Client Advisory

January 2008

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Hildebrandt International and the Citi Private Bank are pleased to present this 2008 Client Advisory highlighting the trends that we perceived in the legal market in 2007, as well as the trends that we believe will impact the market in 2008.

"It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, … it was the spring of hope, it was the winter of despair, we had everything before us, we had nothing before us … ."

– Charles Dickens
A Tale of Two Cities

2007: A Year of Stark Contrasts

The year 2007 was one of stark contrasts for the US legal profession – a story of two very different years rolled into one. The year began in a spirit of optimism, coming off a good (though not blockbuster) performance of firms in 2006. Although there were some signs of economic trouble on the horizon (rising interest rates, high oil prices, and a sharp downturn in the residential housing market), firms grew at a healthy pace in 2006, and there were expectations that growth would continue in 2007.

The first half of 2007 not only met these expectations but exceeded them, with firms around the country reporting high levels of activity. Indeed, at the mid-year point, the firms that provided their results to the Citi Private Bank[1] were reporting revenue growth in excess of 13 percent and demand growth (as measured by total billable hours) in excess of 7 percent. To put those figures into perspective, the compound annual growth during the 2001-2006 period were about 10.5 percent and 3.6 percent, respectively.

In the third quarter, however, the picture changed dramatically. In most firms, productivity dropped, in some firms significantly, as the growth in business subsided, driven by the precipitous drop-off in structured finance work triggered by the sub-prime mortgage crisis, a decline in M&A and transactional work due to a growing sense of uncertainty in the economy spawned by fears of a recession and resulting in an overall slowing of economic activity, and a continuing softening of the litigation market.

On the litigation side, we continue to see a gradual reduction in workloads throughout the country. In some locations (Texas and California in particular) there has been a sharp decline, impacting realization rates and prompting some firms to increase their inventory of contingency litigation. And, in what may well be a harbinger of a changing attitude toward mass tort litigation by corporate America, Merck & Co. in November announced the comprehensive settlement of tens of thousands of liability claims relating to its former product Vioxx for an overall settlement amount of $4.85 billion. Merck had previously set aside $1.9 billion for litigation costs (not including judgment or settlement amounts)

[1] Citi Private Bank data used in this Client Advisory are provided from a number of Citi's Law Watch reports including the *Annual Survey of Law Firm Financial Performance*, which includes 247 firms broadly representative of the industry; its quarterly *Flash Reports*, which typically include more than 150 firms; and other studies conducted by the Law Firm Group of Citi Private Bank. *Data provided by law firms to the Citi Private Bank is considered confidential and, as such, has not been shared with Hildebrandt International either in aggregate or on an individual firm basis*. For ease of reference, the source of all Citi Private Bank survey data not more specifically identified in this Client Advisory is given as "Citi Private Bank Law Watch."

and had spent $1.2 billion of that amount at the time of the settlement. The company estimated that the settlement would save it hundreds of millions of dollars in annual legal fees for many years to come.[2]

Unlike previous downturns in the legal market, the present slowing of economic activity has not (yet) been accompanied by upturns in litigation or bankruptcy or reorganization work. In a sense, the current downturn has thus far been a "perfect storm" in which finance, transactional, and litigation work have all trended downward at the same time, with no offsetting surge in work related to the economic downturn itself.

A few firms (primarily those with large structured finance practices or commercial litigation practices) have already begun to respond to these challenges with announcements of associate layoffs and other cutbacks. Most firms appear to be biding their time, however, holding off on any drastic expense reductions and hoping that the economic downturn will be short-lived.

We have for some time been predicting that the legal market was perhaps overdue for a "correction" and that the era of easy or widespread double digit annual growth in profitability could well be coming to an end. The key question as we look ahead to 2008 is whether that "correction" might now be occurring.

A Reprise of 2001?

The last year in which the legal market experienced a flat to slightly down year was 2001. So, questions logically arise as to whether the current slowdown is like the downturn in 2001 and whether there are lessons to be learned from that previous experience.

To be sure, there are similarities between the state of the market in 2007 and 2001. In both years, the legal industry was coming off a long period of sustained growth in which firms had experienced steadily rising revenues and profits, expanded headcounts and leverage, and a substantial rise in associate salaries with mounting pressures for even more increases. In other respects, however, the two years are quite different, and some of those differences could presage a more difficult period of recovery than the industry experienced after 2001.

