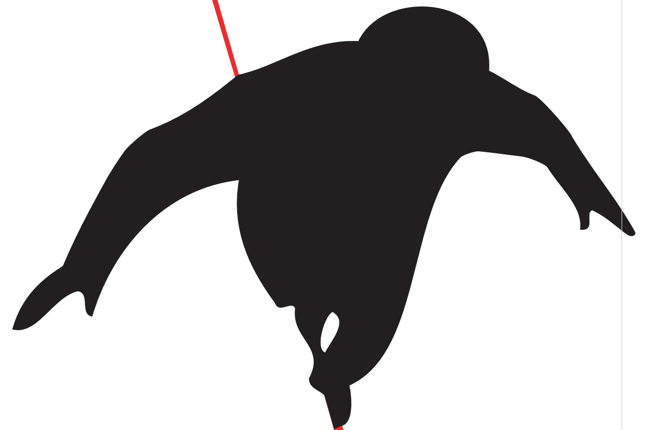
Risky business

The world's first law firm IPO has taken place in Australia, and regulatory reform underway in the United Kingdom ensures that more firms will follow. Here's a look at the steps law firms must take and the risks they must address to prepare for this brave new world.

By Gerry Riskin



THE FIRST LAW FIRM IN the world to float shares is Australian firm Slater & Gordon. The 400-person personal injury and class action firm took advantage of recent legislative reform and made its shares available on the Australian Stock Exchange on May 21. The shares rose 40% on the first day of trading and generated $35 million for the firm before the end of the month. The legal profession will never be the same.

Slater & Gordon went public in order to finance an ambitious growth scheme by acquiring other practices, as well as to create a greater marketing and advertising presence. A week after the IPO was declared, Slater & Gordon acquired D'Arcy Solicitors of Brisbane for $2.8 million — the firm's sixth acquisition in the previous two years.

It is unlikely that publicly traded law firms will stop at the Australian coast. In the United Kingdom, the recommendations of the watershed Clementi Report are being implemented through the *Legal Services Act*, which will similarly allow non-lawyer investment in and control of UK law firms. If London-based global law firms can access that kind of capital, their rivals in New York will quickly demand to compete on that playing field too.

In short, the Slater & Gordon prospectus heralds the dawn of a new age for law firms. But that same prospectus also offers an intriguing glimpse of what law firms must demand of themselves — and what they must openly admit to the marketplace — in terms of how they operate now and how they must change in the era of publicly traded law corporations.

This article focuses on insights arising from the summary of risks in the Slater & Gordon prospectus (not to be confused with the more comprehensive risk identification in Section 7 of the same prospectus). Law firms contemplating a future IPO must publicly acknowledge these everyday risks and take steps to minimize or neutralize them to the market's satisfaction.

1. Conflict of duties

Lawyers have a primary duty to the courts and a secondary duty to their clients. These duties are paramount, given the nature of the company's business as an incorporated legal practice. There could be circumstances in which the lawyers of Slater & Gordon are required to act in accordance with these duties and contrary to other corporate responsibilities and against the interests of shareholders or the short-term profitability of the company.

Essentially, shareholders are told that their interests will be considered tertiary to those of courts and clients. This answers the absurd question about whether law is a "business" or a "profession" in the post-Clementi age. I hope this risk survives forever, for that will mean law is still a profession and will remain so.

A law firm can reduce the impact of this risk by having state-of-the-art, early-warning conflict identification protocols (including software) in place. However, the wild card is the discretion that must continue to reside in partners.

The key here is to ensure that all potential conflicts are vetted by a designated committee of the firm, created for this purpose and comprised by at least two senior, highly respected partners — plus, in all cases, the firm's own general counsel. Avoiding clear conflicts is easy; avoiding the murky ones may mean the firm's future.

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2. Government actions and legal developments

The company's business operations could be adversely affected by changes in commonwealth, state or territory government legislation, guidelines and regulations. Slater & Gordon is subject to regulation by the regulator of lawyers in the States and Territories in which it practises. The regulators' powers include the right, in certain circumstances, to disqualify lawyers from practice.

Legislative change made the Slater & Gordon IPO possible — legislative change could take it away again. More to the point, governing bodies are on the lookout for conduct that could threaten the public interest, and a law firm that invites regulatory action because of unethical or illegal activity could see its share price plummet.

The firm can reduce the impact of this risk by insisting on ethics and practice management training for every lawyer, together with appropriate protocols such as supervision, monitoring and spot file audits (which very few firms now carry out). Such protocols will be the key to detecting inappropriate lawyer behaviour, which usually is not even suspected by the firm before allegations are made.

It is not possible to eliminate this risk. But spot auditing will both reduce it and generate the perception that the firm is doing all it reasonably can.

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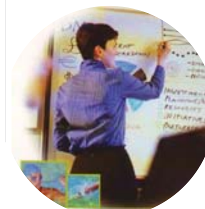

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3. Reputation

The reputation of the company could be damaged if it does not meet client expectations or is involved in high-profile, unsuccessful or unpopular legal proceedings.

