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# Benchmarking the supply of legal services by city law firms

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## FOREWORD

We are pleased to welcome this publication as the first of our studies looking at specific aspects of supply of legal services in England and Wales. We are publishing this report alongside our market framework study by OXERA, which outlined the overall approach we will take to segmenting the legal services market for further analysis and review.

The OXERA report developed a framework based on segmenting parts of the supply of legal services that exhibit similar features. Segments defined by the services offered and clients served, rather than traditional supplier-focused measures such as the number of partners or turnover. A particular challenge for the LSB in piloting this framework was to understand how to develop a sample for the study. For this first pilot, the decision was taken to use the common term 'city (of London) firm' as a proxy for firms offering advice to large corporate clients.

We chose large corporate law firms for the pilot study since, while small in number (around 2% of firms), they represent a significant proportion of the legal services market, whether measured by turnover or by employment (more than 40% of solicitors). Understanding the operation of this part of the market is of huge importance to the structure of regulation of the legal services market, whether deciding the application of outcomes focused regulation or the scope of reserved activities.

The findings presented in this report provide an insightful analysis of this part of the legal services market. As a proxy for a particular type of segment, the sample approach (applied flexibly) has provided a relatively homogenous group of firms in the scope of their services. However, there is huge variety in the detail, with individual firms competing against a different set of competitors in different types of law; specialist firms able to compete against the very largest firms; and diversity in the international reach of firms.

The report will help us understand better the risks presented by one part of the legal services market to the regulatory objectives set out in the Legal Services Act 2007. The results support the view of a relatively strong correlation between the shorthand 'city firms' and a market segment focused on the legal needs of large corporates. The clients of this segment have a greater capacity to use knowledge and buying power to make informed purchasing decisions and therefore the firms are likely to pose relatively few of the traditional regulatory risks. Any regulatory concerns are more likely to focus on the broader public interest concerns outlined by the Regulatory Objectives set out in the Act. That said, regulators will also need to be mindful of the effect of their actions on competitiveness – both of the larger firms discussed here and of the corporate clients which they serve.

We are grateful to all of the individuals from firms who participated in this study and provided CRA with their time and expertise. We hope that the resulting report will be read widely and seen to provide a benchmark in understanding of one area of the legal services market.

Chris Kenny, Chief Executive, Legal Services Board

## EXECUTIVE SUMMARY

Charles River Associates (CRA) was commissioned by the Legal Services Board (LSB) to undertake a pilot study for benchmarking the supply of legal services by “city” law firms.

### *City firms*

There are a number of key characteristics of city law firms that differentiate these firms from other law firms in the legal services market as a whole, although these issues do not have “hard-line” boundaries:

- Location – Firms are located in and around the City of London although the boundary moves over time and would currently include areas of Canary Wharf, Holborn and Southwark where many clients would also be located;
- Type of firm - Firms are among the top 50 or 100 largest law firms in the country (top 1%) and commonly have high average profits per lawyer or partner;
- Type of work – Firms commonly provide corporate work with corporate finance and M&A transactional work particularly strong areas, along with work that would relate specifically to financial services issues; and
- Type of client – Firms typically have large corporate clients with financial institutions especially well represented and international clients playing an important role.

### *Variation between city firms*

Although city firms are distinguishable from the majority of other law firms, their reputations, and closest competitors, vary between firms and between practice areas within firms. Legal directories are available which convey this information to clients (and regulators).

In general, the firms with the best reputations are more likely to undertake more complicated, and higher value, work. The very largest corporate clients (in the FTSE 100) more commonly use the bigger firms with the best reputations while smaller (but still large) corporate clients would be more likely to use smaller (but still large) city firms. In certain technical areas of work, however, smaller specialist city firms are able to compete against the very largest city firms.

Headline hourly fee rates also vary, with partners of the firms with the best reputations (including US head-quartered firms) able to charge rates above other city firms and which are multiples of those charged by firms outside the city.

### *Staff and structure of the firm*

Fee earners in city firms are primarily qualified solicitors and they are more specialised than at other firms as seen by declaring fewer areas of expertise per practising lawyer. The recession has increased pressure from clients to seek cheaper methods of work through outsourcing or on/off-shoring of more standardised areas of work although the

use of paralegals to conduct due diligence and document review can bring similar benefits.

Increased numbers of staff within litigation departments are obtaining advocacy qualifications and although currently used mainly for early stages of cases with external barristers appointed for the rest, it is expected that the amount of advocacy done in-house will increase over time. Many city firms have a small number of fee earners who are experts in other disciplines (accountants, economists, town planners, trademark attorneys) although the individuals have generally been trained elsewhere and would not be partners.

Firms will be able to operate Alternative Business Structures (ABSs) from October 2011, but interviewees, especially large firms, did not generally see ABSs as attractive because they are reluctant to cede control of the firm for external funding which they do not currently need. However, it is possible that firms (potentially including mid-tier city firms) who wish to rapidly expand through acquisition may have capital needs and therefore pursue an ABS.

Large city firms also did not see the advantage of ABSs in order to offer a wider range of services since they see themselves as specialist firms and can already bring other experts in-house anyway. In addition, ABSs bring complications for international law firms operating in jurisdictions where such structures would not be permitted, although these firms generally already have complicated institutional structures internationally anyway hence these complications would not be insurmountable.

### *Type of work*

City firms will often describe services at a much finer level of categorisation than other firms as well as commonly marketing the sectors in which they work highlighting the importance of understanding the business environment in which their clients operate. Corporate finance, M&A and advice specific to the financial services sector are prevalent areas of work for city firms. Corporate transactions often represent a core issue which leads to other areas of work being provided alongside it, such as employment, property, tax and pensions. Other areas of work may be common to many law firms, such as litigation and commercial property, but the underlying issue will be much more complex and high value at city firms. Similarly, legal directories rank firms not simply for M&A transactions but differentiate between firms on the basis of the underlying value of these transactions.

Pricing arrangements vary according to the specifics of the case and frequently involve a complicated mix of hourly rates, blended rates, fixed and capped fees. Hourly rates remain typical for litigation whereas success and abort fees are common for corporate transactions.

Regulatory differences such as whether activities are reserved are not considered relevant or currently recorded and to do so would be costly. Neither is work categorised according to the activity such as research, advocacy, litigation and advice.

### *Type of client*

Most clients of city law firms are corporates such as large financial institutions and national or multinational corporations. They are highly sophisticated purchasers, commonly have in-house lawyers and are repeat, if not continual, purchasers of legal services.

City law firms would commonly advise central government and quasi-government organisations on corporate issues, and even where advice is specific to the role of government (infrastructure projects, state aid, regulatory investigations etc) this would usually have a corporate equivalent.

Many corporate and government clients will use panel arrangements to pre-select firms and as a way to reduce prices in return for larger volumes of work. Panels also commonly require the provision of training as well as the secondment of staff to the client.

Many of the largest city firms have spun off their private client departments although some city firms retain private client practices alongside very well regarded commercial practices. These clients would be among the more sophisticated purchasers of individual advice and would tend to receive advice on complex tax, wills and trust arrangements, and landed estates.

### *Interaction with regulators*

City law firms had little interaction with The Law Society (TLS) or the Solicitors Regulation Authority (SRA) in the past. This has altered recently in the light of the SRA seeking to have staff explicitly responsible for large corporate firms, the use of relationship managers beginning and the development of outcomes focused regulation. Despite the fact that city firms have sophisticated clients, interviewees were nonetheless generally in favour of being regulated and the role the SRA could play in encouraging best practice in respect of regulation and risk.

The cost of risk management and compliance had increased over time, although this has not been driven by TLS/SRA requirements but rather from the increased complexity of large (and international) law firms and greater focus on compliance related issues in the business world generally.

### *Improvements to consumer redress*

The development of the Office of Legal Complaints (OLC) is not anticipated to affect city law firms as the majority of their clients (corporates) are not eligible to use the OLC anyway. Few complaints are received from individuals, but since even these clients are considered to be relatively sophisticated this also limits the expected impact of the new procedures among city firms.



## 1. INTRODUCTION

Charles River Associates (CRA) was commissioned by the Legal Services Board (LSB) to undertake a pilot study for benchmarking the supply of legal services by “city” law firms. There are a number of different aims of the research including to:

- Help the LSB benchmark and understand in greater detail various aspects of city law firms in order that future work can help to identify the impact of the following reforms in this segment:
  - Ensuring regulation is independent of professional bodies and vested interests;
  - The introduction of Alternative Business Structures (ABSs); and
  - Improvements to consumer redress when things go wrong.
- Provide information regarding the characteristics that are common between city law firms, as well as examining areas where there is variation between city law firms; and
- Use the opportunity of a pilot study to provide feedback for the methodology study such that lessons from this study can help with future examination of the legal services market.

### 1.1. Methodology

There are a number of different components to the work that have been conducted including:

- Engagement with methodology study – prior to the pilot study, the LSB commissioned Oxera to develop a methodology for benchmarking the supply of legal services.<sup>1</sup> Discussions have been held with Oxera to ensure that lessons from the methodology study can be applied to this pilot benchmarking study as well as later discussions ensuring that lessons from the pilot study are taken into account in the methodology study. There are a wide range of issues that it would be possible to consider in a benchmarking exercise of this kind, and discussions with the LSB led to prioritising the issues to be covered in this study to topics including focusing on firms, types of legal services, types of clients, regulatory costs and pricing;
- Desk research – there is limited existing research on the supply of legal services, although we have sought to ensure that existing information is taken into account including information from the Smedley Review of corporate legal work, evidence from the UK 200 survey of the largest UK firms, and data provided by the LSB; and

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<sup>1</sup> Oxera, Benchmarking the legal services sector, June 2011.

- Interviews – interviews with law firms and their representatives were a major component of the study aimed at examining the industry and providing insights on the supply side of city law firms. The interviews were designed to gather qualitative information about city law firms rather than quantitative data.

Throughout the report we use the term “firm” to refer to law firms unless otherwise noted.

## 1.2. City law firms

One of the aims of segmenting the legal services market is to understand whether there are differences between segments in the way markets function. Identifying consistent segments can help in the future evaluation of regulatory and other changes to assess the overall impact of the market on the outcomes for clients.

Different parts of the legal services sector may vary according to the types of clients that they have (and whether suppliers and clients have full information about the services being offered); the alternative choices available to clients or to firms in terms of the services offered; and the particular types of services that clients are seeking from their legal service providers.

The LSB proposed that city law firms would be the first segment of the legal services market to be considered in their market analysis. The term “city” law firms is a widely used concept, but there is no definition of what it means and therefore no clear sense of which firms would count as city firms and which would not. The early developments of the methodology study proposed a definition of such firms as: Limited Liability Partnerships (LLPs); with a postcode in EC1, EC2, EC3, EC4, E14, WC1 or WC2; and with more than four partners. We have refined this definition to capture a range of different factors as set out below.

### 1.2.1. Key characteristics of city law firms

There are a number of characteristics which were commonly seen as the key issues with respect to whether or not firms were city law firms which we set out below. In each case it is important to note that there is not a “hard-line” around the definition, but rather there is some fuzziness to the boundaries.

#### *Location*

Firms that do not have offices in central London would not be categorised as city law firms. The broad location within central London is also important, with co-location with financial institutions and other major clients a determining factor. Hence while most city firms are located within the boundaries of the City of London, Canary Wharf, the south side of the river (in Southwark rather than the City of London), and the Holborn area (where many significant firms have been located, in part due to the location of the courts and barristers’ chambers) would also be seen as locations where city law firms may have their offices. Often these offices would be the firm’s only office in England and Wales.

The importance of location is somewhat curious especially given that many city firms stress the number of international clients that they have and therefore for whom the actual physical location of firms would seem less relevant. Nonetheless interviewees stress that

there is a key business area in most capital cities (the areas described above for the UK) where clients expect their legal advisers to be located. (It may also be useful to international clients who wish to meet face to face with a range of advisers if they are clustered in the same area.)

#### *Type of firm*

In general, city law firms are among the largest law firms in the country. In part this reflects the fact that large firms can undertake the bigger and more complicated deals on which financial institutions and large corporates require advice.

There is no clear cut-off size in terms of turnover or headcount above which all firms are city firms and below which no firms are city firms. There are some relatively small specialist firms that compete against the very largest city firms and similarly there are some large firms who city firms would not consider to be a competitor. Nonetheless, as a general guide, city firms are more likely to be in the top 50 or 100 firms by turnover or headcount. City firms are also likely to have higher than average profits per lawyer or equity partner and some outliers of smaller firms can be identified as city firms in this way.

In advance of ABSs, how firms are structured, such as whether they are LLPs, does not currently differentiate city firms from other firms. While the great majority of city law firms were LLPs, there were notable exceptions to this; furthermore, being an LLP was not limited to city law firms but was seen as a very common way of structuring law firms more widely.

#### *Type of work*

Closely linked to the type of clients, the majority of legal services that a typical city law firm provides would be on corporate work with corporate finance and M&A transactional work a particularly strong area of work, along with work that would relate specifically to financial services issues.

#### *Type of clients*

City law firms are characterised by having clients that are large corporate clients with financial institutions especially well represented. By contrast, firms that conduct the majority of their work for individual clients would not be seen as city firms. City firms are also much more likely than other firms to have international clients and may also have an international network of offices.

### **1.2.2. Categories within city firms**

Defining categories within city firms is a more controversial issue than the definition of city firms itself and there are disagreements on where particular firms would fall. Nonetheless, a range of different groupings were suggested by interviewees including:

- Magic Circle firms who are generally regarded as the firms with the best overall reputation. There are five members of this group including the top four firms by turnover in 2010: Clifford Chance; Linklaters; Freshfields Bruckhaus Deringer; Allen & Overly; and Slaughter and May (which ranked eighth by turnover, but first by profit per

lawyer). While some firms may consider themselves to be “Magic Circle” in particular areas of law, it is only these five firms that were consistently identified as Magic Circle firms by interviewees.

- The term Silver Circle is used to describe firms that are perceived to be just below the Magic Circle in terms of their overall reputations. There is much less consensus regarding the firms in the Silver Circle but firms commonly described as such in either interviews or in the press include: Ashurst, Berwin Leighton Paisner, Herbert Smith, Hogan Lovells, Macfarlanes, Norton Rose, SJ Berwin, Simmons and Simmons, and Travers Smith.<sup>2</sup> As well as maintaining high reputations, these firms would also tend to have relatively high turnovers and boast an average profit per equity partner and average revenue per lawyer far above the UK average.
- International work is particularly important for city firms and there are a number of firms that would be seen as being in a “global elite”. This group would usually be seen as including the Magic Circle firms (although Slaughter and May is perceived by others as being more domestically focused than the rest of the Magic Circle) along with US firms such as White & Case, Baker & McKenzie, and Latham & Watkins amongst others.
- Other less commonly used terms including a “mid-tier” group, which broadly represented the next tier down from the Silver Circle. Some firms may have a number of offices in England and could fall into a “national” grouping but their city office would be competing against city firms and therefore their city office could be seen as falling into the category of a city law firm. Furthermore, some US based firms are clearly competing against UK based firms even if they would not be considered to be in a category of the global elite

It should be noted that while terms such as Magic Circle and Silver Circle are useful shorthand terms, there is clear overlap in terms of firms in different categories competing against each other. Hence while we refer to these terms in the remainder of the report, these different categories would not represent different segments for the purpose of the overall segmentation of the whole legal services market (i.e. in which market functioning is significantly different).

Similarly, it is not the case that city firms would only ever compete against other city firms. As with the definition of these firms itself there are borderline issues where we would expect some overlap between city firms and other law firms. However, in general, the closer to the “centre” of the definition of the city firm, the less likely it is that firms would be competing against non-city firms.

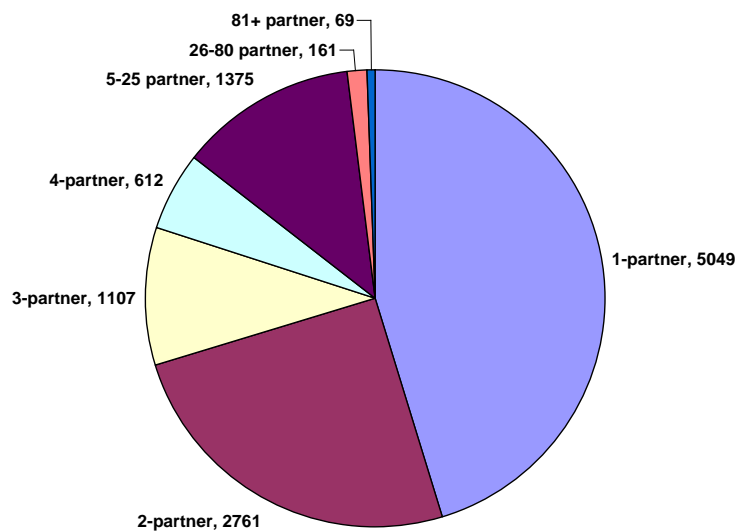
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<sup>2</sup> See for example, *The Lawyer*, Silver Circle, 3 September 2007; *Sunday Times*, ‘Silver Circle’ firms upset the legal order, 28 August 2005.

### 1.3. Selection of interviewees

There were around 11,100 law firms registered in England and Wales as of July 2010. As can be seen from Figure 1 below, small firms constitute the bulk of the market in terms of the number of firms. Sole practitioners and 2-3 partnership firms together account for 80% of the number of firms while those with more than 25 partners only account for only 2% of firms.

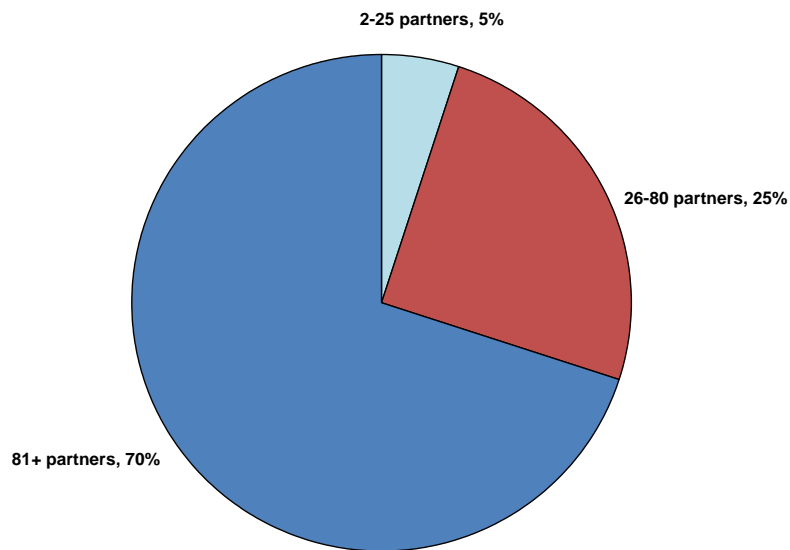
**Figure 1: Number of solicitor firms broken down by number of partner as of 23 July 2010**



Source: CRA calculation based on SRA data.

Given the focus of our study it was not appropriate to seek to interview firms which reflect the entire population of firms but rather to ensure that the bulk of firms were city firms so that this segment could be benchmarked. For this reason, and given that information was available on the turnover of different firms, we sought to focus the interviews on the largest firms. At the same time, we were keen to ensure that there was a spread of different firms represented, as well as to incorporate US firms that have major operations in the UK and against whom UK based firms compete. Figure 2 and Table 1 below provide more detail on the interviewees.