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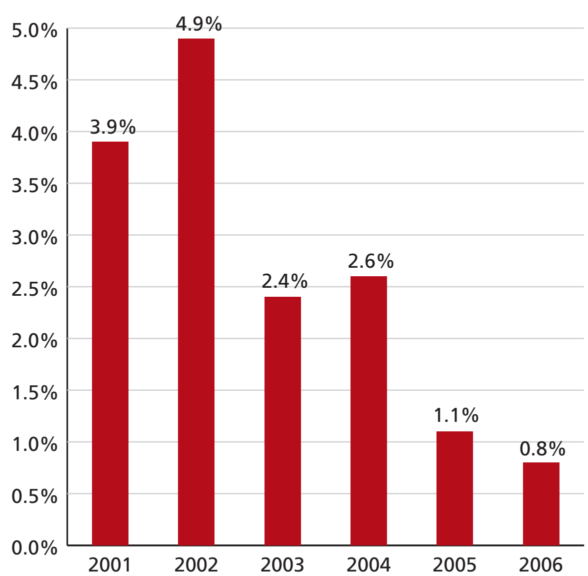
[2] *See* "Merck's Tactics Largely Vindicated As It Reaches Big Vioxx Settlement," *The Wall Street Journal*, Nov. 10, 2007, at A1.

The Cost of Leverage. In 2001, leverage was less expensive for firms because there were more lawyers at lower levels within the non-equity ranks. The relatively higher rates of equity partner growth in 2001 meant that more senior associates moved up to partner status. Today, most successful firms have thinned the equity ranks significantly by raising the bar for admission and, in some cases, by "de-equitizing" existing equity partners. This has resulted in a clustering of highly paid people at the top of the non-equity ranks, thus making the cost of leverage comparatively higher than in prior years.

This change in the mix within the non-equity partner ranks is reflected in Charts 1 and 2 below for 139 firms included in the Citi Private Bank Law Watch since 2000. Chart 1 shows the substantial decline in the growth rate of equity partner ranks over the six-year period from 2001, from a high of 4.9 percent in 2002 to a low of 0.8 percent in 2006. Chart 2 shows the changing mix of non-equity lawyers in those same firms over the seven-year period from 2000 through 2006. As can be seen, as the growth in equity ranks has slowed, there has been a corresponding increase in the numbers of income partners and "other" non-equity lawyers, as well as a reduction in the share of the non-equity ranks accounted for by associates.

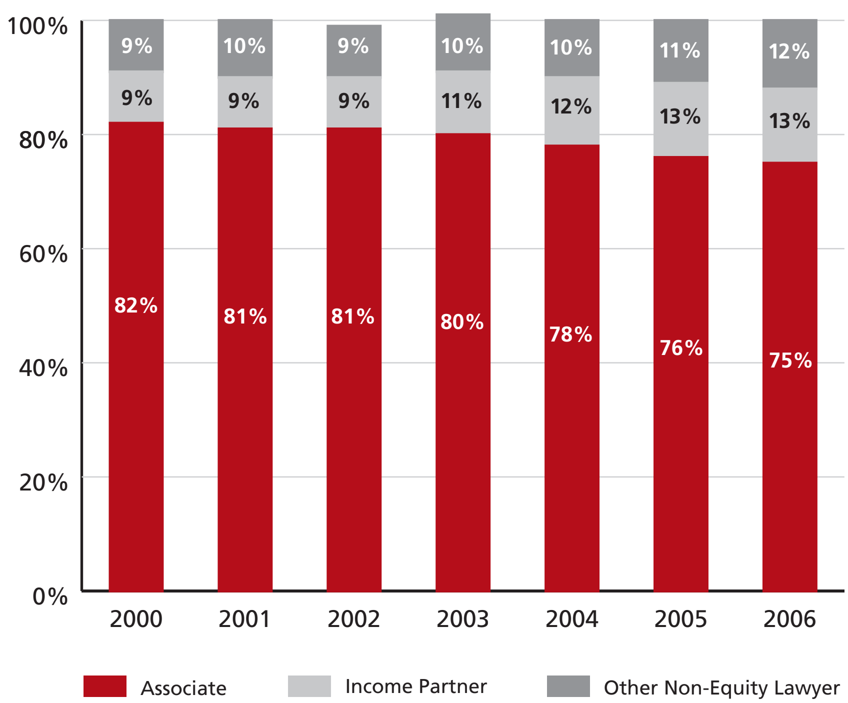
Chart 1 – Annual Growth in Equity Partner FTE*



