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ANALYSIS

In Recession Planning, Firms See 'Opportunities' and 'Challenges'

Bet-the-company transactions are down, but litigation, restructuring and smaller deals offer a way forward.

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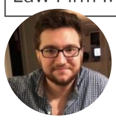
Law Firm Management



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What You Need to Know

- Firm leaders see opportunities to expand client relationships during a period of economic slowdown.
- Large firms are hoping growth in bankruptcy and white-collar defense practices will supplant the continued downturn in large-cap transactions.
- For firms with a middle-market focus, deal activity remains strong at the outset of 2023.

Signs of an imminent recession aren't deterring law firm leaders from a "cautiously optimistic" financial outlook this year, as they plan for short-term economic headwinds to be supplanted by rising demand for litigation, restructuring and white-collar defense practices.

Firm leaders contacted for this story say the downturn in transactional activity has been principally concentrated in a narrow area of deal-making practices, that is, those with a focus on emerging companies, tech-sector clients or large-cap bet-the-company-type transactions. Meanwhile, middle-market deals have continued to move forward, at least at the outset of 2023, and the higher fees generated by complex financing vehicles can offset some of the downturn.

And this is to say nothing of the increase in regulatory activity, litigation and restructuring work that is expected this year, as clients seek to resolve their financial challenges with help from their law firms.

As such, firm leaders at Dechert said this week they're "cautiously optimistic" in their projections for this year, hoping that clients will see past the Fed's messaging.

"Slowdowns can present significant opportunities as well as challenges," Dechert CEO Henry Nassau said in an email statement. "Even when capital deployment slows, there are always areas where capital flows instantly to the highest risk-adjusted returns—for example, secondaries, continuation funds, or companies that can't grow organically needing M&A."

Given the economic headwinds clients are expected to face this year, many firm leaders also see this year as an opportunity to deepen client relationships and make the firm's practices more relevant to their round-the-clock business needs.

Andy Levander, chair of Dechert's policy committee and a white-collar partner, said many of the firm's clients continue to have dry powder on hand and the need for strategizing on litigation and investigations remains strong.

"Litigation has been more active around the globe," Nassau said. "Therefore, our main goal is to use this time to deepen our relationships both externally, with our clients, and internally, through the recruitment and retention of talent."

Although the trajectory and depth of an economic downturn is yet unknown, firm leaders said they don't want a short-term economic shock to deter them from long-term growth strategy.

Take Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, which acquired lateral partner James Ball from Milbank earlier this month to help open a capital markets practice for the firm in South Florida.

"This is a long-term proposition," said Robert Bodian, Mintz's managing partner. "One year isn't relevant to the long-term play. A lot of businesses are moving down there so there's a lot of opportunity."

Despite the “volatility” of capital markets practices, Ball, the former Milbank partner now at Mintz, said the lack of volume in transactional work has been offset by higher fees generated by work on more complex financial instruments.

“More convertible notes are being done and more uniquely structured products, which translate into more significant legal fees,” Ball said.

Leaders at Am Law Second Hundred firm Robinson+Cole credit the continued flow of deal work at the firm on its concentration on middle-market clients, rather than big-ticket, bet-the-company-type transactions. Rhonda Tobin, the firm’s managing partner, said in an interview this week that transactional teams are seeing deals in the billion-dollar range getting put on hold while multimillion-dollar deals are moving forward.

“We’re hearing transactional clients are adjusting to the interest rate changes and have settled in their own transactional planning so they’re seeing a pick up in activity,” Tobin said.

The medical, retail and cryptocurrency sectors are showing early signs that restructuring legal services are on a demand-rise this year, according to Robinson+Cole’s bankruptcy group co-chair Natalie Ramsey, who pointed to recent news that Bed, Bath and Beyond was closing more than 100 stores.

“Restrictions on new capital, that will result in an uptick [in restructuring],” Ramsey said. “A majority of commentators are expecting that we will see more activity in the distressed area.”

Ramsey said her group is seeing more inquiries from distressed businesses that aren’t just looking to file for bankruptcy but seeking “other creative ways to resolve their debt issues,” such as prepackaged bankruptcies, the bulk of which can be negotiated prior to filing with a court.

But with regard to both traditional and “nontraditional restructuring” services, Ramsey said “our expectation is that we’re going to be very busy.”

Michael Heller, CEO of Am Law 100 firm Cozen O’Connor, said a recession could prove fortunate in the lateral market for some firms as many lawyers will look to move to a platform with more financial security. In 2009, Heller said as an example, his firm onboarded 75 lawyers from an ailing firm, many of them real estate lawyers.

“That’s why we reserve a portion of our profits every year, whether it’s a good or bad economy,” Heller said. “We want to make sure we have the strongest balance sheet so while other firms are recession planning, we can use financial strength to expand.”

Yet concerns for clients’ ability to make payments are motivating firm leaders to shore up their back-office billing and collections functions, according to law firm consultants. Chris Ryan, executive vice president of client development for legal adviser HBR Consulting, said firms are increasing attention on improving timekeeper discipline.

“Firms have a lot of room to make improvements,” Ryan said. “If firms can improve on a lot of these areas, they can neutralize some of those additional days on time cycle for some of this.”

Evidence that recessionary contingency plans were being developed by firm leaders came to light when Proskauer Rose, in its suit against former COO Jonathan O’Brien, alleged O’Brien took with him files on the firm’s recession contingency planning that hadn’t been presented to the firm’s partnership.

The so-called “recession-deck” included “detailed information about the firm’s assumptions, expenses, financial projections, and plans for changes in economic conditions, including strategic and contingency planning for a potential economic recession in 2023.” A spokesperson for the firm said leaders declined to elaborate.