**Figure 2: Proportion of law firms interviewed by number of partners**



Source: CRA

As can be seen from the contrast between Figure 1 and Figure 2, the proportion of large law firms we interviewed is vastly greater than the legal services market as a whole reflecting the fact that city law firms tend to be large firms. In addition to large firms, we have also interviewed some smaller firms who would not be considered to be city law firms and who could therefore help in identifying differentiating characteristics between city law firms and non-city law firms.

In total, we have conducted 21 interviews with details in Table 1 below.

**Table 1: Summary of interviews**

Law firm by value of turnover	Number of interviews
Top 10	5
Top 11-50	8
Top 51-200	4
US firm	3
Representative group	1
<b>Total</b>	<b>21</b>

Source: CRA

## 1.4. Structure of the report

Within the rest of the report we provide information to meet the multiple aims of the research. Some information represents a snapshot picture of city firms and the variation between city firms such that this information can be gathered over time or examined again at a particular time in the future in order to assess the impact of the various reforms that the LSB is seeking to understand. Other information directly feeds into the definition of city firms which was set out in section 1.2 and lessons for the methodology study are drawn out as appropriate.

The rest of the report is structured as follows:

- Chapter 2 provides an overview of the broad size of city law firms as well as examining the types of staff they employ and trends in these issues. This chapter also considers the potential impact of ABSs;
- Chapter 3 sets out information on the types of work services provided by city law firms and how this varies between different firms;
- Chapter 4 examines the types of clients which city law firms serve as well as considering various important elements in client acquisition;
- Chapter 5 discusses issues that are specific to regulation including the level of interaction between city firms and the regulator, the specific issue of consumer redress and the cost of regulation; and
- Chapter 6 examines market outcomes covering volume, quality, costs and profitability, and pricing.

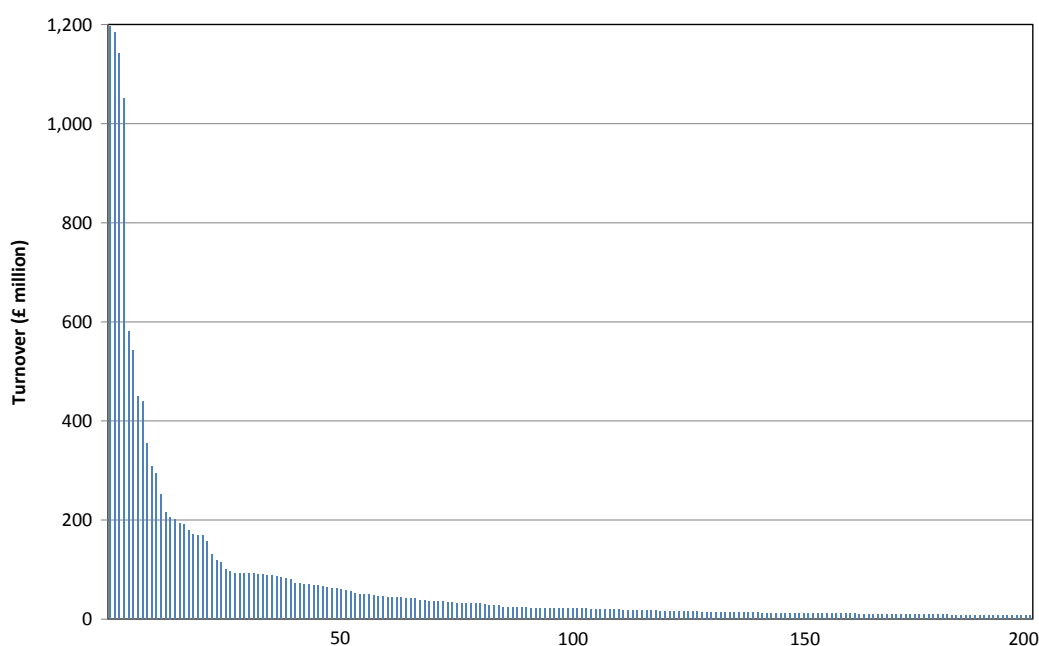
## 2. FIRMS AND FIRM STRUCTURE

In this section we start by exploring the landscape of law firms considering how city firms vary both in comparison to other firms and also between different city firms. Section 2.1 provides an overview of city law firms and other firms that are in the top 200 in the UK in terms of turnover. Section 2.2 and 2.3 examine the types of staff within law firms and trends in these arrangements respectively. Section 2.4 considers the different firm structures that are used. Section 2.5 considers Alternative Business Structures (ABS), the impact of which is one of the three areas that the LSB wishes to assess in future.

### 2.1. Overview of city law firms and other UK 200 firms

As noted in section 1.2, one of the characteristics that are generally associated to being a city law firm is size, hence it is useful to present some information for large firms.<sup>3</sup> Figure 3 below shows the turnover of the 200 largest UK law firms (as measured by turnover).

**Figure 3: Turnover for top 200 UK law firms**



Source: The Lawyer, UK 200 Annual Report 2010.

As Figure 3 above shows, even within the top 200 UK law firms, there is very considerable variation in the size of firms as measured by their turnover:

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<sup>3</sup> Caution needs to be used with the data from the UK 200 since data for some firms relates to the entire international operations whereas other firms are mainly, or entirely, UK based firms. In addition, information has been estimated for a small number of firms.

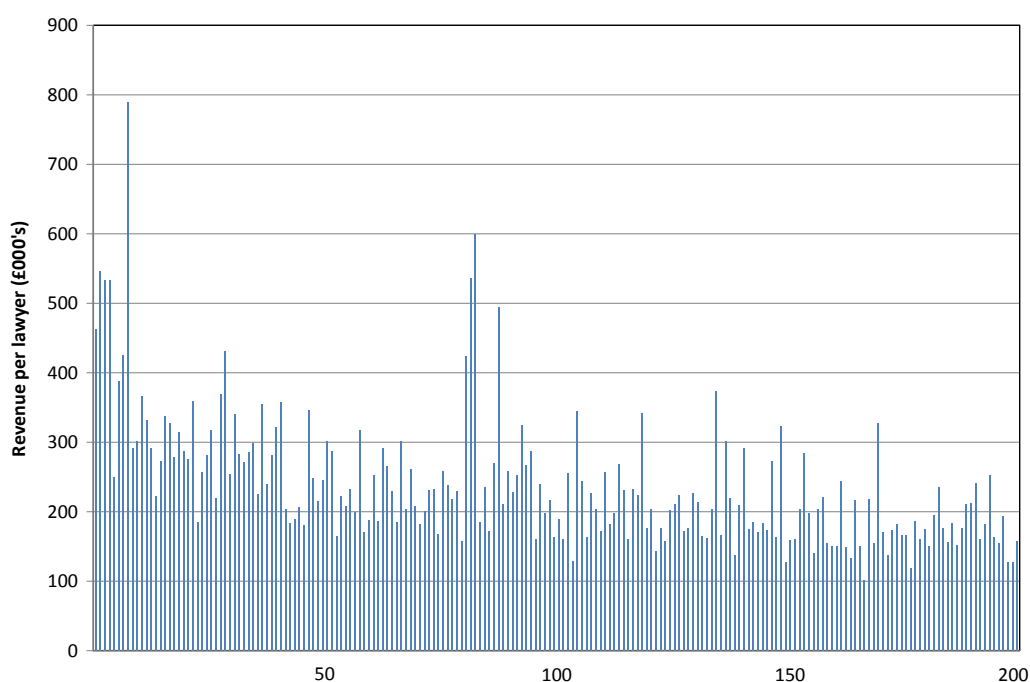


- the four largest firms (Clifford Chance, Linklaters, Freshfields Bruckhaus Deringer, Allen & Overy) have revenues of over £1 billion while that of the fifth (DLA Piper) is around half that of the largest firm at just under £600 million;
- only the top 25 have revenues of over £100 million; and
- the 100<sup>th</sup> firm has turnover of around £20 million, and the 200<sup>th</sup> around £6 million.

The number of lawyers within different firms follows a broadly similar pattern to that seen for turnover. The top five firms have around 2000 lawyers or more, firms around the 100<sup>th</sup> largest by turnover have around 100 lawyers, while those ranked 196-200 by turnover have approximately 30 to 50 lawyers each.

Having a broadly similar pattern between turnover and the number of lawyers suggests that the average revenue per lawyer may not vary as much between firms as either turnover or numbers of lawyers. Indeed, this is shown in Figure 4 below.

**Figure 4: Revenue per lawyer for top 200 UK law firms**



Source: The Lawyer, UK 200 Annual Report 2010.

Apart from a few outliers, revenue per lawyers generally decreases with the firm size in terms of turnover. For the top four firms, average revenue per lawyer ranges between £450,000-550,000 whereas £250,000-350,000 would be more common for the remainder of the top 50 and £150,000-200,000 common for the firms ranked 151-200. It is also clear from Figure 4 that there are a small number of outliers outside the top 50 who have relatively high levels of revenue per lawyer and a number of these firms would be considered to be city law firms who compete against the largest firms.

### **2.1.1. Impact of economic conditions**

Over the last 15-20 years, the growth in both the economy and the city of London as a centre for financial services also led to an increase in the work available for city law firms who have grown in line with this activity. In more recent years both the number of staff and the turnover of city firms were considerably affected by the recession with some firms shedding around 15% of staff and seeing a similar reduction in their turnover.<sup>4</sup> While the recession affected law firms across the board, certain areas of law saw much greater reductions in activity reflecting the nature of the economic downturn. In particular, the economic downturn led to substantial reductions in work for some firms in areas related to banking and finance as well as to the property sector.

## **2.2. Types of staff**

In this section, we examine the business models adopted by law firms in terms of the fee earning staff that they have.

### **2.2.1. Solicitors**

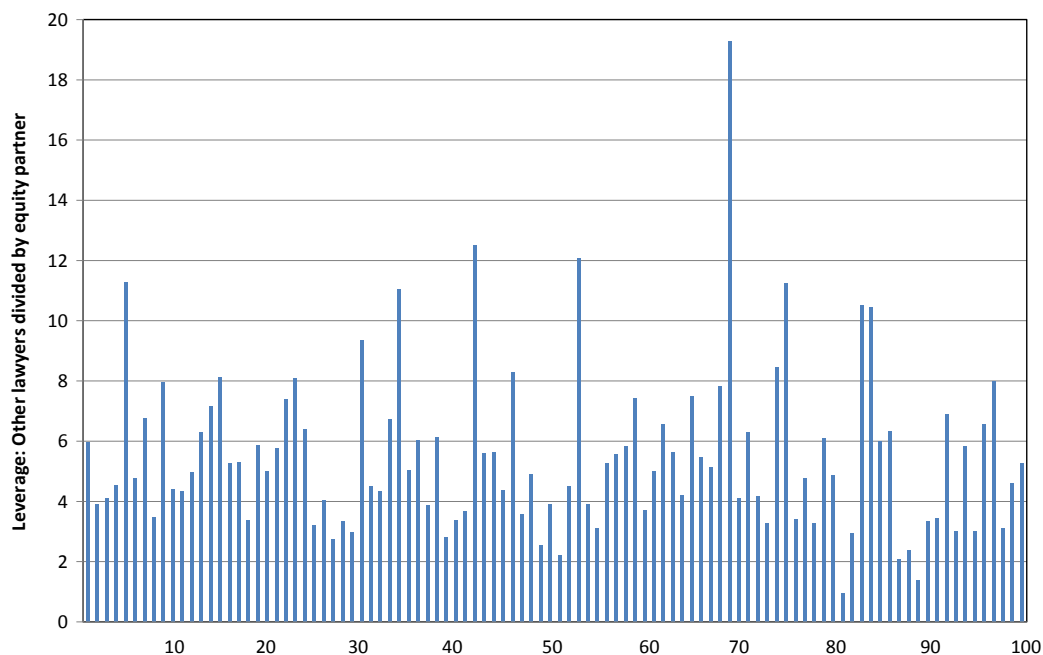
Among all interviewees, the overwhelming majority of fee earners within the firms were qualified solicitors and there were no particular firm characteristics that appeared to be linked to any variation in this.

Figure 5 below provides information on the leverage within firms which is calculated as the ratio of the number of non-equity-partner lawyers to equity partner lawyers. A higher leverage ratio indicates fewer partners in comparison to other lawyers and the leverage ratio may have implications for the supervision of less experienced staff.

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<sup>4</sup> The Lawyer, UK 200 Annual Report 2010.

**Figure 5: Leverage for top 100 UK law firms**



Source: The Lawyer, UK 200 Annual Report 2010.

As is seen in Figure 5, the leverage ratio generally varies between 3 and 6 across the board although there are a number of outliers. There does not appear to be any clear trend between the leverage ratio and the size of the firm (as presented in Figure 5) or between the leverage ratio and the total number of lawyers within firms. Instead, according to interviewees, the leverage ratio within city firms may be affected by issues such as:

- Differences regarding the organisational approach related to becoming equity partners – some firms will have large numbers of salaried partners and relatively few equity partners while other firms have almost no salaried partners; in other cases firms may be more or less restrictive in the number of individuals who are “made up” to partners more generally. These differences appear to reflect the culture of the individual firms rather than other characteristics on which segmentation could arise;
- Differences between work types – some types of work lend themselves to a greater use of less experienced staff than other types of work. For example, litigation and corporate transactions may require more routine checking of documents compared to other disciplines and therefore enable greater leverage to be obtained. Hence differences in the mix of work between different city firms will lead to differences in their leverage.

### *Specialisation*

One noticeable trend among solicitors in city firms is that solicitors have increasingly become specialists at earlier stages in their careers compared to in the past. There was no variation in this issue according to different characteristics within city law firms.

Trainees would usually have four “seats” during their two year training contract and it was clear that within city firms, the choice of longer-term specialism would typically be determined within this training period. Newly qualified staff would be expected to join one of these four areas and then remain in that particular practice area. Some interviewees indicated that, given the intensive nature of the work and the training that they receive, this would lead lawyers to develop a fair amount of expertise in their chosen practice area even after being qualified for only a relatively short period of time.

Given that city lawyers now specialise very early in their career, moving between different practice areas has become increasingly difficult within some interviewees suggesting that individuals with two years post-qualified experience (PQE) might be too specialised in one particular practice to be able to successfully move into a different area. Indeed, during the recession where certain areas of work were particularly affected by the downturn, no interviewee indicated that they had been actively seeking to redeploy staff from one area of work to another. In part this was because there were few areas of their practices that had sufficient work available to be able to absorb additional numbers of staff, but it was also because of the specialist knowledge required in different areas of the law.

In general there appeared to be a preference among these firms to be able to attract the best trainees and then train new staff in the relevant areas of practice rather than to re-train existing staff. Alternatively they may seek to hire more experienced lawyers externally who already have the relevant experience in certain disciplines.<sup>5</sup>

Evidence related to practise certificates also supports the view that individuals in city firms are more specialised than lawyers working in other firms. For example, examining data on the areas of expertise by those holding a practicing certificate finds that:

- For the top 50 firms (according to the UK 200), on average practice certificate holders indicate that they have 2 areas of expertise; whereas
- For firms that have fewer than five holders of practising certificates, on average they indicate that they have 4 areas of expertise.<sup>6</sup>

Some caution needs to be applied to this data since some areas of law may be considered to be “wider” in their definition than other areas of law. However, it nonetheless supports the view of interviewees that lawyers within city firms are more specialised than other lawyers.

In part this specialisation of individual lawyers is likely to reflect the relative size of city firms compared to other firms, but interviewees also indicated that it reflected the preferences of clients who, when seeking a city firm, expect to have individual lawyers who are experts in the precise area of law that they need advice.

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<sup>5</sup> It is also possible that retraining staff could give rise to tensions related to relative salaries which appear to mainly depend on the number of years of PQE. If staff move from one area of practice to another they may have higher salaries (linked to PQE) compared to the amount of experience they have in the new area of law.

<sup>6</sup> Based on data provided to CRA by the LSB.

### **2.2.2. Trainees**

Most firms have a trainee programme and will take on numbers of trainees in proportion to their overall staff levels. Trainees at city firms will generally take new graduates from what would be considered to be the best universities and law schools. The number of trainees taken on will depend on the overall financial performance of both the firm and the individual practices as well as their plans for growth. While the number of trainees hired during the recession was cut back substantially, before the recession, firms could have been hiring trainees representing around 10% of qualified lawyers.

### **2.2.3. Paralegals**

Paralegals, who undertake some components of legal work but who are not qualified solicitors, are widely used by most city law firms. The use of paralegals rather than qualified solicitors or trainees helps to keep costs down for clients as they are cheaper to employ than qualified solicitors and charged out at lower rates.

Unlike the role of trainees, the role of the paralegal is not usually seen as part of the career path for solicitors at city firms. (Although some law graduates may spend time as a paralegal before training contracts begin, it would be rare for city firms to take on paralegals and subsequently offer them a training contract.) It also appears common for foreign qualified lawyers who want to spend a short period of time in the London to work as paralegals in city firms. Paralegals at city firms are commonly employed on short-term contracts, providing firms with flexibility to increase or reduce their overall staffing numbers according to the needs of particular cases.

In particular, paralegals are often used in areas of work which are very time intensive but relatively standardised. For example, the proportion of fee earning staff that are paralegals would usually be somewhat higher in litigation practices rather than in other areas. This is because litigation work often has a greater need for document processing such as reviewing large volumes of client documents which is time-intensive but does not necessarily require as much expertise as other areas of work. While the proportion of staff that are paralegals could reach as high as 20% of litigation practices at certain times, it varies considerably between city firms and could vary considerably over time within any given firm reflecting the needs of specific cases. The use of paralegals is common across all types of city firms.

### **2.2.4. Solicitor advocates and in-house barristers**

Many city firms have staff that obtained their rights of audience in higher courts and are solicitor advocates. In addition, city firms may have staff who originally trained as barristers before re-qualifying as solicitors. Firms do not generally have a high proportion of staff with advocacy training, although solicitors in litigation teams would be more likely to have such qualifications. In general the reasons for having solicitor advocates were:

- This enables firms to keep in-house some advocacy work for which they would otherwise have to instruct outside counsel at a higher cost to the end client. Firms were consistent in stating that solicitor advocates were currently used for procedural issues and early stages of cases and would not be used to handle entire litigation cases; and

- Having the training and experience of some advocacy helps solicitor advocates to think in the way that external advocates would think which means that they are more likely to be able to prepare information that is helpful to the advocate appointed.

Some interviewees have observed that there has been an increase in the number of solicitor advocates within firms and some firms have explicit aims to ensure that the majority of their litigation departments obtain advocacy qualifications. In part this reflected an expectation that over time the amount of advocacy that could be done in-house would increase.

In addition, some firms have appointed a very small number of QCs who have highly specialised knowledge in particular areas. There is some evidence that this is more likely to be the case for the larger city firms who are more likely to be able to have sufficient advocacy workflow in a very specialised area to justify appointing a QC internally. It is notable that these have been external appointments where QCs have been brought into city firms after they have established careers as among the best specialists rather than city firms expecting to have trained advocates to this standard in-house.