*Includes 75 Am Law 100 firms, 32 Am Law 200 firms, and 32 non-Am Law firms

Source: Citi Private Bank Law Watch

Chart 2 – Composition of Non-Equity Lawyer Headcount*



*Includes 75 Am Law 100 firms, 32 Am Law 200 firms, and 32 non-Am Law firms

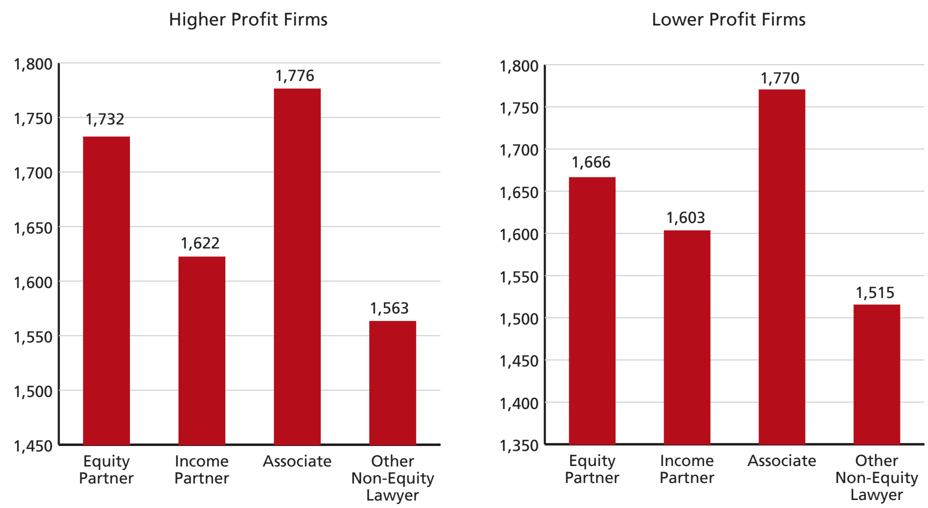
Source: Citi Private Bank Law Watch

Of course, this change in the mix of non-equity lawyers could be beneficial to firms if the lawyers in those categories remained productive. Unfortunately, with the exception of associates, that is not usually the case. Chart 3 below shows the average annual productivity for all categories of lawyers in firms participating in the Citi Private Bank Law Watch during the seven-year period from 2000 through 2006, broken into "higher profit firms" and "lower profit firms."[3] As indicated, productivity levels of income partners were significantly below those of both equity partners and associates in both categories of firms, as were productivity levels of other non-equity lawyers. What these data suggest is that many firms are now bloated with some income partners performing mostly associate-level work while, at the same time, generating

[3] For these purposes, "higher profit firms" are defined as those firms having profits per equity partner ("PPEP") equal to or greater than $500,000 in 2000, and "lower profit firms" are defined as those firms having PPEP less than $500,000 in 2000.

less overall profitability. While two-tiered partnership structures have been helpful in firms that have used them prudently, the truth is that for many firms today, moving partners into "income partner status" has become a convenient way to avoid making difficult decisions.

Chart 3 – Average Annual Productivity by Categories of Lawyers (2000-2006)



Source: Citi Private Bank Law Watch

Another ironic effect of the reduction in the growth rate in equity partner ranks – undertaken by many firms in recent years to improve their profitability figures – is that this tool is not as readily available in the present downturn. In 2001, as shown in Chart 1 above, the annual growth rate in equity partner ranks was almost 4 percent, rising to almost 5 percent in 2002. By 2006, the rate had fallen to less than 1 percent. It will be very difficult to push it much lower.

Realization Rates. One of the contributors to the decline in profitability growth in 2001 was a decline in firm realization rates. Today, overall realization rates are lower than they were in 2001,[4] and the pressures on such rates are greater. This reflects, to a significant extent, the disappearance of "big ticket"

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[4] In 2001, firms participating in the Citi Private Bank Law Watch reported an average overall realization rate of 91.2 percent. In 2006, that figure dropped to 90.8 percent. While a decline of 0.4 percent may seem modest, it is important to remember that, given the total revenues involved, a shift of a half percent in realization rates represents a substantial amount of money.

premium work as well as increasingly sophisticated clients more than capable of pressuring their law firms to slow the effects of rate increases. As a result, improving realization rates will be much harder to do today than seven years ago.

Closely related to realization rates is a firm's asset conversion cycle – the amount of time required to convert an hour of invested time into cash actually received by the firm. In the benign period since 2001, most firms have successfully worked to improve their conversion cycles, with the result that there is not much additional improvement that can be realistically expected to help cushion the effects of the present downturn.

