amount (rumored to be \$15 million) in exchange for claimants taking down their Web site. However, similar sites soon appeared, displaying outrageous sexual and bullying behaviors of BigLaw partners.

In apoplectic press releases, the Association of Corporate Counsel and numerous general counsel loudly condemned X&Y and called for an industry-wide crackdown on abusive behavior. Several X&Y clients immediately replaced the firm in big deals and major litigation. Fifteen law schools informed X&Y that the firm would not be allowed to interview on campus until 2012. X&Y began to issue layoff notices, and by early 2010 its future is uncertain. New York society and global BigLaw firms have been rocked to the core by the downfall of one of America's greatest law firms.

This cruel nexus between Web 2.0 transparency, associates' access to firm secrets, and their desires for revenge has made many BigLaw partners understandably anxious about their futures. After all, many a law firm, no matter how prestigious, has a few bad apples whose personal behavior is best left unpublicized. Many well-behaved partners began to fear that even though their own behavior is beyond reproach their professional fortunes were too dependent on the shaky reputations of partners whose behavior was once considered privileged.

By Thanksgiving 2009, a dozen Am Law 50 firms had announced the election of new managing partners, all women. Another three dozen firms have since established new “women’s initiatives.” Large law firms everywhere are busily describing their genteel cultures where ladies and gentlemen practice law together in a workplace exemplified by mutual respect.

Some big firms have preemptively begun to clean house, telling their behaviorally challenged partners to leave. Other firms, dependent for their survival on rain made by a few bad-apple partners, have seen the departure of others who will not tolerate the risk of staying where others’ dark secrets might bring the firm down. As a result, some of the country’s biggest rainmakers have opened their own firms and staffed them with teams brought from the old firms. In a kinder economic environment, these partners might have moved laterally, but few big firms are now able to invest in new partners. Some women rainmakers, sensing this is the right time to strike out on their own, have opened women-owned law firms on both coasts, attracting strong talent and much corporate client attention.

After suffering through the recession, firms of all sizes now question the once conventional wisdom of growing larger through leverage of permanent associates and other legal staff. Firms are now much more likely to use contract labor to staff large matters that come their way. Although some firms build their own temp subsidiaries, most firms still rely on temp lawyers from contract houses.

New law firms that serve all tiers of the market are sprouting up everywhere. With so many downsized partners on the street, “value law firms” that emulate the Summit and Valorem firms are parroting ACC’s Value Challenge program materials. Virtual law firms of telecommuting solo lawyers are also forming, particularly to offer low-cost transactional IP services (in patents, trademarks, and copyrights). With so many new firms, new legal vendors are also appearing to offer ancillary and back-office services. Many of these companies are staffed by former law firm employees eager to fill this need.

At the same time, scores of lower-priced mid-sized and regional law firms, flush with new client relationships acquired in the economic blizzard of 2008-09, are determined not to relinquish their new client relationships. They plan to beat BigLaw at its old branding game, by becoming the *new* safer choice.

It appears the legal industry is finally reversing its bigger-is-better trend. Although these are exciting times, no one knows if the growing economic recovery will allow BigLaw to repair its embattled reputation and rule again. One thing *everybody* understands is that for the first time in a long time BigLaw has lots of serious competitors.



The Big Chill

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Federal stimulus plans have dramatically slowed home foreclosures, but failed to thaw banks' lending practices. An unforeseen complication is that several of the country's healthiest banks, reacting to heavy-handed TARP restrictions and demands on management, have declined to receive government bailout funds. This development and consumers' lower demands continue to slow the flow of credit to consumers, small businesses, and big companies.

Unemployment in the US is over 10%. In 15 states, public services and public agencies are operating on three- and four-day schedules. In many corporate offices, Fridays are no longer casual days, but the first day of the weekend. Consumers, fearing more job losses, tamp down further on non-essential purchases. New car sales are down 30% from early 2008, when sales were down 50% from 2007. GM has filed for bankruptcy, but restructuring plans have stalled. Ford is barely alive. Oil is at \$27 a barrel.

The only bright spot in the corporate legal services market comes from the huge corporate M&A deals being struck in pharma, transportation,

real estate, and energy at enormous fire-sale prices. The strongest companies are swallowing the weakest. Every deal's anti-competition and tax implications are significant and hotly debated by regulators and stockholders. Many smaller companies are simply closing their doors.