Although there are a small number of QCs that have been appointed within city firms, it is clear that in the great majority of cases where advocates are required, firms will seek outside counsel. The primary reason for this is that most clients of city firms, especially the very largest city firms, want to appoint the very best advocates for the particular case and the best experts were considered by interviewees to be at the bar rather than within solicitor firms. In particular, because external barristers can be appointed by a range of different law firms, they are able to gain a greater degree of experience in very specialised areas. In contrast to this, interviewees indicated that most firms were unlikely to be able to have a sufficient level of workflow in a very specialised area to be able to justify having the best advocates in-house and to be able to keep them fully employed on fee earning work.

#### **2.2.5. Non-lawyer fee earners**

Many firms have a small number of fee earners who are experts in disciplines other than law although the number of these individuals are very small at city firms (usually under ten). The types of skills that were most commonly cited usually linked to a very particular area of law including people with the following skills:

- Accountants, particularly to work alongside tax lawyers, or to assist with estimation of damages in litigation cases;
- Trademark attorneys or patent lawyers on intellectual property issues;
- Economists for competition law or transfer pricing issues; and
- Town planners or surveyors for property work

Usually these additional skills are brought in because there are clear synergies and considerable repeat work that combines both legal and non-legal skills, although in the great majority of cases the individuals concerned have trained elsewhere and are brought in at relatively senior levels. One of the implications of this is that non-lawyer experts will

usually be found in areas of work in which the firm is particularly strong or where they have chosen to focus. For some of the smaller city law firms, they would not have sufficient workflow in any particular area to justify having other experts in-house, whereas larger firms would be more likely to be in a position to do this (although they may or may not chose to do so in any given area).

In general, however, most city firms currently take the view that they do not want many non-lawyer experts in-house as they prefer the ability to identify the best experts for any given case and they consider that they are usually to be found at specialist firms where individuals will have had a greater range of experience in their particular area of specialisation.

### **2.2.6. Impact of economic conditions**

There did not appear to be any clear distinction between city firms regarding the types of staff that were particularly affected by the downturn in economic conditions with reductions likely to have been faced by all types of staff.

A small number of interviewees suggested that the recession had caused some firms to consider what their core competencies were and to seek to focus on those areas. While this may have affected the types of work that firms offered, some interviewees suggested that the recession had caused firms to not want to expand the number of non-lawyer fee earners as they wanted to re-focus on their areas of strength in offering purely legal services. However, this comment should be seen in the light of the relatively small proportion of non-lawyer fee earners currently present in city firms.

## **2.3. Trends regarding staffing and firm size**

There are a number of key trends that are affecting both the overall level and the different types of staff within city firms.

### **2.3.1. Relationship with in-house legal departments**

As explained further in Chapter 4, city firms are typically working for clients that have their own in-house legal departments. One of the implications of this is that there is the potential that some work could either be done through using external advisers or could be done through expanding the in-house department. As such, not only are the in-house legal departments acting as clients, they may also be acting as competitors in certain areas.

Many, particularly large, city firms do not perceive in-house teams to be a particular competitor for the great majority of work that they conduct for those teams. That is because city firms tend to stress the specialised nature of the work that they are doing for clients and frequently not even the most sophisticated in-house teams would have sufficient specialisation within their staff to be able to conduct these cases.

However, it is clear that city firms have seen some types of work be increasingly conducted in-house by clients. In particular, over the last 10-15 years, in-house legal departments now work more on commercial contracts, employment contracts, sale and

purchase agreements and some aspects of mergers and acquisitions. In general, it tends to be the lower value, more standardised and more regular pieces of work that are brought in-house although, unlike outsourcing (discussed below) it would not tend to be work that involves large numbers of staff to be involved on a short term basis. Interviewees did not state that they expected in-house work to lead to reductions in overall staffing at city law firms.

### 2.3.2. Outsourcing, off-shoring and on-shoring

In recent years the recession has caused significant cost pressure from clients. One of the results of this has been through changing the structural methods through which legal services are delivered by city firms including:

- Outsourcing – where some work is done through a separate and distinct firm that conducts Legal Process Outsourcing (LPO) such as CPA Global, Exigent, and Integreon or where work is outsourced to smaller regional firms in the UK or abroad;
- Off-shoring – where work is done through another office within the same overall law firm where this office is outside the UK in cheaper locations such as India or South Africa; and
- On-shoring – where work is done through another office within the same overall law firm where this office is located within the UK. Belfast currently represents a popular location for city firms to locate an office explicitly for this reason. Firms that already have a network of offices across the country are also able to gain cost advantages though using their existing network.

Although there are differences between outsourcing and off/on-shoring since the former involves the use of a distinct corporate entity, the driver for all of these arrangements is the same, namely the desire to seek a lower cost option for conducting some of the work. The drive for this from clients' perspective is clear when newly qualified staff can be charged out at hundreds of pounds an hour (see section 6.5). The pressure for this has been seen across the full range of city firms including Magic and Silver Circle firms as well as other city firms.<sup>7</sup>

Typically the work that is conducted outside city offices (whether through outsourcing or on/off-shoring) tends to be lower value transactional work, often with repeat processes such as conducting due diligence, setting up data rooms, document review, data mining, and contract management. Many of these types of work require large numbers of staff to be involved in order to examine large numbers of documents. In addition, "back office" functions such as human resources, finance and accounting, and new client intake checking may also be outsourced or located outside the city.

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<sup>7</sup> See for example: The Lawyer, Slaughters sets up panel for outsourced business, 4 October 2010; The Lawyer, A&O signs outsourcing deal with LPO provider Integreon, 18 November 2009; The Lawyer, Lovells launches South African outsourcing pilot, 14 January 2009; The Lawyer, Mexican wave is the model outsourcing arrangement. 14 June 2010; The Law Society Gazette, How legal process outsourcing is changing the legal landscape, 25 February 2010.



One of the advantages of outsourcing as distinct from retaining work within the same organisation is the additional flexibility that the provider offers of additional staffing at particularly busy times. In this regard some of the issues related to outsourcing could overlap with some of the work conducted by paralegals.

In contrast it is clear that since city firms primarily trade on the basis of their reputations for giving high quality advice, one of the risks involved for them in outsourcing work is to ensure that quality is maintained through this. City law firms would discuss the appropriate way to manage specific cases with clients, with the relative importance of price compared to other issues seen as key in determining the use of outsourcing or on/off-shoring. In many cases it is clear that it is the clients who are obliging city firms to set up these arrangements. Other factors of relevance include concerns about confidentiality issues with work being done by a separate firm in another country, language ability, regulatory oversight and whether individuals are subject to the same code of conduct and code of ethics as the outsourcing law firm. Despite trends for outsourcing, interviewees did not indicate that this would reduce the overall size of city firms.

### 2.3.3. Mergers and acquisitions

One key trend that has been observed over the last decade has been the amount of M&A activity within law firms. These have occurred both domestically as well as internationally and most of the largest firms are the product of a number of different mergers. For example:<sup>8</sup>

- Clifford Chance represents the result of mergers between Coward Chance and Clifford Turner in 1987 and a major international tripartite merger with Germany's Pünder Volhard Weber & Axster and New York-based Roger & Wells in 2000;
- Linklaters first created an alliance with other leading firms in Europe during the 1990s and expanded rapidly in the early 2000s with multiple mergers across the globe; and
- Freshfields Bruckhaus Deringer is the result of two mergers in 2000 between Freshfields, Deringer Tessin Herrmann & Sedemund, and Bruckhaus Westrick Heller Lober.

In general, law firms consider M&A as a quick way to expand the breadth of its expertise and gain access to clients and markets where it did not have presence before. Moreover, given the globalisation of the world economy, some international clients may seek legal services at a global level.

Although M&A activity between firms was relatively rare during the economic downturn, there have been a number of recent mergers since then such as those between Hogan & Hartson and Lovells to form Hogan Lovells; Sonnenschein Nath & Rosenthal and Denton

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<sup>8</sup> Clifford Chance, Our story, [http://www.cliffordchance.com/about\\_us/our\\_story.html](http://www.cliffordchance.com/about_us/our_story.html); Linklaters, Our history <http://www.linklatersgraduates.co.uk/about-us/our-history>; and Freshfields Bruckhaus Deringer, Our history <http://careers.freshfields.com/our-firm/our-history.aspx>.

Wilde Sapte to form SNR Denton; and Ogilvy Renault LLP becoming part of the Norton Rose Group.<sup>9</sup> It is possible that this may signal another trend in M&A activity beginning. It is clear, however, that the mergers are driven by strategic and commercial considerations rather than by any regulatory issues.

## 2.4. Legal structure

Since firms have been able to do so, the vast majority of city law firms have changed their legal structures to be organised through a Limited Liability Partnership (LLP) rather than a general partnership. The main reason for firms changing is simply to gain from the benefits of limited liability. There are notable exceptions to this where firms have remained general partnerships, but the reasons for this appear specific to the individual firms rather than linked to any other characteristics.

Most city law firms, especially the larger firms, have separate service companies that employ the lawyers and which then provide services to the LLP. This structure is prevalent for tax reasons.

### 2.4.1. Location of offices

Firms that do not have offices in central London would not be categorised as city law firms, but not all firms with offices in central London would be seen as city law firms. The broad location within central London is important in determining whether firms would be considered to be city firms but it is clear that this has changed over time.

Most city firms are located in or around the City of London itself although historically the Holborn area has also been seen as very important as it is the location of certain courts such as the Royal Courts of Justice as well as being the location of barristers' chambers. Over the last decade, the Canary Wharf area has grown in importance as a location in which financial services companies have located along with various advisers to these companies including law firms. More recently, areas close to the City of London but on the south side of the river (and therefore in Southwark rather than the City of London) have also attracted city law firms.

Hence while there are key geographical areas in which city firms are located the precise locations have changed over time reflecting the relative prestige of certain areas, and the location of financial services companies and other firms that cluster around these areas. Hence identifying city law firms over time would need to take into account the movements in the boundary of locations considered sufficiently prestigious to qualify as the "city".

It is interesting to note that physical location remains important to firms serving major corporations and financial services companies. In particular, the importance of location is surprising given that many city firms stress the number of international clients that they have and therefore the actual physical location of firms would seem less relevant. Nonetheless interviewees stress that there is a key area in most capital cities (in the UK's

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<sup>9</sup> The Gazette, Law firm merger now official, 1 June 2011; The Lawyer, UK 200.

case the areas described above) where many major financial institutions locate and where there is clustering of a range of different advisory firms that service these clients. Although much of the work with international clients may be conducted through remote means such as email and video conferencing, even international clients nonetheless expect their legal advisers to be located in the city. Furthermore, such clients may want to see a range of advisers on different issues and having them clustered in the same area makes this more convenient.

#### **2.4.2. Number of offices in England and Wales**

City law firms vary according to the number of offices that they have both domestically and also internationally (see section 2.4.3). Many city firms have only one office within England and Wales while other firms would have offices in a number of other major cities.

Where firms did have multiple domestic offices, they typically had offices in only a handful of locations. Usually they had multiple offices as a result of mergers of firms that were historically located in different cities and where they had retained their presence in these locations. In general the city office was seen to conduct different types of work and compete against different types of firms, compared to their other domestic offices that may compete for work from clients that are relatively near to those offices.

#### **2.4.3. International arrangements**

One of the clear trends over a number of years has been the movement among many firms to have a much greater geographical footprint. Indeed some city firms would describe themselves as “global firms” rather than specifically “city firms” and there has been a considerable increase in the geographical reach of some of these firms over the last 15-20 years.

In addition to firms that consider themselves to be global firms, it is relatively common for other city law firms to have a range of international offices. Most commonly these would involve offices in cities with major financial services sectors or in capitals of major economies. In particular, in recent and current times there appears to be greater consideration of having offices in financial services centres in Asia and in the Middle East such as in Dubai. Similar trends have seen US headquartered firms opening in London.

International law firms with offices across the globe may have to organise the firm as separate entities to meet the regulatory requirements regarding legal structures permitted in different jurisdictions. For example, firms in Hong Kong or Australia have to be organised as traditional partnerships as LLPs are not allowed (although Australia does allow ABSs). More generally, international firms are likely to have a vast array of different institutional structures reflecting tax and regulatory requirements in the different firms in which they operate as well as the idiosyncrasies of their own firms.

City law firms with international offices also vary on how the sharing of profits arises across their different locations. Some firms have a single profit pool which applies across the entire firm across the globe while others have profit pools on a national basis although the choice between the two appears to be specific to individual firms rather than driven by particular characteristics. Furthermore, while firms may in practice have a single profit

pool, the way that this is arranged from a technical perspective may vary in order to meet the regulatory restrictions of different countries.

As well as these global firms, it is common for city law firms that do not have their own offices in different locations to work alongside other, similar, law firms in different locations when conducting work with international aspects. There is variation between firms as to whether they are in networks with other firms, have “best friend” arrangements with firms in other countries, or simply work with other firms on a relatively regular basis without formal arrangements being in place.

#### **2.4.4. Entities for specific functions**

Some city firms may also have separate trust companies which act as a professional trustee for clients while others may have nominee companies for the acquiring of land for celebrities who do not want their identity on the deeds or to assist in transactional work. There is also some evidence of a small number of separate firms being developed through which legal services are delivered for specific clients.

### **2.5. ABSs**

Firms in the legal services market in England and Wales will be allowed to operate alternative business structures (ABSs) from October 2011. This will allow more flexibility in the funding of law firms through enabling non-lawyers to invest in law firms and enabling law firms to offer other forms of services alongside legal advice.

#### **2.5.1. Financing**

ABSs offer an opportunity for law firms to gain access to external funding through for example, public floatation on stock exchanges or private equity investments. This could be valuable for firms planning to expand their business rapidly but which are restricted by the amount of capital that they can raise internally or through debt.

Although interviewees acknowledge the additional flexibility that ABSs can bring regarding the financing of their firms, interviewees did not generally see moving towards an ABS as an attractive option for their individual firm. In particular, the large firms believed that they could easily fund their business plans through retained profits or through borrowing directly from banks if they had a particular need. There was considerable reluctance among firms to seek external funding that would involve partners ceding control of the firm to external investors. Furthermore, interviewees generally saw little advantage of seeking external investment for which a proportion of the future profit stream would have to be paid, preferring instead to maintain full ownership of that profit stream.

For these firms, they also considered that even if they wanted to have a merger with other firms that this had happened frequently in the past without the need for external investment and that M&A activity in the future was likely to involve similar types of firms coming together with no particular capital needs for the deals to go through.

City firms that we interviewed generally distinguished themselves from firms that had publicly stated that they intended to seek external financing through ABSs or other firms that were thought more likely to use ABSs.<sup>10</sup> Interviewees considered ABSs to be more likely to be seen among firms who offered legal services for individuals or smaller companies where the work was more standardised. In addition, firms who wish to rapidly expand through acquisition may have capital needs and therefore pursue an ABS. This could include firms seeking to have a national brand through the acquisition of local firms and it is possible that this may include mid-tier city firms.

As well as interviewees generally perceiving little advantage from ABSs for city firms, they were also sceptical whether outside investors would want to invest in law firms, citing the difficulty that arises when the individual partners are free to exit the firm and to move elsewhere, potentially taking clients with them and leaving external investors with little value in the firm if this happened on a wholesale basis. Indeed, the relative importance of human capital rather than financial capital within city law firms may affect the attractiveness of ABSs more generally.

While most interviewees indicated that because there was no financing need that they could currently see, they did not think that they would move towards an ABS even if some of their closest competitors did so although a small number of interviewees recognised that if large numbers of firms began to use ABSs and there was evidence of benefits arising to the partners of those firms from the ABS then other firms might become under greater pressure to also move to an ABS.

### **2.5.2. Wider set of services**

ABSs also allow law firms to expand the areas of service they provide into multi-disciplinary practices not restricted to legal areas. For example, law firms will be permitted to have non-lawyer owners, facilitating the provision of services in other areas such as accounting with firms then able to provide “one-stop-shop” services that meet all the aspects of a client’s needs for a particular case.

There was a reasonably strong consensus that the city firms were not currently interested in offering one-stop-shop services to their clients. This reflected the view that specialisation would continue to be of greater attraction to large corporate clients than would a more generalist firm offering.<sup>11</sup> In particular, firms were of the view that clients would go to a specialist law firm for the best legal services and a specialist accountancy firm for the best accounting services. They did not believe that one organisation would be able to provide the best services across a multitude of disciplines. This is also consistent with the view that city firms conduct the most specialised pieces of work for clients.

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10 Financial times, Legal firms set for “Tesco law”, 28 December 2010. This research suggests that 7 of the largest 30 firms in the UK were looking to raise external capital

11 A further concern of city firms is that expanding the range of services that they offer would give rise to the risk of an increased number of conflicts across the combined business.

Instead, interviewees stated that ABS would be more suitable for firms whose main work is more standard and which could be commoditised and carried out on a large scale. Examples given included where there was considerable repeat business with multiple clients such as within the property market (surveyors and conveyancing), advice for reasonably wealthy individuals (combining financial advice, will writing and accountancy services) or small businesses (combining accountancy and legal services). It was noted that many of these issues will have common processes across clients and the clients may prefer to have a one-stop-shop from whom all of the services can be purchased.

Despite the general view that clients of city law firms wanted highly specialised advisers, as noted in section 2.2.5, many law firms do currently have a small number of non-lawyer experts. Typically interviewees considered that there were very specific reasons for the experts that they had in-house, they had not generally been trained purely internally, and there appeared little appetite to greatly expand these numbers.

Furthermore, since law firms can already employ experts from other disciplines if they had wanted to expand the number of such experts they could already have done so. This suggests that ABS would not be expected to lead to a sudden expansion in this in the short-term. The main constraint currently imposed from the regulation is that the experts concerned are not able to be partners, but most law firms find a way around this through linking remuneration to what it would have been had the individuals been partners.

Offering a wider set of services, and having partners who are not lawyers brings complications for international law firms that have a presence in jurisdictions where ABSs are not permitted. Some interviewees have therefore indicated that the restrictions in place in other countries would therefore limit the ability to have non-lawyer partners in the UK. For example, in the US lawyers are not able to share profits with non-lawyers and therefore it is argued that a firm with a US office would not be able to have non-lawyer partners.

While it is clear that international law firms (which would not necessarily include all city law firms) would certainly need to consider the impact of international regulation, it is less clear that this means that firms would therefore not have non-lawyer partners. Instead it may be possible for law firms to be restructured into separate entities to meet regulatory requirements. This would have cost implications as firms would need to take into consideration many factors such as tax implications and the precise nature of regulation in different jurisdictions. Nonetheless, many firms already have complicated structural arrangements for their international offices hence this would not represent a step that is out of the ordinary compared to the way that many firms are already organised.<sup>12</sup>

It is also worth noting that the trend of some firms to move towards international offices could also be seen as an analogy to the provision of non-legal services. Some city law firms with large international offices see it as an advantage to their clients that they are able to offer a one-stop-shop to clients in offering legal services across the globe and in

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<sup>12</sup> More generally, the fact that most city law firms are already structured with service companies which employ the staff and which then provide services to the LLP could also suggest that the service companies themselves could be used for ABS arrangements.

providing advice on both UK law, and for example, US law at the same time. Other city law firms take the view that they have arrangements (with variations in the formality of these arrangements) with other law firms in other locations that specialise in the law of that particular country rather than having merged with them.

Overall, however, given the considerations discussed above, most city law firms are very cautious about adopting ABSs in the near future and do not consider their segment as likely to see significant changes on this issue in the short term.