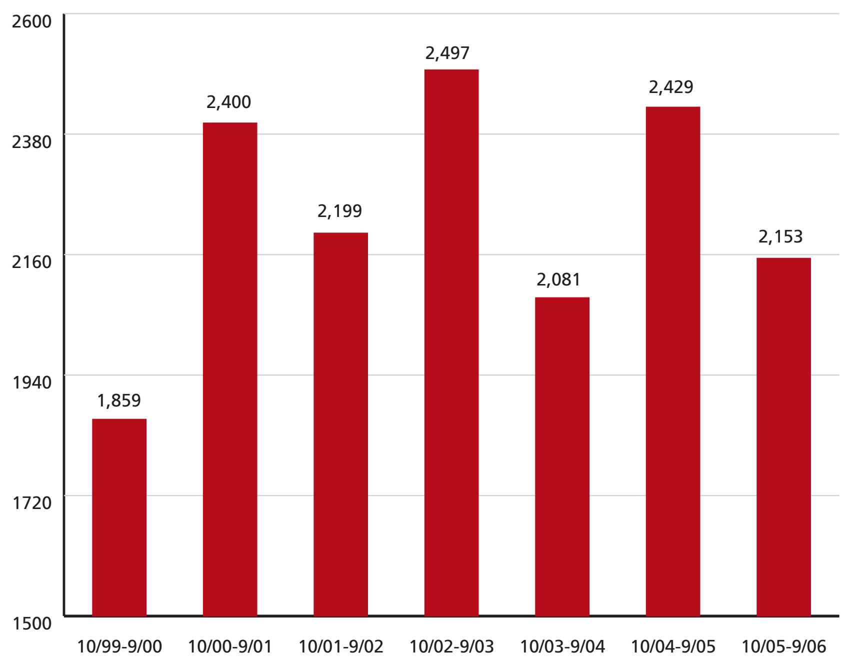
Client Push Back. In 2001, there was less "push back" from clients regarding firm rates and billing practices than there is today. The widespread use of RFPs for legal services, the growing client perception that some types of legal work previously thought to be highly complex (like project finance) have now become routine and should be priced accordingly, the involvement of corporate procurement departments in outside counsel selection, client insistence on multiple-year rates or other kinds of rate freezes or discounts, and the ongoing patterns of "convergence" will make it more difficult for firms to grow their way out of the present slowdown with rate increases. This does not mean, of course, that firms will be reluctant to try and increase their rates this year. Indeed, *The American Lawyer* survey of leaders of Am Law 200 firms conducted this past fall reported that 99 percent of respondents planned to raise their firms' rates in 2008, and that almost two-thirds planned to raise rates by more then 5 percent (the largest proportion since the survey started asking the question in 2003).[5] It remains to be seen, however, whether firms will reap the full benefits of these increases. As described above, the trends in realization rates suggest they will not.

The Challenge of Laterals. In 2001, most partners in most law firms were "homegrown." Today, laterals make up a higher percentage of the partnership ranks of most firms, and in many firms the laterals even outnumber the "natives." This change reflects the cumulative effect of lateral partner movements among large law firms. As shown in Chart 4 below, the number of lateral partner moves within Am Law 200 firms over the past seven years has averaged 2,231 per year, ranging from a low of 1,859 in 2000 to a high of

[5] "Firm Leaders Survey – *Fog* Advisory," *The American Lawyer*, Dec. 2007, at 113, 116.

2,497 in 2003.[6] The impact of this lateral movement is reflected in Chart 5 below, which indicates the average percentage of new equity partners who have been "homegrown" – i.e., promoted up from the associate ranks – as opposed to those who have come through lateral moves, for the Citi Private Bank Law Watch firms during the same seven-year period (2000-2006). Note that the percentages are the same for both "higher profit firms" and "lower profit firms"[7] – 52 percent of new partners are "homegrown" and 48 percent are laterals.