Even the healthiest industries are sluggish. The upstream (development) side of healthcare is a bright spot, where federal funding, private equity, and VC attention spur growth, particularly for healthcare information systems. However, on the healthcare downstream (services delivery) side, rising unemployment and higher numbers of uninsured patients have more than offset federal and state funding contributions, and healthcare providers and patients alike are suffering. Life sciences R&D companies and mid-sized pharmas are banking on a single exit strategy—to be acquired by whales that will survive this ice age.

As expected, funds from both the federal government and private capital are flowing toward alternative energy and transportation projects. Those companies showing promise of early profits attract private investors. In a surprising innovation twist, only government funding flows toward those technologies that promise to be most disruptive.

Corporate legal clients face a double-whammy. While having less to spend on legal services, they face an overwhelming burden of legal issues, including bankruptcy, financing, litigation, and regulatory changes. They badly need good legal services, but their in-house and outside legal budgets are being reduced—some by as much as 50%. Companies *must* find competent legal counsel, but at greatly reduced prices.

Law firms, at all tiers of service, continue to look for ways to reduce their own costs and keep their firms working. Following Orrick's early lead, most firms are quickly relocating their back-office operations to lower-cost, non-metropolitan locations in the US and abroad to lower staffing costs. Global law firms with big operations in China are delighted to have access to a well-educated, low-cost labor force and are rapidly transferring most of their IT, accounting, and marketing functions there.

To control labor costs, almost every large law firm is now building its own temporary lawyer subsidiary. Unable to compete with so many law firm subsidiaries, the big contract houses have sold themselves as turnkey operations to the country's biggest law firms. Many firms have moved as many as half of their associates, senior attorneys, and income partners (who otherwise would have been laid off) into these subsidiaries, to be utilized when workloads demand extra hands. Not surprisingly, this new caste system is creating huge cultural conflicts, which are described loudly in the blogosphere.

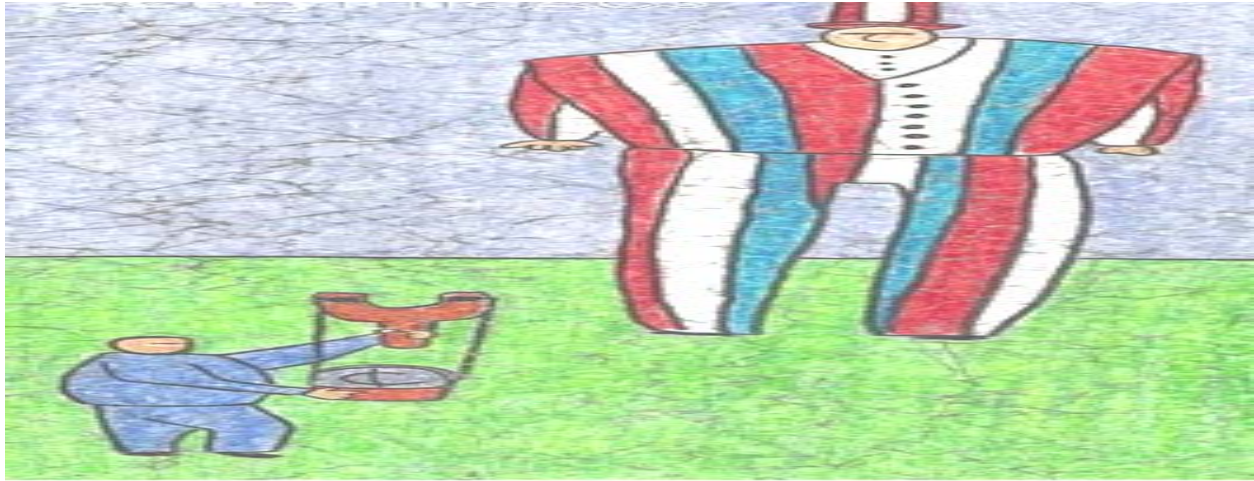
In this cold climate, legal vendors are also struggling. Companies that provide aggregated information, technology services, staff placement, and supplies have cut costs to the bone and reduced their prices. Several big litigation support and E-discovery vendors have also been bought by large

litigation law firms that seek a competitive advantage through their exclusive access to these technology tools. Vendors with inadequate capitalization have closed shop or are desperately seeking buyers.

By cutting their costs, sometimes dramatically, large firms have found a way to survive by competing on price, at least for commodity work. Corporate clients warmly welcome this move. With so many legal challenges on their plates, the largest companies discover they have no energy left to find and deal with scores of smaller firms. The exchange of large amounts of commodity work for law firms and the BigLaw promise of safety for corporations becomes the two-ingredient glue that keeps big companies with big law firms.