## **2.6. Conclusions on firms and firm structure**

### **2.6.1. Lessons for the methodology study**

There are particular locations in and around the City of London and Canary Wharf where city firms are based but these precise locations have changed over time reflecting the relative prestige of certain areas suggesting that flexibility may need to be applied to this characteristic when repeating an examination of city firms. The size of firms is identified as of considerable importance in identifying city firms but in general 10 partners rather than 4 would be a minimum and the majority of city firms would have over 50 partners. The corporate structure of firms is not currently a differentiating factor (whether a firm is an LLP is not a relevant indicator), although this may change once ABSs are allowed.

### **2.6.2. City firms and variation between firms**

#### *Size*

City law firms are typically within the largest 1% of firms although there is considerable variation in their size with the four largest firms being multiples in size of others in the top ten. Despite the considerable variation in size, even specialist firms would have relatively high turnovers compared to the legal services market as a whole and are identifiable from high profits per lawyer or per partner. Other than the impact of the recent recession these firms have grown strongly over time reflecting the growth of the financial services sector and the importance of international clients.

City firms are observing pressure from clients to seek cheaper methods of providing work through outsourcing and other structural arrangements but this is not expected to lead to reductions in overall head count. At the same time pressures for M&A activity and a recovering economy meant that city firms are likely to continue to grow especially in the light of the importance of international work to city firms where further expansion of geographic footprints is expected among some city firms. Data on the size and turnover could be monitored over time for the LSB's benchmarking exercise.

#### *Staff*

Fee earners in city firms are primarily qualified solicitors who are increasingly specialising in particular practice areas early on in their career and are highly unlikely to move between practices; lawyers outside city firms tend to have more practice areas in which they work than those in the city. Paralegals are commonly used for work such as due diligence and document review to provide flexibility in staffing levels and to control costs

in areas of high volume work. Within litigation departments there are increases in the number of staff taking advocacy qualifications although most interviewees indicate that external barristers will remain the advocates of choice other than for early stages of cases given the high value and specialised nature of work that city law firms conduct.

Many firms have a small number of fee earners who are experts in disciplines other than law such as accountants, trademark attorneys, economists, town planners, although the number of these individuals are very small at city firms (usually under ten) and are usually poached from specialist firms rather than being trained in-house.

### ***ABS***

City firms do not generally see ABSs as attractive because they are reluctant to cede control of the firm for external funding which they do not currently need. Neither do they see huge demand for providing a wider range of services beyond the experts that they are currently able to bring in-house anyway. In addition, offering a wider set of services, and having partners who are not lawyers brings complications for international law firms that have a presence in jurisdictions where ABSs are not permitted.



### 3. TYPE OF LEGAL SERVICES

The type of legal services offered by firms is an important dimension to differentiate between firms. In this section, we first discuss the framework set up by the methodology study and then examine the types of legal services that city law firms provide, how they categorise the work they undertake and how firms compete in different fields of law.

#### 3.1. Framework from the methodology study

Type of law is one of the three dimensions suggested by the methodology study to segment the market (along with type of clients and type of legal activities). The early drafts of the methodology study considered type of law by three levels:

- In Level 1, there are 17 categories of type of law such as crime – prosecution, crime – defence, injury, wills, trusts and probate;<sup>13</sup>
- Level 2 breaks down Level 1 into contentious and non-contentious areas as applicable; and
- Level 2b break down the Level 2 category into further detailed areas:
  - “Other business affairs – non-contentious” is then broken down into corporate structure, procurement, licensing, and business registration; whereas
  - “Other business affairs - contentious” is broken down into law and infringement of contracts, competition, regulation – price regulation, regulation – health and safety, and environmental.

Another dimension suggested by the methodology study is the type of legal activity, which includes research, advice, representation (on paper, litigation or otherwise) and representation (in person) at Level 1. This is further split into research, advice, litigation, other, representation in lower courts, and representation in higher courts at Level 2.

In addition, we have been asked to assess whether city law firms consider different types of legal services according to the basis of whether or not they involve reserved activities as against other services.

#### 3.2. Type of legal services provided by city law firms

The methodology study is aimed at benchmarking the supply of legal services across the whole market covering all different types of firms. Since the categories are aimed at being comprehensive, not all of them will be applicable to all law firms or to city law firms in particular. For example, in general city law firms do not tend to undertake immigration

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<sup>13</sup> The other 13 categories are conveyancing; family; property, construction and planning; employment (excluding injury at work); immigration and nationality; consumer problems; welfare and benefits; other rights; intellectual property rights; corporate finance; other business affairs; other; and other public and administrative law.

work (a Level 1 category), but would commonly distinguish between offering competition work compared to environmental work both of which are Level 2b categories within “Other business affairs – contentious”.

When describing the type of work that they do, many firms distinguish both between the legal areas, and also between sectors in which the law is conducted, often choosing to present their firm to potential clients using both of these descriptions. For example:

- Common areas of types of law that were frequently mentioned by firms included: corporate transactions and M&A, litigation and dispute resolution, competition, construction, employment, pensions, intellectual property, project finance, public law, regulatory enforcement, restructuring and insolvency, and tax; and
- Common sectors that were frequently highlighted included: banking and finance, funds and investment management, private equity, insurance, real estate, consumer goods and retail, energy and natural resources, health care, pharmaceuticals, infrastructure, transport, technology, telecoms, media, and Government and public policy.

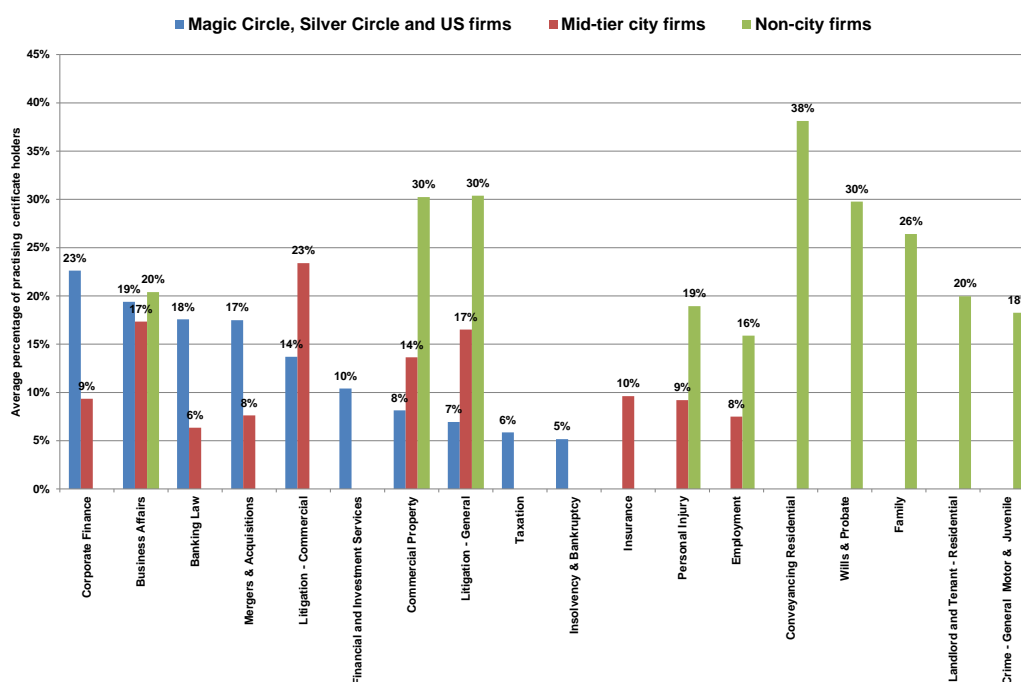
These two ways of categorisation are adopted by many city law firms. The exact types of law and the sectors that they highlight vary according to the particular strengths of individual firms. It is also notable that the financial services sector generally plays a very important role in terms of the flow of work with city law firms commonly distinguishing between work for different types of financial institutions. The fact that city law firms distinguish between sectors is further indication of the degree of specialisation within these firms and interviewees highlighted the importance in their service offering of understanding the business environment in which their clients operate.

None of the firms we interviewed separated their services by the type of legal activities conducted such as examining research, advisory, advocacy and litigation activities. Neither would firms keep information in this way. As explained in section 2.2, while some advocacy work is conducted this is generally limited within city firms.

### **3.2.1. Main types of work conducted by city firms**

During the course of interviews city law firms stressed the importance of corporate work (usually referring to corporate finance and M&A transactions), commercial work (relating to more ongoing legal requirements in the ordinary course of business) and litigation. The importance of these areas can also be seen from data on the proportion of practising certificate holders in firms who state that they have expertise in particular areas as presented in Figure 6 below.

**Figure 6: Average percentage of practising certificate holders by legal areas and type of firms**



Source: CRA calculation based on “Find a Solicitor” data provided by LSB. Note that for the purpose of this figure, mid-tier firms include all firms in the top 50 by turnover excluding those that are in the Magic or Silver Circle. Non-city firms include all firms outside the top 50.

As Figure 6 shows there are substantial differences in the types of work conducted by different types of firms with this particularly clear between city firms and non-city firms. Firms in the Magic Circle, Silver Circle and top US firms, were identified from data as having very similar areas of expertise and therefore have been grouped together. In particular these firms are particularly strong in corporate finance, M&A, and areas of work specific to the financial services sector.

Although corporate work such as corporate finance, M&A and work in the financial services sector are still important among the other, mid-tier, city firms, they are less of a focus among these firms compared to the previous group. By contrast, commercial and general litigation are relatively more important among the mid-tier firms (although the first group of firms may have a higher overall turnover for this type of work and the underlying issues are likely to be more complex when conducted by these firms). Furthermore, personal injury work is among the top ten areas of work for mid-tier firms although this will commonly be conducted for insurers rather than individuals.

The differences between city law firms and non-city firms are also clearly shown in the figure. Although non-city firms also have high proportions of practising certificate holders in areas of litigation, commercial property and business affairs, the nature of the work they conduct is much more skewed towards private client work rather than the corporate work that city firms do. Their top 10 work areas include residential conveyancing, wills & probate, family, and residential landlord and tenant, which do not feature among the top areas for city law firms.

As well as there being broad areas in which the largest and other city firms are generally strong, it is clear from discussions that there is much variation between firms as to practice areas in which they would consider themselves to be relatively strong or in which they have a greater focus compared to other firms.

### *Corporate transactions*

One area of work which is considered to be particularly key especially for the largest and most well regarded firms is that of corporate transactions. In particular, it is often the case that the transactional work (involving buying or selling a company) will often represent a core type of work which then requires other types of legal services to be provided in order that the overall transaction can be successfully completed. For example, many transactions will involve:

- Financing arrangements – this could be debt based, or involve private equity investments or public listings;
- Employees – most transactions involve companies that employ staff and therefore buying or selling the company will have implications for the staff involved necessitating advice on employment law as well as frequently on the pension arrangements for those employees;
- Property – most transactions will involve companies that have property and therefore property advice will also be needed; and
- Taxation – completing the transaction may well give rise to tax liabilities.

Within some firms it was estimated that up to half of the work which was done in certain other practice areas could be generated because of the corporate transaction itself. One of the implications of this is that clients may prefer to use firms for the advice on the corporate transaction itself if they know that the same firm can also provide advice on all of the areas of law that will be affected by the transaction.

### **3.2.2. Changes in types of work over time**

Over the last 5-10 years, the broad type of work conducted by city law firms has been similar other than due to the effects of the economic cycle. Before the recession there was a considerable amount of legal work directly related to financing arrangements and financial services markets. During the recession there was a reduction in many areas of work as clients were less likely to conduct corporate transactions, with less M&A activity and therefore work in other areas of law associated to these transactions also reduced. Similarly, work related to the property market was also affected as fewer property deals arose and therefore less legal advice was required in this area.

### **3.2.3. Variation in types of work by clients**

The types of legal services city law firms provide vary slightly according to the clients that firms have.

### *Corporate clients*

As discussed further in section 4.2, law firms do not generally distinguish between different types of corporate clients according to, for example, the size of the business. There are many types of work that will be common across a whole range of different corporate clients including:

- Corporate transactions and the associated advice highlighted in section 3.2.1 above; and
- Commercial advice such as advice on governance arrangements, assistance with sale and purchase agreements, employment and pensions advice, advice on tax and tax planning, and commercial property advice.

There are also some differences between the type of work provided to corporate clients simply because the needs of different clients will vary according to both the type of their own business, and also how their own company is structured. For example:

- Construction companies will need advice on construction law;
- Firms in the financial services sector will need advice on meeting their obligations from being regulated by the FSA while telecoms companies will need advice on being regulated by Ofcom; and
- Publicly quoted companies may require advice related to listing rules, their ongoing requirements related to disclosure to markets, assistance on board structuring and the appointment of new directors.

In addition, the nature or scale of the advice may vary between different corporate clients with, in general, larger clients likely to be involved in larger and more complex transactions.

Many firms also distinguish between work done for financial institutions compared to work done for corporate entities. For example, with financing arrangements it is likely that the banks or other financial institutions that are providing the financing will have legal advisers and the company that is raising the debt will also have legal advisers. Since firms are unlikely to be able to work for both the company and the financiers on any given deal, some city law firms would be known as working slightly more for the financial institutions and some city law firms would be known as working slightly more for the company. However, the nature of the underlying work is likely to be very similar.

### *Government and quasi-government organisations*

Many of the legal services that city law firms provide to government departments and similar organisations are very similar to the advice that law firms give corporate clients. This is especially the case in respect of ongoing commercial advice such as on employment arrangements, arrangements with suppliers etc.

However, there are also areas of work that are done because of the particular role and responsibilities of Government. For example:

- Arranging contracts related to public private partnerships (PPP) and private finance initiatives (PFI) particularly related to infrastructure projects – although here it should be noted that city law firms could either be advising the Government or could be advising the private sector organisations involved in these initiatives;
- State aid advice may be required by Government departments such as in the light of the recent credit crisis and state aid being provided to the banking sector – although again, the individual banks concerned would also be expected to be receiving their own legal advice;
- Advising on the disposal of certain assets such as through privatisation or using auctions or tendering mechanisms to transfer assets from the public sector to the private sector; and
- Regulatory investigations such as advising the FSA in investigations of insider trading – here city law firms could also advise companies or the individuals involved in the work.

While it is clear that city law firms do offer advice to government departments and other organisations with some form of “constitutional” role, it is clear that the advice given is typically related to issues of a corporate nature. This is very different to providing advice to, for example, local authorities in child custody cases which city law firms would not be involved in doing.

#### *Individual clients*

There is a clear split in the type of work that is conducted for individual clients by different firms.

- Most city law firms only give advice to individual clients that is of a “corporate” nature. These clients tend to be very high net worth individuals who may own a variety of different companies and city law firms would be advising them in a similar manner to corporate entities that wanted similar advice;
- Some firms offer a small amount of advice to individual clients because the individuals concerned have specific corporate roles. For example, individual directors of listed companies may require advice related to their role or firms may be asked by corporate clients to provide advice for individual employees such as with respect to insider trading investigations;
- Some city law firms will offer advice to individual clients where the nature of the advice is similar to that which the firm could have given to a corporate firm for example they may offer employment advice to highly paid executives who are moving firms (although firms would usually seek to ensure that this would not cause a conflict with any work for the client’s current or future employer); and
- A small number of city law firms do provide advice for individuals for work that would be traditionally associated with individuals. Such firms would be described as having “private client” departments where work would include issues such as wills and probate, residential conveyancing, trusts and personal taxation.

In general, however, city law firms would have relatively few individual clients and the great majority of work done for individual clients would be corporate in nature. The very largest firms would be much less likely to conduct private client work but there are a number of smaller firms that have good quality reputations and would certainly be seen as city firms who also have private client departments representing around 15% of their work.

#### **3.2.4. Reserved activities**

Reserved activities are specified in section 12 of the Legal Services Act as the exercise of a right of audience, the conduct of litigation, reserved instrument activities, probate activities, notarial activities and the administration of oaths. At present, legal services involving reserved activities such as litigation, advocacy, conveyancing, or probate are reserved to solicitors, barristers and certain other persons under the Solicitors Act 1974 and/or the Courts and Legal Services Act 1990.<sup>14</sup>

During the course of the research we have examined whether the split of activities according to whether or not they are reserved is of relevance to city law firms. No firm stated that they distinguished work between reserved activities and non-reserved activities. In part this is because lawyers in city firms are able to conduct the various types of reserved activities once they are qualified (although additional qualifications may be required for advocacy) and therefore the distinction is, to a large extent, irrelevant to the operation of the firm.

Information as to whether work involves reserved activities is currently not captured in the administration system of law firms. While some firms are seeking to capture more information about the nature of the cases that are being conducted, it is not always possible to identify the full extent of the issues that will arise when the case first begins and the scope of the work may also change over time. Interviewees consider that it would be difficult to assess the proportion of work that involved reserved activities and that this would need to be done on a case by case basis.

It should be noted that if regulatory costs become too high and if a large proportion of these costs could be avoided through splitting the part of the business that did not conduct reserved activities into a different legal structure, then firms may be willing to incur the costs to identify whether or not reserved activities are arising within specific cases. Conversely, if obliged to incur the costs of assessing whether and where reserved activities are conducted, this would clearly reduce the costs of splitting the business into separate legal structures on this basis.<sup>15</sup>

In addition, for firms that operate internationally the concept of reserved activities is irrelevant for operations in other countries and they would be unlikely to want to invest in systems to assess reserved activities which are peculiar to the UK.

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<sup>14</sup> <http://www.sra.org.uk/sra/legal-services-act/lga-glossary.page>.

Furthermore, even where a case does involve reserved activities it would not always be possible to precisely consider when reserved activities commenced. For example, although the conduct of litigation is a reserved activity, not all work done by litigation teams is a reserved activity. For example, in many cases, the litigation team would assess the merits of a case and the costs of conducting it and conclude that it was unlikely to be sensible for the firm to proceed, but some degree of work would be involved to identify this. In other examples, cases will settle before formal litigation proceedings are issued or before the case goes to court.

In this regard, some interviewees indicated that clients (professional services companies) had requested that they give advice on whether certain activities were reserved activities. They noted that the definitions involved were not terribly satisfactory and that there were different definitions used within the Legal Services Act and the SRA handbook.

On the basis of “educated guesses”, most firms estimated that the proportion of work that involved reserved activities would probably be less than one-quarter of the work of firms. This varied depending on the firms involved since some were strong in commercial property transactions, and others considered all of the work of litigation teams even though they did not believe that a strict definition of reserved activities would cover all of the work conducted by these teams.

### **3.3. Variation in types of law offered by firms**

There are considerable similarities between the types of law offered by city law firms, although there are also important differences regarding the nature of the work offered and areas where specialist firms are also seen.

#### **3.3.1. Overlap of work between competitors**

As set out in section 3.2.1, there are similarities between the types of work that are offered by many city law firms with corporate finance, business activities, litigation and work for financial institutions particularly prevalent. However, this is not to say that all city law firms are identical and compete against all other city law firms in terms of the type of services they offer.

In particular, the nature of the work offered means that as a broad generalisation firms in the Magic Circle and international firms mainly compete against other firms in this group, and firms in the Silver Circle mainly compete against other Silver Circle firms. This does not imply that Magic Circle firms only compete against others in the Magic Circle, but rather that firms in any given category most commonly compete against others in that “circle”. Indeed, it would be very common for firms in the Silver Circle to be competing for the same type of work as firms in the Magic Circle, but more common for them to compete against other firms in the Silver Circle.