Chart 4 – Lateral Partner Moves Among Am Law 200 Firms



Source: ALM Lateral Report, published in Feb. 2003-2007

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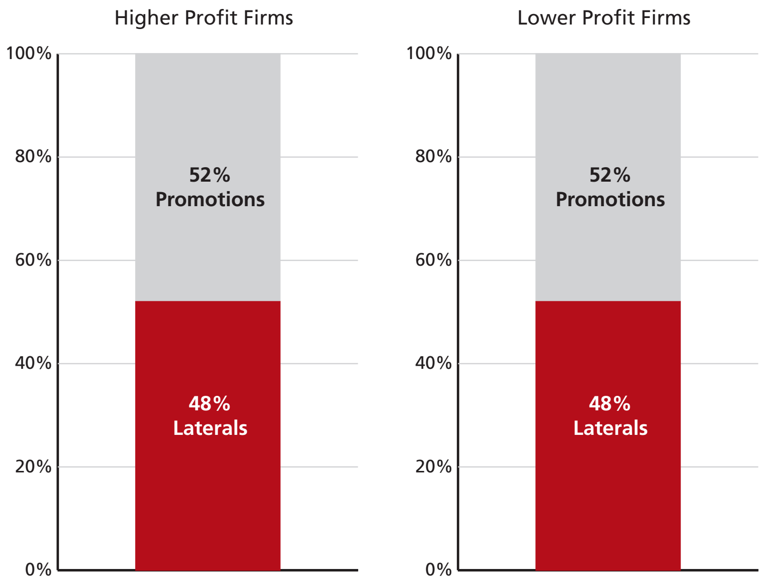
[6] The ALM Lateral Report uses an annual reporting period from October 1 of each year to the following September 30. Hence, data that we refer to as "2000" data actually reflects firm figures from October 1 of the preceding year through September 30, 2000.

[7] For these purposes, "higher profit firms" are defined as those firms having profits per equity partner ("PPEP") equal to or greater than $500,000 in 2000, and "lower profit firms" are defined as those firms having PPEP less than $500,000 in 2000.

Chart 5 – Average Percentages of New Equity Partners Resulting from Promotions vs. Lateral Acquisitions (2000-2006)



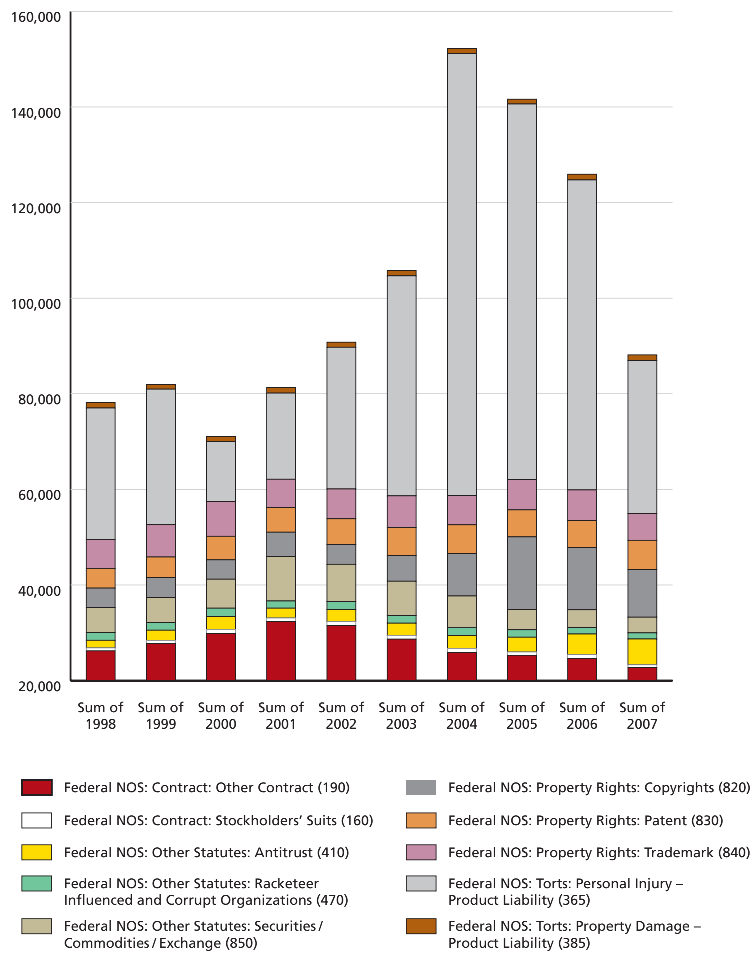
Source: Citi Private Bank Law Watch

History has shown that in tough times it is often the laterals who bolt for the door first, a pattern that could be exacerbated in the present climate by the presence in many firms of a large group of demoralized and disaffected former equity partners (the "de-equitized"). For a number of higher profit firms, a substantial amount of their lateral equity partner growth has been in overseas offices, thus making full integration into the firm even more challenging and the risks even higher.