Some firms have found an interesting way to deal with in-house legal departments that demand fees lower than the firm's ability to provide services—by bypassing the legal department altogether. Some firms are proposing to their clients to handle all a company's legal services on an annual fixed-fee outsourcing basis, thereby eliminating the need for any in-house legal staff. This proposal is particularly attractive to companies that already spend more than 70% of their legal budgets on outside counsel and have ten or fewer in-house lawyers. By eliminating the middle man, these firms are highly motivated to become more efficient and begin in earnest to streamline their delivery of legal services. The Association of Corporate Counsel is not amused.

Large law firms are finally finding ways to maintain and even expand their market shares in this economic deep freeze. Their size, brands, and intellectual capital still translate into "safety" for the largest legal clients, who in these highly stressful times find themselves unwilling to dip very far down into the legal services DNA pool.



Dauids vs. Goliaths

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Corporate legal clients face a double-whammy. While having less to spend on legal services, they face an overwhelming burden of legal issues, including bankruptcy, financing, litigation, and regulatory changes. They badly need good legal services, but their in-house and outside legal budgets are being reduced—some by as much as 50%. Companies *must* find competent legal counsel, but at greatly reduced prices.

As a result, clients now see a low risk in moving from one law firm to another. All relationships are up for grabs. Some clients cancel their convergence programs, turning to in-house procurement agents or consultants to deliver the best combination of price and expertise on each matter.

Firms of all sizes question the old conventional wisdom of growing larger through leverage, leaving so many mouths to feed. International expansion ceases for all firms except those that already have a global presence, and a “smaller is better” management philosophy gains momentum. Some firms have shrunk dramatically and now use contract labor to staff large matters that come their way. Although some firms build their own temp subsidiaries, others still rely on temp lawyers from contract houses.

The largest firms struggle to keep their top revenue generators and further marginalize partners who have less than \$10 million of portable business. Top performers are allowed to carve out autonomous practice groups within the firm structure. Enjoying their new autonomy, some of these stars decide the time is right to start their own firms. Several high-profile trial lawyers, encouraged by the success of Quinn Emanuel and Bois Schiller, open their own litigation boutiques, offering contingency pricing for high-stakes, high-probability-of-success litigation.

In fact, new law firms are sprouting up everywhere. Many of BigLaw’s most entrepreneurial partners, whether they are stars or not, now believe

they can compete with their old firms on price, service, and quality of life. Scores of new boutique firms, founded by partners who have close ties to corporate clients, now offer services in bankruptcy, employment law, IP, litigation, and more. Many top law school grads are attracted to these smaller, specialty firms that promise better mentoring and earlier access to clients. These specialty boutiques are exploring best-friends relationships with other boutiques that serve different areas of the law.

Virtual law firms are also a viable option for clients, particularly for low-cost transactional IP services (in patents, trademarks, and copyrights). Hundreds of solo lawyers who work from home have formed a virtual, telecommuting network.

More technology vendors, badly pressured on price, now begin to offer turnkey services for technology + lawyers + better work processes to run big litigation projects. This reconfiguration of their services leads to both competition and alliances among tech vendors, contract houses, and law firms.

A few in-house legal departments start to bring significant amounts of legal work in-house, having determined they can perform the work more efficiently and inexpensively than can outside counsel. Most legal departments accelerate their outsourcing of all legal work, primarily to India and China. They strike more direct alliances with technology companies and contract houses to support their in-sourcing/out-sourcing efforts.

Many law firms now rapidly outsource their own non-legal functions to lower their fixed costs of marketing, HR, accounting, IT, legal research, etc. Some of this work goes overseas, and some stays in the US. New outsourcing vendors pop up to respond to these needs, many led by former law firm employees eager to fill this need. Some of these companies are allied with legal-vertical technology vendors and others with large legal consulting firms like Hildebrandt and Altman Weil.

The legal industry is rapidly disaggregating. The fiction that big firms could develop and benefit from economies of scale is now seen for the naked emperor it always was. This is a time of excitement, confusion, disruption, and revolution. Clearly, the old market-leading model of BigLaw is badly wounded, but it is hard to see which of the emerging legal services models, if any, will thrive long enough to become new leaders. The only certainty is that this is a time for pragmatists, not purists. Everyone who hopes to survive this era is now brutally scrutinizing their beliefs, styles, processes, and goals.