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15 It was clear from interviews that firms would need to take into account the potential reputational implications of having a non-regulated business.



### 3.3.2. Variation in practice areas by different types of firm

Although firms would be able to identify a group of other firms that they frequently compete with across most practice areas, an important issue is that competition varies by practice areas. Interviewees stressed that their firms would compete against different firms depending on which particular type of work was under consideration. This is also supported by evidence from legal directories which highlight the top firms and individuals in particular areas of work.

#### *Variation in strengths of different work for different firms*

Table 2 sets out rankings of firms for different areas. This is based on the information from one particular legal directory, but it serves to demonstrate the point that firms may be strong in some types of law but relatively weaker in others.

**Table 2: Top rated firms by work type**

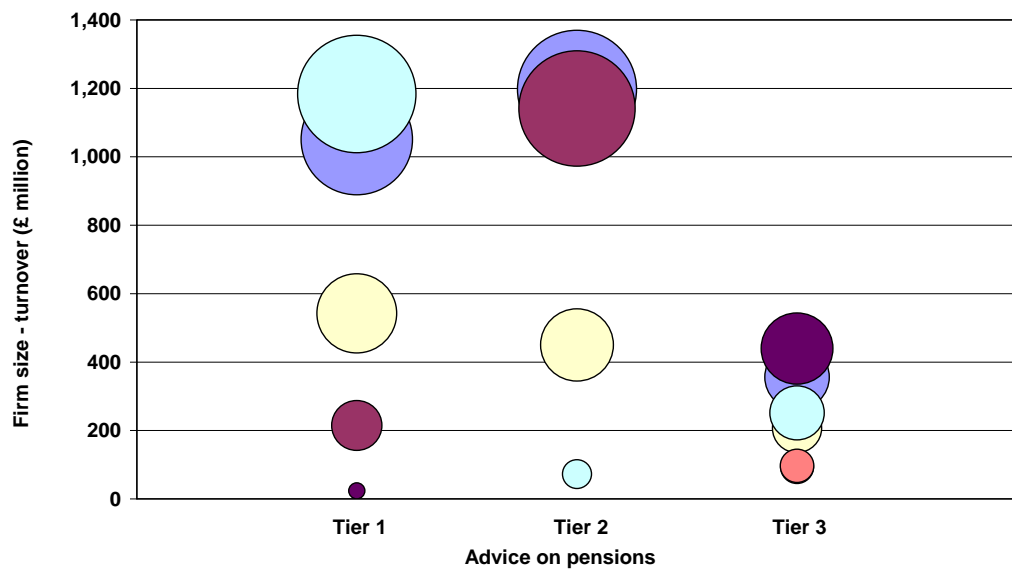
	<b>Corporate tax</b>	<b>Commercial litigation</b>	<b>Commercial property</b>
Tier 1	Freshfields Bruckhaus Deringer, Linklaters, Slaughter and May	Clifford Chance, Freshfields Bruckhaus Deringer, Herbert Smith, Hogan Lovells International	Berwin Leighton Paisner, Clifford Chance, Linklaters, Nabarro
Tier 2	Allen & Overy, Clifford Chance	Allen & Overy, Ashurst, Linklaters, Slaughter and May	Ashurst, Herbert Smith, Hogan Lovells International, SJ Berwin
Tier 3	Ashurst, Berwin Leighton Paisner, Herbert Smith, Hogan Lovells International, Macfarlanes, Norton Rose, SJ Berwin, Travers Smith	Barlow Lyde & Gilbert, CMS Cameron McKenna, Clyde & Co, Mayer Brown International, Norton Rose, Reed Smith, SJ Berwin, Simmons & Simmons, Stephenson Harwood	Addleshaw Goddard, Allen & Overy, CMS Cameron McKenna, DLA Piper UK, Denton Wilde Sapte, Eversheds, Field Fisher Waterhouse, Forsters, Freshfields Bruckhaus Deringer, Macfarlanes, Norton Rose, Olswang, Slaughter and May, Taylor Wessing, Wragge & Co.

Source: The LEGAL 500

#### *Variation in firms competing for types of work*

It is also the case that a specialist firm can compete against the very biggest firms. This is more likely to be the case when the advice is of a more technical nature rather than where advice requires larger numbers of people to be involved in the process. This finding is supported by the evidence in Figure 7 below which shows the turnover of law firms in the top 3 tiers for pension advice.

**Figure 7: Law firms ranked highly for pensions advice**



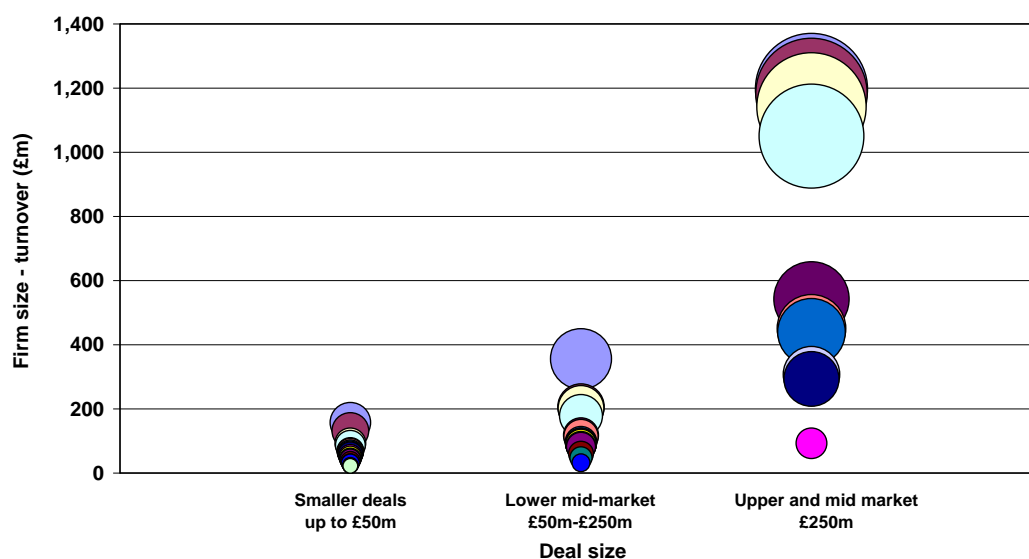
Source: The LEGAL 500. Note that the size of bubbles is proportional to the size of firms in terms of turnover; different colours are used purely to differentiation between firms and do not convey additional information.

As Figure 7 shows, the top tier of firms contains not only two of the four largest law firms (with turnover of over £1 billion), but also Sacker & Partners (ranked as the 88<sup>th</sup> largest firm with turnover of £23 million).

#### *Variation within types of law*

Even within certain types of law, there is variation in the firms that are ranked most highly according to the specific nature of the work. For example, within advice related to M&A, different categories are identified according to the size of the transaction and the firms that are ranked as in the top 3 tiers varies as shown in Figure 8 below.

**Figure 8: Law firms ranked highly for M&A advice**



Source: The LEGAL 500. Note that the size of bubbles is proportional to the size of firms in terms of turnover; different colours are used purely to differentiation between firms and do not convey additional information.

It is clear from this that clients are able to differentiate between law firms on a fairly sophisticated basis as firms that are considered the best for small deals are not considered to be the best choices for much larger deals. In particular, all bar one of the firms that are highly ranked for deals of £250 million and above are among the top 15 firms in terms of turnover with one firm that is in top 30. By contrast, firms highly ranked for smaller deals are themselves smaller firms with turnover ranging from about £20 million to about £160 million.

Larger law firms are not highly ranked for smaller deals despite the fact that they clearly have the expertise and capability to conduct the work. The main reason for this is likely to be the financial considerations for clients since larger law firms tend to be more expensive (see section 6.5). By contrast for larger deals, the range of issues may be more complex and the document review process greater hence firms that have the availability of a large number of lawyers will be preferred. In addition, although most city law firms can work on merger and acquisitions, only the larger firms would be able to work on large cross-border merger and acquisition deals as they would have to be able to summon a large number of lawyers with appropriate international expertise at short notice.

In addition, the risks to clients are greater when entering into higher value deals. As examined further in section 4.3, interviewees note that there are some deals that only the firms with the very best reputation (likely to be Magic Circle firms) will be able to do because clients would not want to take the risk of having chosen a firm with a lesser reputation in case something went wrong with it.

As well as variation by deal size, this would also be expected to vary by client since in general, the deal size will often be linked with the size of client, and therefore this leads to

larger firms working more with larger clients on larger deals and smaller firms working more with smaller clients on smaller deals.

These views were also supported by interviewees that were not city firms who recognised that while they had the ability to conduct M&A work, they would not expect to be appointed for high value M&A work because of the number of staff needed and the desire by clients to pick firms with the best reputations.

#### *Degree of specialisation within types of law*

As partly illustrated with respect to M&A work, interviewees have highlighted that within some types of law, certain issues require very particular levels of expertise and therefore not all firms would be able to undertake work in this area. Typically, it is the largest and most well regarded city firms that would be expected to conduct these areas of work. For example:

- Many firms may advise on corporate financing arrangements, but few firms would be able to advise on issues of securitisation;
- Many firms may be able to advise on commercial property (indeed as noted in section 3.2.1, firms across the size spectrum commonly advise on these transactions), but few firms would be able to give commercial property advice on some of the largest and most iconic new buildings; and
- There may be a number of city firms that could advise on listing arrangements for corporates in the UK, but fewer firms would be able to advise on cross-border listings or on listings on exchanges in other countries.

In general interviewees sought to differentiate the types of work that they did from that conducted by firms outside the city that conduct more standardised work, although there are areas of work where both city firms and non-city firms will offer services.<sup>16</sup>

### **3.4. Conclusions on types of work**

#### **3.4.1. Lessons for the methodology study**

The methodology study is aimed at benchmarking the supply of legal services across the whole market hence not all types of law are applicable to city law firms. Early categories within the methodology study led much of the work that city law firms conduct to fall under “Other business activities” although this has now been refined in the light of further analysis. However, the degree of specialisation of law within different practice areas in large firms means that these firms would commonly use “Level 2b” categories and may

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<sup>16</sup> For example, it is considered that advice on employment law can be conducted by both large city law firms and considerably smaller firms outside the city. Similarly, one of the non-city firms would sometimes compete against city firms for certain aspects of property, landlord and tenant work.

even refine these further such as through consideration of the specific nature of the value or sector of the service.

When describing the type of work that they provide, many firms distinguish both between legal areas, and also between sectors in which the law is conducted. No firms systematically categorise their services by the type of legal activities conducted such as examining research, advisory, advocacy and litigation activities. Neither is the split of reserved or unreserved activities considered relevant or recorded at present. Increases in the cost of regulation could prompt firms to record this in order to restructure their firms.

### **3.4.2. City firms and variation between firms**

#### *Types of legal services*

City firms are distinguished from other firms through the types of work that they conduct with corporate finance, M&A and advice specific to the financial services sector particularly relevant. Corporate transactions often represent a core work which commonly leads to other areas of work (such as employment, property, tax, pensions) being provided alongside it.

The type of law offered does not vary much between clients as within most city law firms most government and even individual clients are being offered “corporate” advice. City law firms vary as to whether they have private client departments.

#### *Overlap of work by different competitors*

In general, city law firms would more commonly compete against other firms in the same segment (Magic Circle against Magic Circle, Silver Circle against Silver Circle etc). In part this reflects the fact that some firms have individuals with highly specialised expertise in particular areas.

However, it is clear that the strengths of different firms vary considerably across practices such that firms compete most closely against a different set of firms according to practice area. This includes the ability in certain areas for specialist firms to compete against the most well regarded firms. Monitoring information from legal directories over time can help to assess how this is changing. In some areas rankings vary according to the very specific nature of transactions for example, examining not simply M&A transactions but the actual value of these transactions. Typically, it is the largest and most well regarded firms that would be expected to conduct higher value transactions.

## **4. CLIENT**

The type of clients that are served is an important dimension in differentiating city law firms from other types of firms. In this chapter, we provide information on the framework set out in the methodology study on the different types of clients (in section 4.1) and then discuss the findings of our research regarding the types of clients that are served by city law firms (in section 4.2). We then investigate further the issue of client acquisition by city law firms (in section 4.3).

### **4.1. Framework by methodology**

The methodology study distinguishes clients into four categories at Level 1 including:

- Natural persons;
- Small legal persons such as small and medium-size enterprises (SMEs), local authorities, and charities;
- Large legal persons such as larger companies, and central government; and
- Government including all government and quasi-government bodies acting within their constitutional roles.

For natural persons, the Level 2 breakdown is a split of legal aid or non-legal aid; and Level 3 considers ethnicity, ONS socio-economic group, income, age and postcode. Both small and large legal persons are broken down in Level 3 by for-profit, not-for-profit government, not-for-profit non-government, number of employees and turnover. Government clients can be broken down by local, central government and quasi-government organisations at level 3.

### **4.2. Type of clients**

In general, most law firms do not specifically segment their businesses on the basis of the client type, but rather organise their firms around the type of work that is provided, although as noted in section 3.2, there is considerable overlap between the type of work provided and the clients to whom the work is likely to be provided.

None of the firms we interviewed would separate corporate clients according to whether they were small or large hence in the sections below we consider corporate clients as a whole rather than two separate types of corporate clients.

#### **4.2.1. Corporate clients**

Corporate clients are the most important type of clients for city law firms in some cases representing close to the entire turnover of the firm. The type of work that is conducted for these clients covers the whole range of corporate work including, for example corporate transactions and M&A, corporate finance, litigation and dispute resolution, project finance, and tax as has been discussed in greater detail in the preceding chapter.

There are a variety of different characteristics by which corporate clients can be assessed, and where variation between city firms may be seen, as well as differences between city firms and other firms.

#### *Size of the corporate client*

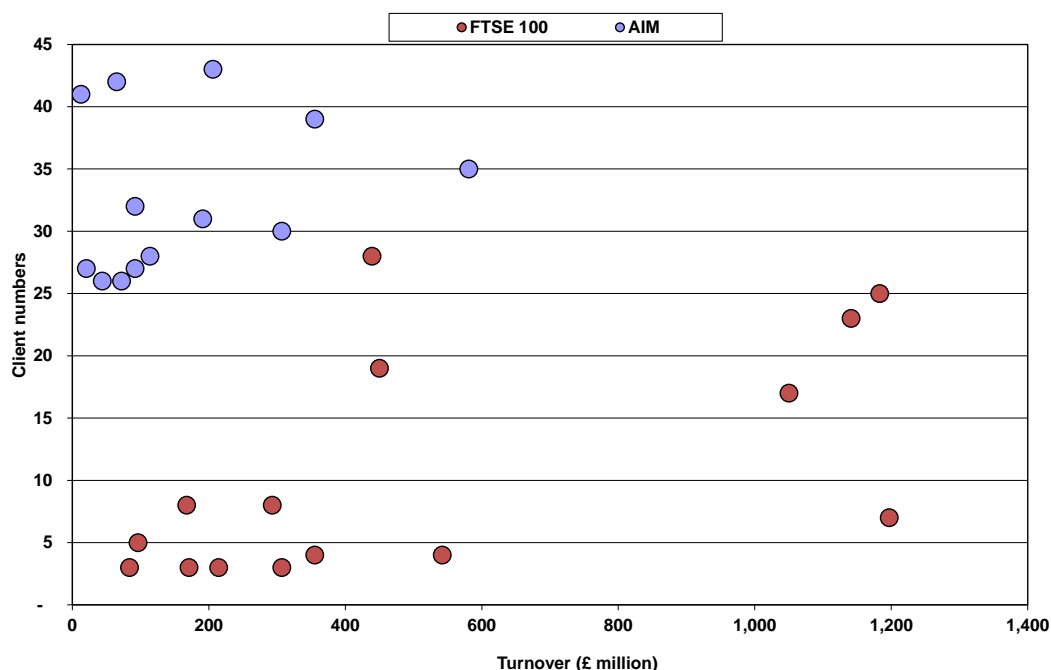
The corporate clients of city law firms are mostly large national or multinational corporations. While firms do not distinguish their clients on the basis of size, they would have relatively few SME clients reflecting the fact that such firms would be expected to have less complex legal issues on which a wide range of law firms would be able to advise. In addition, larger corporate clients will generally have a larger absolute value of spending on legal services compared to smaller companies and therefore city law firms would typically see these larger companies as more beneficial clients to seek to attract.

A number of interviewees highlighted the difficulty in attempting to characterise clients according to their size since there may be complex corporate structures which affect the interpretation of the type of client that is being served. For example, city law firms may work for investment vehicles or help to set up new funds, where the actual corporate entity that is engaged as the client may be very small, especially if it is being newly created, but where a larger corporate entity may sit behind this or where very rapid growth might be expected such as when a new fund is launched.

There is clear interaction between the type of work being conducted and the value of that work to the individual client. For example, some large corporate clients may only be willing to use Magic Circle firms on corporate transactions, but use other city firms for other types of legal services. However, as discussed in the preceding chapter regarding the type of work, the higher value work and the more innovative work would tend to be conducted by the high end city law firms. Similarly, there is variation in the types of clients which are served within city law firms with larger clients with more complicated needs being more likely to use larger city law firms because of their deep talent pool, broad expertise, and high reputation for innovative and complicated work.

These findings are supported by the data on the number of FTSE 100 companies that are clients for different law firms as shown in Figure 9 below.

**Figure 9: Number of FTSE100 clients by law firm size in terms of turnover**



Source: The Lawyer, Slaughters still rules the blue-chip jungle, 14 March 2011.

As Figure 9 shows, in general FTSE 100 clients tend to use the larger law firms to a greater degree with the Magic Circle firms all well represented. By contrast, firms that are on the AIM market (of whom there are more than 100, hence the higher overall client numbers) and are therefore generally smaller firms, would not tend to use the Magic Circle firms and would be more likely to use some of the slightly smaller city firms.

Although this shows that smaller corporate clients in general use smaller city law firms it should nonetheless be recognised that even clients that are listed on AIM are among the largest corporate entities in the country and advising these clients is very different from advising a typical SME client.

### *International clients*

As well as generally having large clients, it is also clear that international clients are a key type of client for many city law firms. The degree to which firms have international clients varies considerably, in part reflecting their geographic footprint, with some firms having as much if not more work from international clients than from domestic clients. Interviewees indicated that the number of international clients has grown considerably over the last 15-20 years reflecting the economic growth of other countries and the growth of corporate (and individual) clients in other countries where legal systems are less well established.

Again there are difficulties in defining which clients are international since firms could be appointed by UK based individuals even though the entity for which the advice is given may not be based in the UK. Conversely, firms may be requested by international clients to advise on transactions related to investments in the UK.



Interviewees highlighted that one important feature in this regard is the importance of English law as the basis of law on which contracts are written. English law and English courts are (along with New York law) extremely well regarded internationally. This reflects a number of factors including the historic rule of law and well established property rights, courts systems and arbitration arrangements which can enforce legal contracts as well as the quality of city lawyers who are involved in providing advice on English law.