This is a tough one. What the drafters of this prospectus have not highlighted is the duty to take on an unpopular cause if no other lawyer will. Admittedly, this is a low-probability issue (perhaps higher for a personal-injury specialist like Slater & Gordon). However, the firm should have very strict intake procedures that inform it as to the "reputational risks" associated with new matters.

As for not meeting client expectations, this is clearly a client-relations skill training issue.

While the initial enthusiasm of acquisitions, along with publicizing the fact to existing clients, tends to generate some additional business, the natural forces that tend to damper cross-selling tend to create disappointment.

Expectations are largely creatures of perception (subjective) rather than the interpretation of hard facts (objective). The good news is that well-trained lawyers can shape the expectations of clients in such a way that they can dramatically reduce the probability of falling short of them.

4. Acquisition risk

There is a risk that the company will not be able fully to complete its acquisition program, or integrate acquired firms successfully. Competition from rival law firms may inhibit the acquisition program.

Wow — are we having fun yet? It's true that there is uncertainty relating to the firm's acquisition program. Furthermore, many acquisitions falter because of a lack of post-acquisition integration programs. Recent law practice history is littered with firm mergers that didn't take or were called off at the last minute. But the legal profession has prospered up to this point without sophisticated management or extensive training. Just like some of the major accounting firms learned to do both of these (when they had critical mass and the resources to do it), law firms like Slater & Gordon, with their new capital resources ought to be at the forefront of management and training.

5. Growth risk

Diversification of services may not attract clients to new areas of operation to the extent anticipated. Costs associated with growth may increase beyond current estimates.

The diversification risk is very real. While the initial enthusiasm of acquisitions, along with publicizing the fact to existing clients, tends to generate some additional business, the natural forces that tend to damper cross-selling tend to create disappointment. These forces include, among others, internal competition, client-relationship hoarding, and incongruity between compensation systems and desired behaviours.

The key here is to create initiatives and then follow up diligently. If the compensation system is inconsistent with the desired behaviours, then it must be at least fine-tuned — if not completely revamped.

6. Personnel

Reliance on key personnel. Market for quality lawyers is very competitive. Growth is reliant on retaining and attracting the best lawyers.

Here we have financial proof of the adage that law firms' best assets have feet. When the failure to retain associates and partners has a direct impact on share price, suddenly the firm's management committee will start taking the issue extremely seriously.

With high (and growing) levels of staff turnover, firms need to foster professional development and access to challenging work. At the time this article was penned, recruitment was a real challenge and terms like "war for talent" were being bandied about by the legal profession worldwide.

Let's assume that the firm has an even chance of competing for talent. The key question will be whether lawyers can be glued to the firm through the provision of rewarding careers, appreciation and adequate compensation (taking into consideration that a portion of all firm revenue must be allocated to offering a return to the investors).

This can be achieved through leadership and management training for the firm's internal leaders and various practice and industry groups within the firm. It will also require the ability to transcend geographic office locations and create a true "one-firm" culture. Constant cross-firm communications will be needed, while "orphaned' individuals and offices must be avoided.

7. Control

Ownership of a large proportion of the shares in the company is concentrated in the hands of the vendor shareholders, and there are restrictions that apply to the ability of the vendor shareholders and other existing shareholders to dispose of their shares.While there are exceptions to those restrictions in certain circumstances in the event of a takeover or scheme of arrangement, the concentration of ownership may reduce the likelihood of a takeover, and the restrictions may affect the ability of a prospective bidder to secure a pre-bid stake in the company.

This last risk is admittedly peculiar to the circumstances of a firm that has offered shares to the public. However, if the Clementi reforms proceed as anticipated through the *Legal Services Act* in the UK, there may soon be global legal mega-giants that are the very entities contemplated by this enunciated risk. Should that occur, I think it will all sort itself out based on the firm's general behaviour.

On that note, consider this reference found elsewhere in Slater & Gordon's prospectus:

People development is a priority. The company assists all key employees to form and implement a personal development program shaped by the needs of the individual's current position and likely future positions.With the significant increase in the breadth of the company's operations, succession planning for key roles and leadership development for current and future senior employees are priority issues for Slater & Gordon's management.

Slater & Gordon's execution of this probably summarizes the entire ball game. Do this right and succeed, or else. I wish Slater & Gordon the best of luck, and I hope that the profession can look back with pride in ten years' time on its first public offering.

Perhaps we will all learn from this bold initiative.

But alas, my integrity demands a caution. If Slater & Gordon carries on "business as usual" — meaning, as most law firms manage themselves today — we may be watching shareholders selling the firm back to its lawyers for a few cents on the dollar. I hope not.

Slater & Gordon has created a whole new playing field, and with it must come new standards.

It would be a mistake for it to look to other law firms for its management and leadership role models. It would do better instead to learn from the business schools and translate to the legal profession as required.

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