One of the implications of this is that international work is attracted to city law firms because of a preference to have contracts arranged on the basis of English law. These contracts may not necessarily involve parties that are based in England, or transactions related to English companies. For example, it would be relatively common for infrastructure projects in other countries to be written on the basis of English law rather than on the basis of the domestic legal system where the infrastructure is being provided. Similarly, many international clients choose to hold international arbitration cases in London where the rule of law is considered to be better regarded than in some developing countries.

Indeed, English law is currently being exported with courts and arbitration systems being set up in other locations such as Dubai. Multinational corporations conducting business in the Middle East can choose to arrange contracts on the basis of English law and have them arbitrated in Dubai. Many city law firms are providing services in such cases (and many now have local offices in the Middle East).

#### *Financial institutions and other corporates*

Firms often distinguish between financial institutions and other corporates reflecting the relative importance of work for financial institutions compared to other types of corporates for the majority of city firms. Indeed, for many interviewees, financial institutions will often represent the majority of their top 10 or 20 clients by revenue. As noted in the previous chapter, some firms are better known for working for financial institutions rather than corporates within corporate finance work, although such firms would work for both types of client across a range of other types of law.

#### *Sophistication of clients*

Interviewees stressed throughout discussions that corporate clients (especially financial institutions) were highly sophisticated purchasers of legal services. Most of them have their own legal departments which have lawyers working as in-house legal services providers. These clients are large purchasers of legal services and are often continual purchasers of legal advice. In addition, they will commonly have a number of different legal advisers in place such that they are able to compare between the services that they receive from different firms.<sup>17</sup> This is consistent with the findings of the Smedley review.<sup>18</sup>

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17 While the precise level of sophistication may vary between different clients and for different types of law for any given client (according to the skills and experience of in-house staff and the regularity with which they purchase specific legal services) nonetheless, the clients of city law firms remain the most sophisticated.

18 Review of the Regulation of Corporate Legal Work, Nick Smedley, March 2009.

One of the implications of having sophisticated clients which is of particular relevance to regulators is that such clients are likely to be in a strong position to ensure that competitive dynamics deliver high quality services at competitive prices from their legal providers rather than requiring as much regulatory protection as less sophisticated clients. The level of the sophistication of clients is also seen in evidence regarding client acquisition such as the availability of legal directories in which firms are ranked in different areas of law and the use by clients of arrangements such as panels to control their selection of law firms (see section 4.3.3).

#### 4.2.2. Government

As discussed in the preceding chapter, when city law firms work for governments and regulators, in most cases they are simply like another corporate client with the great majority of the work conducted for them similar to work that would be conducted for other corporate clients. As such firms would not tend to segment their business according to whether the client was the government as opposed to segmenting on the basis of the work that is done for a government client.

As noted in section 3.2, there are particular types of legal work that arise because of the particular nature of government roles and responsibilities but many of these will generate work for corporate clients as well as work advising the government itself including: providing tax advice; advice on PPI or PFI arrangements; and advice on state aid.

The income from work directly for government bodies is usually reasonably modest, but would vary considerably over time according to specific cases. Large infrastructure projects could represent a reasonably large value of overall turnover for a number of years but then government clients could represent a much lower proportion of business in subsequent years. In general, work for government bodies typically represented less than 10% of business. Advice for government bodies which is specific to their government role and for which there would be no private sector equivalent would be considerably less.

##### *Type of government client*

Within the range of different government clients, city law firms mainly work with central government departments and national regulators such as the FSA or utility regulators. In addition, it should be noted that city law firms do not only advise UK based government bodies but would also advise similar bodies in other countries such as on issues of financing or infrastructure issues.

City law firms vary according to whether they would work with local authorities or organisations such as Primary Care Trusts. Firms which only have an office in the City of London would rarely advise these types of clients, but those firms that have both a city office and also have offices in other parts of England would be more likely to conduct work for these types of clients. In this regard work might involve advice on property transactions and construction, procurement processes and contractual arrangements with suppliers as well as employment advice. In these areas the firms would be competing against a range of different regional and local firms that would not be considered to be city law firms.

### 4.2.3. Individual clients

There is a variety of different types of work that is conducted for individual clients that it is useful to distinguish since there is variation between city law firms as to whether they would offer different types of work to individual clients.

#### *Individual clients requiring corporate advice*

As with government clients, many of the individual clients of city law firms are those who are seeking advice which is similar to that provided to corporate entities. In these cases, the clients would often be extremely High Net Worth Individuals (HNWIs), typically multi-millionaires, if not billionaires. Clients such as these would be seen to be highly sophisticated, would often own a variety of businesses and would commonly have their own “in-house” legal advisers.

In many of these cases it may be almost arbitrary whether the client is technically an individual or a corporate and interviewees indicated that there would be no difference in the approach taken to the work on this basis. For example, a group of individual fund managers may decide to set up a new fund but the processes involved and the advice given would not be expected to vary depending on whether the work was billed to the new fund or to the individual fund managers. Similarly, some high profile individuals may be engaged in very significant litigation actions and again the legal advice would not vary simply because the client is an individual.

There did not appear to be any clear distinctions between city law firms providing corporate advice to individual clients with most interviewees indicated that they would have a small number of such clients.

#### *Advice for individuals but linked to corporate clients*

A second set of work that would be undertaken for individual clients involves cases where the firm may be advising the individual but where a corporate entity (typically their employer) would be paying for the advice. Examples of this could include insider trading cases and other “white-collar” crime. There appeared to be little systematic difference between types of city law firms according to whether such cases were conducted.

Employment law was an area where there appeared to be more of a mixture of reasons why this type of advice could be provided to individuals by city law firms. In some cases it may be provided to a senior executive who is moving between firms where the executive concerned had worked at a corporate client – issues of conflicts (including commercial rather than regulatory conflicts) were considered important in determining whether or not firms would take on such cases. There was less discussion of these situations during the course of interviews but it appeared to be the case that larger city firms would be less likely to provide individual employment advice of this kind because they would generally work for employers rather than employees.

#### *Private client work*

The final type of work conducted for individuals is that of private client work which is the typical type of work which many individuals would seek legal advice on. This would

include areas of work such as, wills and probate, tax and trusts, agriculture and landed estates, along with residential conveyancing. Advice on family law would be less commonly provided by city law firms although would still be provided by some.

It is clear that individual clients who seek these services from city law firms, as opposed to other law firms that would also offer similar services would usually be HNWI's who would commonly be multi-millionaires with relatively complex personal situations and with considerable amounts of wealth invested and on which they may require advice. Hence the type of advice on wills or trusts would usually involve more complicated structures and issues compared to the average individual who sought advice on these issues from non-city firms. These clients would be considered to be among the most sophisticated of individual clients (although would not be perceived as being as sophisticated as individual clients who seek corporate advice).

There is considerable variation between city law firms as to whether they would have separate private client departments and offer this type of advice to clients. Many of the largest firms spun off their private client departments in the 1990s, since the revenues associated to individual clients was relatively small and it was often difficult for private client work to sustain similar levels of fee rates compared to the fee rates that were achievable on corporate work. These firms would tend to have a very low proportion of individual clients only conducting for example, residential conveyancing in exceptional circumstances and not doing any wills or probate work as they consider that they do not have the relevant expertise. Some would rather refer such requests to other firms (potentially including those formed from their previous private client department). Other firms maintain a very small amount of work for individual clients in order to be able to service the requests of senior executives at corporate clients or because work is done alongside the more corporate work that is being done for an individual entrepreneur.

However, there are also a number of city law firms which do retain private client practices alongside very well regarded commercial practices. In general these firms are more likely to be somewhat smaller city firms. For example, Macfarlanes is ranked as a tier 1 firm for personal tax, trusts and probate as well as, for example, being a tier 2 firm for small and mid-cap flotations, and VAT advice. Other firms in the top two tiers for this kind of private client work who would also be in the top 50 firms by size include Withers (tier 2 for smaller M&A deals), Berwin Leighton Paisner (tier 1 for commodities and futures), and Charles Russell (tier 1 for smaller M&A deals). In addition, as a US based firm, Baker & McKenzie is not in the UK 200 but it is of equivalent size to be in the top 50 and also ranks in the top two tiers for private client (and for example tier 1 for employment). For some of these firms, private client work for individual clients represents more than 10% of turnover.

### **4.3. Client acquisition**

When considering how firms attract clients, there were a range of similar marketing activities that firms conduct in order to raise their profiles and assist in winning new business. Such activities could involve: hosting, speaking at and attending seminars; publishing articles or books on areas of law; highlighting details of recent and innovative cases; offering training sessions to potential clients. As described, these generally aim at raising the profile of the firm or individual lawyers rather than leading directly to new

business. In addition to these more general areas of marketing, there were a small number of factors that were seen as especially relevant for capturing new business.

#### 4.3.1. Repeat work

For all city law firms the proportion of work that comes from existing clients offering repeat work is considerable. Many firms, especially the larger firms, monitor their top clients over time to assist the firm with ensuring that they obtain repeat business. Individual law firms may have slightly different strategies regarding the types of client firms that they are especially keen to attract e.g. corporates versus financial institutions or clients that are active in particular sectors such as media or construction etc.

One of the key aims of law firms is to expand the types of legal services that they offer particular clients and to increase the proportion of the legal spend of the very biggest users of city law firms. That is, while the actual corporate entity may be an existing client of the firm this does not mean that the firm would conduct all of the legal needs for the particular client and firms will seek to increase the range of activities they are offering. For many firms this will also include expanding work across international offices.

Even for repeat business for existing clients, it is increasingly common for firms to have to compete against other firms for particular pieces of work. For example, submitting formal tenders or attending a beauty parade would be typical. (We consider the issue of entering a specific panel in section 4.3.3 below.)

#### 4.3.2. Reputation

Reputation also plays a very important role in maintaining and attracting clients. Reputation can be attached to:

- The firm as a whole;
- A particular practice area within the firm; and
- An individual within the firm or practice.

It is clear from discussions that reputation may also vary across all of these three elements. For example, some firms may be seen as generally very high quality firms – in many ways the labels of Magic Circle and Silver Circle are shorthand ways of indicating that firms have very high quality reputations across the whole of their firm.

In particular, it is clear from discussions that there are some high profile, highly valuable and complex pieces of work for which only the Magic Circle firms would be considered sufficiently high quality to do the work. There are some decisions for which directors or board members of large firms expect to have the best possible advice and individuals appointing their legal advisers would not have to persuade more senior executives as to the quality of these firms. Conversely, if the piece of work did not lead to a successful outcome (such as a deal not going through or not winning a litigation case), individual decision makers would not be blamed for choosing a Magic Circle firm.

However, across many city firms and even within the Magic Circle and Silver Circle firms it is clear that there are some practice areas that are more well regarded than others within any given firm. For example, one firm may be recognised as a market leader in litigation or banking and finance even though other parts of the firm may not be perceived in the same light.

Furthermore, it is also the case that individuals in the firm are seen as particularly prestigious for certain types of work. This may reflect the fact that partners have considerable experience in a very specialised area (such as a partner who is an expert in securitisation deals in particular countries) or they may have successfully conducted certain innovative transactions or be the individuals that have led the two or three types of deals in one field of law, or they may simply have an outstanding reputation in quite broad areas of work reflecting their long experience in delivering high quality work.

The role of the legal directories such as Legal 500 and Chambers were also seen as important ways of conveying reputation to potential clients. Indeed it is interesting to note that they are generally organised around different types of work and ranking firms within these work categories - as noted in section 3.3, different firms are considered to be "tier 1" firms in different areas by legal directories. Furthermore, directories will also highlight individual partners at firms who are particularly well regarded.

As well as the legal directories, reputation can also be conveyed through work which potential clients observe during the course of other legal activities. For example, they may observe other law firms who are on the opposite side in a litigation case or in less contentious areas such as transactions. Observing the quality of the work conducted in these cases can often lead to opportunities to pitch for new work on future occasions.

#### *Individuals moving firms*

The movement of individuals is also important in attracting new business and this can arise both within client firms and also within law firms. If particular decision makers within client firms such as their general counsel changes job, this is frequently seen as an opportunity for law firms to attract a new client.

Similarly, lateral hires of partners from other firms have commonly been used to help the acquiring firm to build up a better reputation in particular practice areas or to expand the services that can be offered in certain practices. Whether or not these partners are able to take existing clients with them usually depends on the individual reputation of partners, whether work for a particular client has been spread around a range of different clients at the previous firm and the calibre of the firm to which the individuals move.

#### *Referrals*

Many firms will get referrals from other law firms through informal arrangements. This may be due to a lack of expertise (although for city law firms the lack of expertise would usually only apply to private client work where firms that do not conduct this work may refer a potential client to a firm that is well known for this type of work). More commonly, the work would be referred to other firms because of conflicts at the initial firm contacted.

Firms that are part of international networks as opposed to having their own international offices may also receive referrals through these arrangements.

It appears less common for city law firms to get referrals direct from other professions such as accountancy firms, but more common for referrals to come from clients. For example, private equity firms would generally require legal advice when considering making an equity investment in a particular company and at the same time the company would be expected to have their own legal advisers and some private equity firms may recommend that companies use particular law firms who have expertise in this area.

### *Lexcel*

Lexcel is the Law Society's (TLS's) practice management standard which assesses whether firms meet various management and client care standards. One of the issues we considered during the course of discussions was whether or not this was relevant to city law firms. The consistent response from city law firms was that the Lexcel standard was not relevant as these firms have already established their reputation for high quality work.

Instead, city firms perceived Lexcel to be more relevant to firms at the smaller end of the profession in order that individual firms could signal the firm's quality to (less informed) clients. This view was supported by the non-city law firms who agreed that Lexcel was of more relevance to them and also saw it as useful for small firms to help to codify some of their processes across their business. These firms also believed Lexcel was of assistance in formal procurement processes, while city firms believed that their own high quality reputations and experience was sufficient to convey their quality in these situations.

### **4.3.3. Panel arrangements**

The use of panels, where clients have a small number of pre-selected firms to whom work will be given, has become much more prevalent compared with 15 years ago. This theme was identified among all different types of city law firms (although different firms may make different decisions as to whether they want to be on any particular panel).

### *Clients*

Financial institutions, especially banks, and the largest corporations were the types of clients that were seen as both most commonly using panels and also having the most complicated panel arrangements which reflected their overall legal spend. Government bodies were also seen to be increasingly using panels.

The increased use of panels reflects preferences of clients who have sought to manage their legal services providers in a more consistent manner. It is seen as beneficial to clients who can pre-select firms of a particular level of quality as only highly qualified firms would gain access to the panel (and firms might lose their panel position if the work is not satisfactory). In addition, firms on panels are able to build up an understanding of how different clients operate and how they are structured which, with complex institutional arrangements, is of benefit to clients as they do not need to continually re-educate their new lawyers about their own structures.

There is clear variation between different clients regarding their use of panels and how focused these panels are. In the main this reflects the total value of legal spend by the clients. Depending on their need for different types of legal services, they may have a panel for all of their legal needs with different firms on it (although in practice they may use particular firms for particular issues) or they may have panels for different legal areas such as for employment, technology, securitisation, wealth management, transactions work (which may be split by transactions of different value). Some clients may give all or the great majority of their work to one firm while others may split the work between multiple firms.

### *Pricing pressure*

A clear intention of having panel arrangements is also to place considerable pressure on prices since clients can offer to provide a large volume of work to firms in return for which they expect to get discounts compared to the usual levels of fees that might be charged. All interviewees stressed the considerable pricing pressure that was being applied through panels especially by financial institutions. Indeed some interviewees noted that some work had even been tendered through Dutch auctions, while for other work the client may set the particular price that will be allowed for work and law firms can determine whether or not they want to be on the panel for that particular type of work at that particular price.

### *Panel conditions*

Entry on to panels involves not only demonstrating high quality through law firms' general reputation, their experience in the area, the number of lawyers that they could make available for the work, and details of similar cases, but also agreeing to certain conditions once on the panel.<sup>19</sup> As indicated above, price is one of the key elements of this, but there may also be arrangements regarding:

- The provision of secondees – some panels specify that law firms must provide a certain number of secondees over the course of the panel period. There is variation in whether the client would pay the salary of the individual concerned or expect the individual to be provided free of charge and this would be one of the elements considered during the course of commercial negotiations related to the client relationship as a whole (this issue is considered further in section 6.6); and
- Training – it is common for panels to require firms to provide certain elements of training to their in-house legal teams.

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<sup>19</sup> Some law firms have indicated concerns that in some organisations the panel process is organised by procurement departments that may be more used to dealing with the procurement of manufactured goods rather than of professional services. While they did not perceive this to necessarily be a positive trend, interviewees did not indicate that it was leading to the wrong firms being selected during the procurement process, simply that it led to some areas of questioning that were not relevant to professional services. In this regard it is possible that Lexcel could become of relevance if procurement departments require an additional firm quality standard beyond being regulated by the SRA.



## 4.4. Conclusions on type of clients

### 4.4.1. Lessons for the methodology study

Most city law firms do not specifically segment their businesses on the basis of the client type (corporate, individual, government), but rather organise their firms around the type of work that is provided as well as the sector in which work is provided. The draft methodology study separates legal persons by small and large legal persons, but none of the firms we interviewed would separate corporate clients on this basis.

### 4.4.2. City firms and variation between firms

#### *Type of clients*

Corporate clients are the most important type of clients for all city law firms. They are mostly large financial institutions, national or multinational corporations and are highly sophisticated purchasers of legal services. They commonly have in-house lawyers and are repeat, if not continual, purchasers of legal services. As well as generally having large clients, it is also clear that international clients are a key type of client for many city law firms and while the proportion of international clients varies considerably reflecting the geographic footprint of different firms, many international clients come specifically to city offices.

In general, larger clients with more complicated needs are more likely to use larger city law firms because of their deep talent pool, broad expertise, and high reputation for innovative and complicated work.

Government clients of city firms are mostly central governments and national regulators and in most cases they are simply like another corporate client. As such firms would not tend to segment their business according to whether the client was the government.

As with government clients, many of the individual clients of city law firms are seeking advice which is similar to that provided to corporate entities. Clients such as these would be seen to be highly sophisticated, would often own a variety of businesses and would commonly have their own "in-house" legal advisers.

Many of the largest firms have previously spun off their private client departments but there are also a number of city law firms which do retain private client practices alongside very well regarded commercial practices. In general these firms are less likely to be the very biggest city firms. Their individual clients would be among the more sophisticated purchasers of individual advice and would tend to receive advice on complex tax, wills and trusts arrangements, and landed estates.

#### *Client acquisition*

For all city law firms the proportion of work that comes from existing clients who seek repeat business is considerable and many firms seek to expand the types of work that they do for existing clients.

Reputation can be attached to the firm, a particular practice area and an individual within the firm and may also vary across all of these three elements with legal directories available to inform clients on this. There are some very high value cases where clients may only be willing to choose from Magic Circle firms because of the comfort factor which this brings, but in general clients of city firms are sophisticated purchasers able to identify the different aspects of reputation. Indeed, one source of new business that is reasonably important is where clients observe individuals in action on the other sides of cases.

The Lexcel standard is not seen as relevant for city law firms as these firms have already established their reputation for high quality work although both city and non-city firms do see it as valuable for smaller firms to signal their quality .

### *Panel arrangements*

The use of panels has become much more prevalent for all different types of city law firms. Financial institutions, especially banks, and the largest corporations along with government were the types of clients that were seen as both most commonly using panels and also having the most complicated panel arrangements reflecting their overall legal spend. Panel arrangements place considerable pressure on prices since clients expect to receive substantial discounts in return for placing a large volume of work to panel firms.

## 5. REGULATION

In this chapter, we assess issues which are specific to regulation. Although some of the issues could be combined into other chapters, since one of the aims of the benchmarking study is to enable an assessment of the impact of regulation to be conducted in the future it is useful to specifically understand the current effect of regulation on city law firms.

### 5.1. Interaction with the regulator

Interviewees from city firms were consistent in observing that in the past they had very little interaction with TLS as the regulator of the profession and most interviewees indicated that this did not change following the creation of the SRA. The main interaction was simply in regard to renewing practising certificates each year.

Since their clients are overwhelmingly large corporate clients that are highly sophisticated purchasers of legal advice and who are aware of the range of alternative providers of legal services, clients were not considered to be disadvantaged by this lack of regulatory interaction. Indeed, interviewees stressed that the importance of their reputation for doing high quality work meant that they would seek to ensure that regulatory rules were appropriately followed.

Interviewees do, however, perceive that there has been a change in the level of interaction with the SRA over the last couple of years in the light of: the SRA seeking to have staff explicitly responsible for large corporate firms; the use of relationship managers beginning; and the development of outcomes focused regulation.

Most interviewees consider this to be a positive development despite holding the view that, given the nature of their client base, there are few regulatory risks associated to their businesses. In particular, some interviewees see the potential for the SRA to communicate information related to examples of best practice of regulatory requirements to be a useful role.

Some interviewees place the increased regulatory interaction into a wider trend both of additional regulation attention in legal services more generally (in which this and the LSB's wider benchmarking study would be seen as evidence), as well as a greater regulatory and compliance culture more generally in society.

There is a greater divergence of views as to whether regulation is necessary to protect against damage to the reputation of the profession as a whole or of city law firms as a whole. Some supported this view, but most interviewees believed that poor quality services would damage only the individual firm concerned and would not affect the reputation of other firms in the city as a whole or in the particular segment (such as Magic or Silver Circle, or mid-tier firms). The examples of Andersen's in the accounting field, and the dissolution of Howrey's were cited as evidence of the lack of detrimental impact on the collective reputation of large firms from difficulties in specific firms. Far from damaging the reputation of the sector as a whole, in both cases interviewees perceived the major effect to be benefits for competitors from hiring individuals or teams from the firms that were failing.

In general the impact of TLS/SRA regulation was thought to have had relatively limited impact on the overall business of city law firms and many firms considered that, while the degree of compliance costs may increase, regulatory issues were unlikely to greatly affect the way that city law firms operate over the course of the next few years.

## **5.2. Specific areas of regulation**

There are a number of specific areas of regulation that were highlighted during the interviews which we set out below.

### **5.2.1. Money laundering**

The main area of regulation which was highlighted by interviewees as causing a burden was that of ensuring that money laundering requirements, which include checking that firms “know their clients”, were complied with. Most firms considered this to impose considerable costs although the SRA is not responsible for these requirements.

### **5.2.2. Conflicts**

One key area where considerable resources are expended is in the conflicts process relating to the intake of new business for firms. This has grown in importance over time, primarily because of increased complexity in business and because of greater concerns about this issue by clients. In addition, high profile cases related to conflicts have also contributed to the trend.<sup>20</sup> Conflicts have also increased in importance because of the increase in size, and the international growth of some of the largest firms.

However, despite the fact that this is an area where costs are incurred, it is clear from discussions with firms that their conflicts checking process would in general be very similar even absent SRA regulation because of purely business considerations.

### **5.2.3. International firms**

A number of firms raised concerns about the regulatory approach to firms which have international offices. Some firms believed that multiple international offices brought additional regulatory risk compared to firms that did not have international offices or that only had a small number of offices.

However, firms with multiple international offices raised the concern that the SRA was seeking to regulate lawyers in other jurisdictions who were conducting work in accordance with domestic law in the country in which they were situated. In general these

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For example, conflicts were identified as an issue when Freshfields was separately advising both Marks and Spencer (M&S) as well as Philip Green, the owner of BHS and Arcadia, and was then appointed to advise Philip Green on the bid for buying M&S. M&S then obtained a High Court injunction forcing Freshfields to abandon the case because of the risk of conflicts because of the firm’s relationship with the M&S. (Source: Herman, M., Conflict of Interest cost Freshfields lawyer £59,000, 2 August 2007, Times Online, <http://business.timesonline.co.uk/tol/business/law/article2188167.ece>)

firms considered it infeasible for the SRA to regulate lawyers in these circumstances, arguing that domestic regulators were better placed to conduct the appropriate level of regulation.

#### 5.2.4. Complaints and client redress

One of the changes in the Legal Services Act that the LSB is specifically seeking to monitor is the change to client redress mechanisms when things go wrong. In particular, the Office for Legal Complaints (OLC) opened in October 2010 as the single complaints-handling and consumer redress body in respect of all members of Approved Regulators, subject to oversight by the LSB. The OLC can make enforceable awards on consumer redress of up to a limit of £30,000. It is expected that this change should improve complaints handling and client redress.<sup>21</sup>

Many of the city firms indicated that they sent information to all of their clients regarding the new processes. The majority of firms considered this to not have been a worthwhile exercise since it involved sending information to the types of clients that would not use these new complaints processes.

As discussed in Chapter 4, clients of city law firms are mostly large corporate clients who are highly sophisticated and possess substantial bargaining power. In this regard, interviewees have stressed the fact that they do not require regulatory protection in order to seek redress. Further, if such clients are not satisfied with the services they have received, they would rarely set out a formal complaint. The great majority of clients of city firms are not entitled to use the OLC and interviewees consider it a remote possibility that even their individual clients who could use the OLC would do so.

Instead of relying on a formal complaint procedure after work has been done, clients of city firms will have continual interaction with their lawyers and would raise any concerns about poor service during the progress of the case. They would inform the partner who is in charge of the case or the senior partner of the law firm about their dissatisfaction and seek to find resolution from the firm.

If the underlying legal advice is found to be lacking after the case has completed, for example because the corporate structure designed was not possible, or the tax advice offered did not deliver the claimed benefits, then it is much more likely that clients would seek redress directly with the firm (and give future work to other firms) or through litigation than through regulatory prescribed processes

Disagreements with clients were identified as most commonly being about the size of bills. However, it was clear that city firms consider this to simply be part of the commercial negotiations that they have with their clients and that these disagreements are usually resolved in collaboration with the client rather than this leading to formal complaints.

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<sup>21</sup> Awards are enforceable through the courts as a civil debt while previously not all of the Approved Regulators were able to make enforceable awards. Explanatory memorandum to the Legal Services Act 2007 (Commencement No. 2 and transitory provisions) order 2008, 2008 No. 1436 (C.65)

By contrast, formal complaints were rare and firms could only identify a handful of such complaints over the last few years (one or two per year or over a few years were the most common responses). Given the very small number of complaints, it is not possible to draw strong conclusions about any similarities between cases.

However, it was common for firms that conducted private client work to highlight that the formal complaints generally came from individual clients on private client work rather than from corporate clients.

### **5.2.5. Regulatory requirements beyond the SRA**

As well as requirements related to money laundering, the other main areas of regulatory requirements faced by firms that were highlighted by interviewees were issues to do with data protection and also FSA rules.

In the latter case, it is difficult to distinguish the need to abide by FSA rules from the advice that law firms give clients regarding the client complying with FSA rules. For example, it may be the case that the law firm maintains the "insider" list which is required under FSA rules, but this is part of the service that law firms offer to their clients. Similarly, firms need to make sure that they do not undertake FSA regulated activities if they are not regulated to do so (which firms are generally not).

### **5.3. Cost of regulation**

Despite the fact that city law firms were consistent in stating that until the last year or two they had not had much interaction with the SRA, they were also consistent in stating that the cost of risk management and compliance had become increasingly important over time.

Ten years ago it was thought that there were only one or two of the largest firms that had centralised risk management functions but now all of the large city law firms have this in place. At the same time, the number of staff on compliance and risk management functions has been increasing in the last ten years and especially in the last five years.

Firms vary in the way in which they organise some of their risk management functions (including international firms commonly centralising some aspects, particularly conflicts, in one location) although many firms have departments which examine:

- New client intake and conflicts including know your client requirements and money laundering issues;
- Renewal of practising certificates;
- Arrangement of professional indemnity insurance; and
- Development of internal policies related to professional standards.

The number of staff involved in these activities varies considerably between firms reflecting their size and complexity. In general there is around one employee working on these functions for every 40-100 lawyers. It should be noted that this is based on only a

small number of responses and it is clear that there are substantial differences regarding how international firms organise their compliance functions.

However, although regulatory and compliance pressures have been increasing over time, it is clear from interviewees that this has not been driven by the SRA but rather from a greater understanding of risk management over time, increased complexity of law firms, changes across the business world to have more concerns about compliance related issues, and client requirements. Indeed, in the absence of SRA regulation, firms nearly all stated that they would operate in broadly the same way and would require the same number of staff in these functions as they have today supporting the view that many of the activities they currently undertake are due to commercial considerations rather than for purely regulatory reasons.

City firms did not raise specific concerns about any undue regulatory costs although one of the non-city firms highlighted the costs that arise from gathering the evidence of compliance over and above the costs of compliance itself. This is connected to a lack of certainty regarding the evidence that the SRA would see as acceptable under outcomes focused regulation.

In addition to this, one of the smaller city firms highlighted that costs were being incurred in altering IT systems and updating internal policies in response to outcomes focused regulation.

## **5.4. Conclusions on regulation**

### **5.4.1. City firms and variation between firms**

#### *Interaction with regulator*

City law firms had very little interaction with TLS as their regulator in the past and most interviewees indicated that this did not change following the creation of the SRA although has begun to alter more recently as the SRA has changed its approach to city firms.

City firms consider that their clients do not need regulatory protection and most do not believe that failures at one city firm would damage the reputation of other competitors or the city more generally. Firms nonetheless see an advantage in the SRA propagating best practice regarding compliance among city firms. In general firms would operate their businesses in the way that they currently do with or without the presence of a regulator.

#### *Complaints and client redress*

City law firms receive few formal complaints although negotiation over fees is commonplace. Their clients are highly sophisticated, possess substantial bargaining power, can switch work to other firms and, at the extreme, would seek redress directly through litigation. These clients do not require regulatory protection to seek redress and furthermore, few are eligible to use the new complaints mechanisms and therefore little impact would be expected from this change.

City law firms who act for individuals indicate that these clients are more likely to complain although most firms considered that they had only a handful of such complaints. Given

the small number of complaints, and the fact that these clients would be among the more sophisticated individual clients, firms do not expect impacts to arise from the new procedures even for their individual clients.

*Cost of regulation*

The cost of risk management and compliance has become increasingly important over time, although this has not been driven by TLS/SRA requirements but rather from a greater understanding of risk management over time, increased complexity of law firms, changes across the business world to have more focus on compliance and client requirements. Nowadays all of the large city law firms have centralised risk management functions in place and the number of staff on compliance and risk management functions has been increasing in the last ten years and especially so in the last five years. Indeed, this trend is expected to continue irrespective of the actions of the SRA simply because of an increasingly compliance focused culture.



## **6. MARKET OUTCOMES**

In this chapter, we first briefly introduce the indicators suggested by the methodology study and compared these to evidence available as to their applicability for city law firms, and present information on the outcomes and how they vary between firms in order to provide benchmarking information for the future assessment of regulation. There are a range of issues covered including volume (section 6.2), quality (section 6.3), costs and profitability (section 6.4), price (section 6.5) and other non-price factors (section 6.6).

### **6.1. Methodology study**

There are four elements of market outcomes which are highlighted in the methodology study:

- Volume – volume could be measured by the number of cases, number of clients, hours recorded and total revenue split by office if appropriate, type of law, and type of client;
- Quality – it is acknowledged that quality of legal services is difficult to measure but potential indicators proposed include the length of case and the duration of time elapsed between opening and closing a file;
- Costs and profitability - the methodology study suggests measuring staff costs and other costs such as training costs and marketing spend, it suggests profitability be calculated by the surveyor based on information on revenue and costs; and
- Pricing – three main types of prices are identified including conditional fee arrangements, fixed fees, and hourly rates which could be split by type of client and type of law.

It should be noted that the methodology study is aimed at setting out a broad range of indicators across the legal services market and therefore some of the measures may be relevant to other parts of the profession but not to city law firms. In addition, the approach agreed for this pilot study is one of qualitative interviews rather than seeking to gather large amounts of quantitative data which therefore affects the information that is presented in this section compared to information which could be available from studies of other segments of the legal services market.

### **6.2. Volume**

City law firms do not consider the volume of cases to be a key metric when considering the performance of their business. Firms would have information on the new instructions which would usually lead to a new file number being generated but they would not necessarily gather or analyse this information. There may be differences in approach between firms as to whether a single corporate transaction and all the associated work that might go with it on pensions, employment, property and tax should be captured as a single case or whether it would be better seen as involving multiple numbers of cases since it deals with multiple areas of law. In general the fact that the cases conducted by

city law firms are far from standard militates against information on the volume of cases being of use in comparing city law firms.

Instead, firms prefer to measure revenue (information on which has been presented in 2.1) and commonly look at the value of work done for their top 10, 100, or 200 clients. Given the considerable variation in work done for different clients they consider value to be a much more relevant issue than volume since cases can range considerably from small matters to cases in which millions of pounds are spent on the legal advice given.

Such information is mainly useful to assess who their key clients are and to ensure that this fits with their strategy as well as helping them to assess the value of client relationships when conducting commercial negotiations. In addition, firms may be concerned if the value of cases from top clients is too small and scattered as that would tend to increase administrative costs or conversely if the revenue is skewed too much on a few big clients as risks might be too concentrated when business relies on a few clients.

### 6.3. Quality

The quality of legal services provided by city law firms is seen as an extremely important factor for city law firms. The two areas which appear to be most relevant for these firms through which quality can be considered are:

- Repeat clients - most clients for city law firms are repeat clients, indeed many clients will be continual clients for firms with a range of different cases being conducted at any given time or, for example, continual assistance on areas such as employment and pensions. Given the sophistication of the overwhelming majority of clients for city firms this is strong evidence of these firms delivering high quality advice; and
- Reputation – as indicated in section 4.3.2, reputation is of considerable importance in obtaining new clients and keeping existing clients. There are clear differences in reputation between firms, practices and even for individuals within firms and the legal directories provide evidence of quality in this regard.

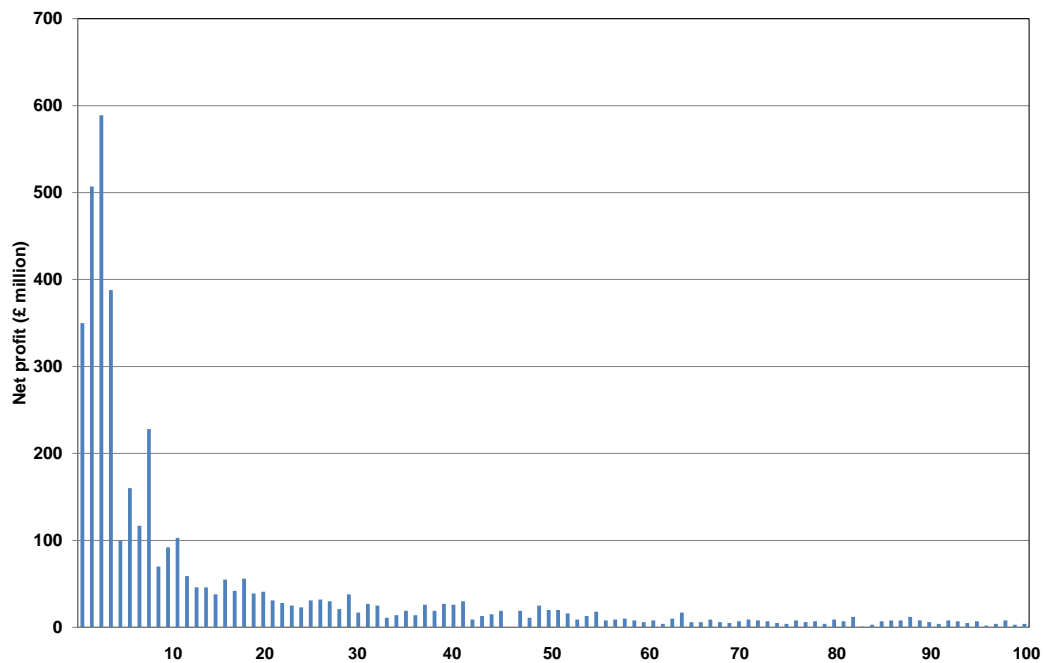
In contrast to this, measures of quality that may be relevant in other parts of the legal services market such as the length of a case or the duration of time elapsed between opening and closing a file are not relevant for city law firms. Even were data to be available on these issues no interviewee indicated that it would be possible to interpret this information to assess quality.

More generally, the quality of the service given to clients is considered to be important along with the quality of the advice given. Many city law firms note that the responsiveness of firms and the expectations of clients regarding this have increased significantly over time reflecting the availability of technology facilitating. This would include the increased expectations on some cases that the availability of blackberries means that lawyers would be responsive to emails outside usual office hours including evenings and weekends (and in some areas of work and at certain times there would be clear expectations that staff would be working at these times anyway).

## 6.4. Costs and profitability

The main costs of operating law firms are staff costs and spending on property. At the time this research was commissioned, TLS was also studying the financial arrangements of a large number of law firms. Hence, we have not sought to capture new information on such issues from this study and neither have they been discussed with interviewees. Information is available through the UK 200, which is shown below for completeness and which could be monitored over time for the purpose of benchmarking.

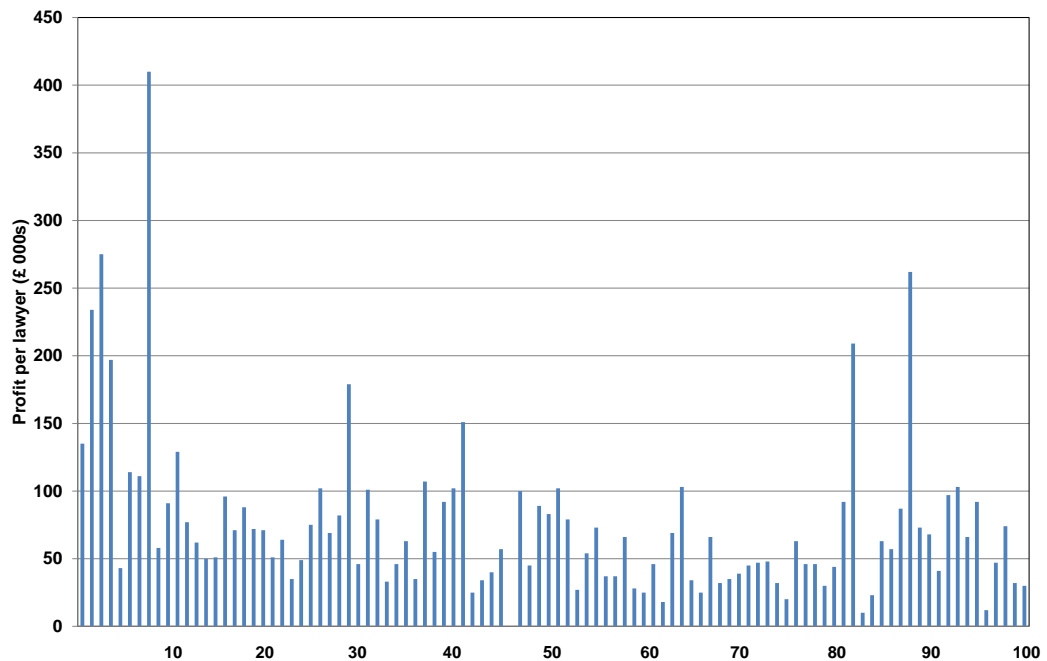
**Figure 10: Net profit of top 100 UK firms in terms of turnover**



Source: The Lawyer, UK 200 Annual Report 2010.

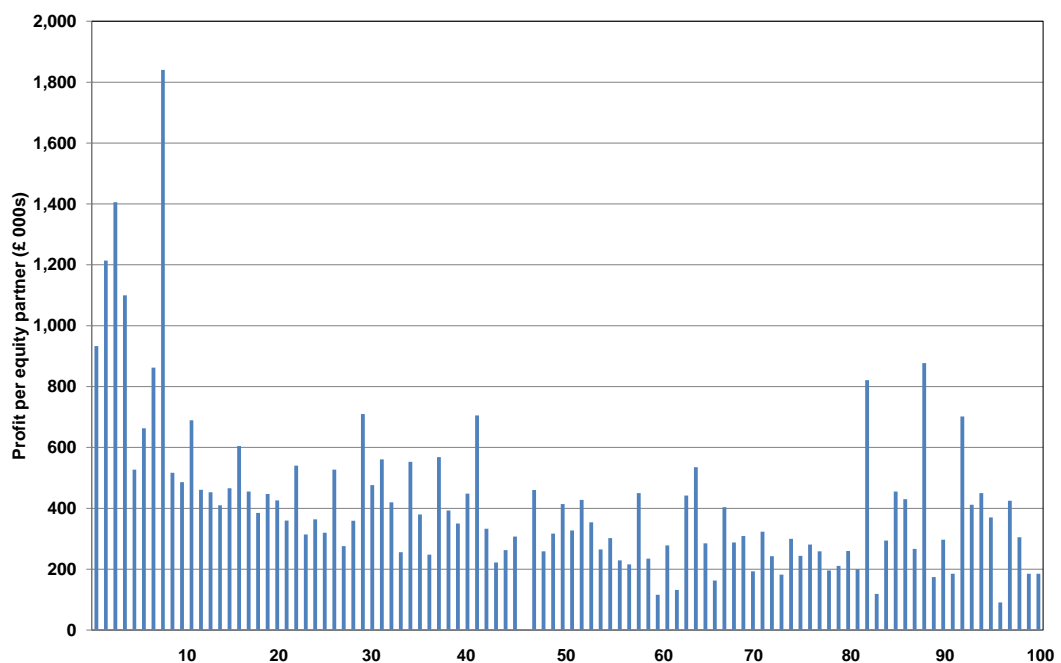
As Figure 10 shows, the net profit of firms at the larger end of the turnover spectrum is much higher than those at the lower end. The top four firms have particularly large net profits compared to other firms reflecting their much higher turnover compared to other firms. However, profitability measured by profit per lawyer and profit per equity partner (PEP) show different results as seen below (the latter is seen as a particularly important metric in comparing the relative performance of firms).

**Figure 11: Profit per lawyer of top 100 UK firms in terms of turnover**



Source: The Lawyer, UK 200 Annual Report 2010.

**Figure 12: Profit per equity partner of top 100 UK firms in terms of turnover**



Source: The Lawyer, UK 200 Annual Report 2010.

Although there is a general trend for larger firms to be more profitable whether measured per lawyer or per equity partner, there are other, smaller, outliers who also have relatively high levels of profits measured on these bases. Often these firms, while smaller, would

compete against much larger firms in particular areas of specialisation and would be considered to be city law firms.

At present comparisons between profits are, while not perfect, possible to do because firms are structured as partnerships. However, should some firms choose to move away from partnerships and towards corporate structures, the assessment between firms will become increasingly complex. Equity partners (typically responsible for generating the work) currently receive remuneration through the pay out of profits, but with corporate structures, if these partners become employees then at least some of the remuneration that they currently receive would move from profits and into costs (as salaries and bonuses).

More generally, it is also clear that there are different ways of distributing profits to the partnership. For example:

- The traditional “lockstep” model where partners take increasing shares of the profit pool according to the number of years that they have been partners at the firm; and
- The “eat what you kill” model distributes profits on the basis of the value of business that individual partners are considered to have brought to the firm.

In general, UK based firms have historically distributed profits on the basis of the lockstep model while US firms operating in London are more likely to be arranged on the eat what you kill model. In practice there are many variations to the models with firms taking different views on whether an individual’s position in the lockstep can be frozen or even reduced, how to treat lateral hires into the partnership and how the value of an individual’s contribution is assessed. Not only could this make comparisons between firms more difficult over time, but as noted in section 2.3, partner remuneration is considered to be one of the more challenging issues to consider when merging with other firms.

## **6.5. Pricing**

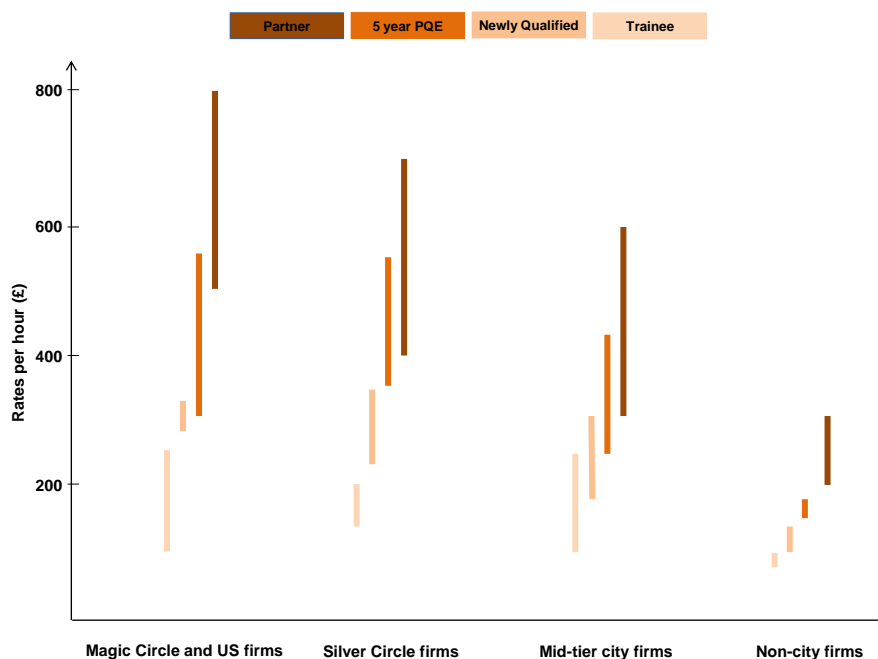
There are a variety of different types of pricing approaches used by city law firms and it is common for pricing structures to be mixed within a particular case as well as other changes to apply during the course of work in light of commercial negotiations with clients and changes to the scope of work over time.

### **6.5.1. Hourly rates**

Hourly rates are usually seen as the starting point for all price discussions. Even when the work is on fixed fees, the estimation of the amount of fees used as the basis for negotiation of the fixed fee would generally start from the a calculation based on the hourly rates and the estimated hours needed for the work.

The key basis by which hourly rates vary is that of the qualification and length of experience of different lawyers, although variation between different city law firms is also observed as shown in Figure 13 below.

**Figure 13: Variation of hourly rates by qualification and firm type**



Source: CRA calculation based on data collected from interviews. For the purpose of this chart, Mid-tier firms include all firms interviewed that were considered city firms but were not in either Magic or Silver Circles and were not US firms.

It is clear that hourly rates vary substantially by qualifications and the length of experience with rates for partners often being multiples of the rates charged for more junior lawyers.<sup>22</sup> This reflects the fact that partners have much greater experience and can provide much more valuable services than a newly qualified solicitor or a trainee.

The rates also vary by the type of firm (which has some correlation with the size of the firm) with partners of larger firms being able to charge rates as much as twice the rates charged by firms at the smaller end of city law firms. As the figure shows, partners of US and Magic Circle firms are able to charge £500-800 per hour while partners of mid-tier city firms may charge £300-600 per hour and partners of non-city firms may charge £200-300 per hour. The different hourly rates also give some indication as to the groups of firms against which individual firms are typically competing. Information was combined for Magic Circle firms and the “global elite” US firms since the information gathered indicated that they had broadly similar rates. The similarity in rates also supports the view that these firms tend to compete against each other more than these firms would be competing against, for example, mid-tier city firms.

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<sup>22</sup> Caution should be applied in interpreting the information since it is based on a small sample of data and not all firms provided information on hourly rates for all types of staff. Furthermore, data was gathered as broad ranges rather than precise figures hence the chart is better to be seen as giving an indication of broad ranges of hourly rates rather than precise estimates.

It is also interesting to note that the variation in hourly rates among city firms is much smaller with respect to trainees compared to the variation at other levels of experience. This is likely to reflect the fact that trainees have a similar level of experience to each other and therefore differentiating between different trainees would be challenging. In contrast, over time individuals work on different cases in different firms and therefore have greater ability to differentiate themselves.

Although different hourly rates for different types of staff are common, it is also clear that blended rates across different levels of staff will be offered to certain clients for particular pieces of work should the client prefer that approach to pricing.

### *Variation by clients*

The hourly rates highlighted above represent headline rates which could be very different from realised rates. While the rates would vary according to the specific characteristics of clients, it does not appear to vary between client type (corporate, individuals, government) per se; hence gathering information on hourly fees by client type would not represent a particularly meaningful exercise for city law firms. Furthermore, since the vast majority of city law firms' clients are large financial institutions and large national or multinational corporations, gathering information on fee rates for other clients would be less representative of the business as a whole.

Fee rates would vary depending on the bargaining power of the client and the total value of work being conducted for that client (which may be correlated to client types as financial institutions and large corporate clients would require more work to do be done than most individuals who require corporate work). Discounts of up to 20% appear common for large scale pieces of work, on panel arrangements or for important client relationships. Differences between the types of work typically conducted for different types of client would also lead to differences in pricing by client (as well as the firms that conduct this work). Information on pricing by client is seen as very commercially sensitive.

### *Variation by type of work*

In general the headline level of hourly rates would be broadly similar within a firm across work areas, as firms try to maintain consistency across the firm. This may be important where firms often seek services from a variety of different practice areas within a particular transaction. However, it is clear that there are some areas of work where hourly rates are somewhat higher than others. In particular, areas such as tax advice (especially if it is international tax advice) or derivatives work, where the work is highly technical and the supply of experts is limited, are seen as areas where premium rates may be applied. Other innovative areas of work might also be expected to receive higher fee rates.

As noted above, hourly rates are the starting point for estimating fees that are structured in other ways but over time there has been a move away from hourly rates and towards more fixed fees. Some areas where this has not been seen, and where hourly rates remain the norm for nearly all work, include most contentious work such as litigation and dispute resolution. The main reason for this is that the amount of work needed is harder to predict as it depends on the actions of the other side. In addition, legal costs are awarded on the basis of hourly rates and therefore it makes sense to bill clients in this way as well so that this forms the basis of any award by the courts.

Some types of work are perceived to be generally more standardised than other types with employment law often described this way although it should be recalled that often different firms will be asked to conduct different levels of complexity of work within any particular area of work and therefore the hourly rates within firms may not always vary.

### **6.5.2. Value based and fixed fees**

Fixed fees or value based fees are being increasingly used by city law firms in order to provide greater certainty to clients as to the overall cost of the service they provide. Economic conditions and the desire by clients to reduce the overall cost of services (as well as having certainty in the cost) are also understood to have led to greater pressure to move to using fixed price services.<sup>23</sup>

Unlike hourly rates where it is possible to obtain information to facilitate comparisons between firms, given the nature of work conducted by city law firms it is not possible to identify typical fixed rates that would be charged for most of the work that is conducted since the work is usually very specific to the client's particular needs. Furthermore, the reasoning regarding variation between clients and work that was set out in section 6.5.1 would also apply to fixed rates and therefore we do not repeat that discussion again.

In general, the use of fixed fees is more common in areas where the work is predictable which could include issues such as registering a trademark, setting up a new company shell structure (although this could also be bought "off the shelf"). In addition they might be used for some types of transactions work where this is non-contentious and where the other side has similar incentives to complete the work. For example, work related to debt arrangements in corporate financing would tend to be on a fixed fee, as would some property work.

Although fixed fees are more common in these areas it is important to note that this would not necessarily imply that the whole of a particular case would be conducted on a fixed fee basis. Much more likely is that fixed fees will be agreed for a particular stage of work with later stages potentially on a different basis or different arrangements should the work go beyond the scope that was originally envisaged. Similarly, capped fees may be agreed where fees are billed on an hourly rate basis until a particular cap is reached.

Some areas of fixed fees may be more described as "value based fees" as the charges may reflect less the time spent by individual lawyers on the case and more the overall value of the advice provided to the client. Some areas of tax advice might fall into this area where the experience of the lawyers involved means that the actual number of hours that would be billed might be relatively small but the value created for the client could be considerable. Similarly if firms are conducting similar work for a range of different clients in the light of changes to tax rules they may not think it appropriate to charge the first client for all of the hours spent and the second client far fewer hours because of the experience gained in working for the first client.

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<sup>23</sup> The Lawyer, Recession sees fixed fees become par for the course, 28 September 2009.



### **6.5.3. Success and abort fees**

In addition to the mixed use of hourly rates, blended rates, fixed and capped fees, it is also common for city law firms to have success and abort fee arrangements especially on corporate transactions. Firms would not usually describe these as conditional fee arrangements as they prefer to distinguish themselves from the extreme version of conditional fee arrangements of “no win no fee” which would be rare within city firms.

However, it would be common for all city law firms to apply success and abort fees on corporate transactions. Generally this would involve a mark-up of up to 20% if the transaction or a discount of a similar amount if the transaction fails to complete. This is described as happening in order that the bills for clients are not as significant if they end up with nothing to show for the time and cost. Since firms would be working with repeat clients on these issues they are willing to enter into the arrangements and reduce fees where transactions fail because they know that there will be future situations where the transactions do complete and they will get an uplift on their fees.

### **6.5.4. Pro bono work**

Many city law firms provide legal services on a pro bono basis although these would be limited to work for charities and often combined with other aspects of charitable work or as part of their wider corporate social responsibility initiatives. This may involve specific legal advice on particular issues or it could be in the form of free training or lectures on legal issues.

### **6.5.5. Trend in prices**

Before the credit crisis, the price of legal services, as measured by hourly rates, had been increasing over time. It is thought that this reflected the growth in demand for legal services in the light of economic growth as well as the increase in the cost of supply due to increases in salaries required to keep staff within legal firms rather than seeing them exit towards financial services clients. During the recession, headline rates were generally kept reasonably stable (although rates for any individual may have increased reflecting additional experience). At present many firms are making small, inflationary, increases in the headline rates.

However, it should be noted that although headline rates may have increased, the amount of discounting, the pressure to price on a fixed fee basis and the increased use of panels means that in general firms consider the realised rates to have remained fairly steady if not fallen slightly in the last few years.

## **6.6. Other elements affecting value**

As well as simply charging for legal advice there are other services which city law firms commonly provide to their clients including the provision of training as well as the secondment of staff to clients. Both of these are commonly associated to panel requirements although not exclusively so. For example, law firms commonly provide training to client’s in-house legal staff, give lectures to or hold seminars for clients at no extra cost.

Secondments have become much more popular over time compared to 10 or 20 years ago and while they could be requested by any clients, they are most common among financial institutions (especially banks) and the very largest corporate clients. This experience was common across all city firms.

Within panel arrangements there would typically be requirements regarding the number of secondees that would be provided over the course of the panel agreement along with agreements as to the level of seniority of staff and whether clients would pay salary costs or expect staff to be provided free of charge (in the light of the other services that they would be paying for).

Historically secondees would have been relatively junior level lawyers, although firms are always concerned to send high quality individuals since their performance reflects on the reputation of the wider firm. However, in recent years there has been increased pressure to provide more senior level secondees including partners. This may be particularly the case to cover temporary needs of in-house lawyers such as to cover maternity leave of a head of department or to run a specific project.

Secondments are also seen as beneficial to city law firms since it provides an opportunity for their lawyers to meet a variety of different members of staff at the client, to understand in much more detail how the client operates and to develop relationships with clients which can be valuable in the future.

In general larger city law firms would be expected to have more staff on secondment and while this may be attractive in large departments where there is more scope to spread work around other staff or during quiet times such as the recent recession, it is more difficult for law firms to offer staff from smaller departments where the management of internal work would then be more difficult.

## **6.7. Conclusions on market outcomes**

### **6.7.1. Lessons for the methodology study**

The methodology study suggests measuring volume by number of cases although this is not considered relevant for city law firms who do not have standardised cases and where value is the preferred metric.

Measures of quality that may be relevant in other parts of the legal services market such as the length of a case or the duration of time elapsed between opening and closing a file are not relevant for city law firms. Instead, the importance of repeat clients and evidence on reputation from legal directories can be used as strong evidence of city law firms delivering high quality legal services.

Fee rates do not vary between client type (corporate, individuals, government) per se rather they reflect the relative bargaining power of clients which will typically be linked to the value of legal spend. Gathering information on hourly fees by client type would not represent a particularly meaningful exercise for city law firms. More detailed information on fee rates is seen as commercially sensitive hence monitoring headline rates and obtaining a qualitative understanding of discounting is more likely to be fruitful over time.

## 6.7.2. City firms and variation between firms

### *Pricing by hourly rates*

Hourly rates are the starting point for all price discussions and rates for partners are often multiples of the rates for more junior lawyers. Rates vary between different city firms with partners of larger firms being able to charge rates as much as twice the rates charged by firms outside the city. Comparisons of hourly rates also lends support to the view that Magic Circle firms and the “global elite” US firms tend to compete against each other more than these firms would be competing against mid-tier city firms.

Hourly rates would vary depending on the bargaining power of the client rather than the type of client itself although there are types of work such as highly specialised tax advice or advice on financial products that may be more expensive.

### *Other forms of fee structure*

The use of fixed fees or value based fees has been increasing in the light of the recession and in order to provide greater certainty to clients. In general, the use of fixed fees is more common in areas where the work is predictable including property and some transactional work, while hourly rates remain the common approach in litigation where the amount of work is influenced by the actions of the other side.

More generally, pricing frequently involves a complicated mix of the use of hourly rates, blended rates, fixed and capped fees and these may vary between different stages of a particular case. In addition, it is also common for city law firms to have success and abort fee arrangements especially on corporate transactions.

### *Trends in pricing*

Although headline rates may have increased until the recession, the amount of discounting, the pressure to price on a fixed fee basis and the increased use of panels means that in general firms consider the realised rates to have remained fairly steady if not fallen slightly in recent years.

### *Other elements affecting value*

City law firms commonly provide to their clients services including the provision of training as well as the secondment of staff to clients. In general larger city law firms would be expected to have more staff on secondment and the pressure to provide secondees has increased considerably over time especially within panel arrangements.