Offsetting Practices. And finally, in 2001, firms had certain practices that increased, in part as a result of the economic downturn, thus offsetting some of the detrimental effects of the overall slowdown in economic activity. For many firms, this was certainly true of litigation which did not suffer (and indeed benefited) from the slowdown. But the economic downturn itself also generated a new wave of regulatory activity in the form of the Sarbanes-Oxley Act and related statutes, regulations, and investigations that spawned a burst of legal activity just when it was needed most.

As previously noted, in the current climate, litigation has softened at the same time as finance and transactional work, and there has not yet been any significant upturn in legal work resulting from the economic downturn (with the possible exception of residential real estate foreclosures).[8] Chart 6 below shows the downturn in litigation, as measured in federal court filings in selected subject areas over the past few years.

Chart 6 – Federal Court New Case Filings in Selected Subject Areas[9]



Source: Thomson West Litigation Monitor

[8] There is some evidence that significant litigation may be looming on the horizon as a result of the sub-prime mortgage crisis, as indicated by recent lawsuits filed by the cities of Baltimore and Cleveland against a number of banks and the ongoing investigations by the New York Attorney General and others of the practices of investment bankers related to the crisis. See "If Everyone's Finger-Pointing, Who's to Blame?" *The New York Times*, Jan. 22, 2008, at C1. To date, however, most firms have not yet seen a general upturn in their litigation practices related to these potential cases.

[9] This chart shows total new cases filed in the federal courts from 1998 through 2007 in selected subject areas of importance to major law firms. These areas include: product liability; IP (trademark, patent, and copyright); securities and commodities; antitrust; stockholders' suits; other contract cases; and related RICO claims.

Favorable Factors. To be sure, there are some factors that are more favorable today than in 2001. For one, firms today are generally carrying less debt than seven years ago, thus reducing their downside exposure. Although this advantage may be offset by other expenses that are rising at faster rates than in 2001, the relatively lower level of firm debt is obviously a positive.

On the expense side, while law firm expenses have generally been rising at a faster rate than revenues, there has been one bright spot in the area of strategic expense control. Firms that have, over the past year or so, undertaken major initiatives to review and restructure their own procurement processes for goods and services have achieved significant expense reductions. Indeed, the Hildebrandt strategic sourcing and procurement practice reports that its 17 current firms have realized savings of $40 million in the past year alone.

And finally, firms today are more diversified than they were in 2001, both in terms of practices and geography. This creates more likelihood of pockets of continuing (or even increasing) activity that might offset the slowing of traditional finance, corporate, and litigation practices. As noted elsewhere in this Advisory, this may be particularly true of foreign offices and practices.

Obviously, the current downturn will not affect all firms equally. Firms with large structured finance practices, for example, are hurting more than others. However, given the "perfect storm" nature of the current slowdown, it is likely to have broad impact across the profession. And, as noted above, in 2008, the industry does not have some of the tools that were available to assist the recovery in 2001. Hence, the duration of the current slowdown could be longer than the one experienced seven years ago.

Of course, the market can change quickly, and we may yet see a burst of legal activity arising from the current downturn – litigation, new regulatory schemes, bankruptcy and reorganization work, etc. Given the factors discussed above, however, as well as the current economic and political uncertainties in the market, we believe it would be prudent for leaders and managers of law firms to assume that the current economic slowdown is likely to have a detrimental impact throughout 2008.

The Challenge of Managing Expectations

Based on numbers reported by Citi Private Bank Law Watch firms through the third quarter, we believe that firms finished 2007 at or slightly above our predictions of overall revenue growth in the 8 to 10 percent range and net income growth in the 7 to 9 percent range. Clearly, 2007 must be regarded as a good year in the industry – a result that is largely attributable to the extraordinarily good numbers we saw in the first half of the year. As noted above, however, the year 2008 is likely to be much weaker. We expect overall revenue growth in 2008 will be in the 6 to 8 percent range, with net income rising only 3 to 5 percent.[10] And firms with large capital markets practices – particularly in structured finance – could experience actual declines.

The average growth rates that we forecast for 2008 would certainly be healthy for most other industries. But in the legal industry – coming off six years of annual double-digit growth – these results are likely to create concern among many partners, particularly younger partners whose expectations have been set during the recent period of economic expansion. This is particularly true because the process by which most firms distribute a large portion of partnership income at year end will tend to mask the effects of the dramatic downturn experienced in the market during the second half of last year. Many partners will receive their year-end payments believing their firms just completed very strong years when, in reality, the financial strength of the past year was largely concentrated in the first six months.

The management challenge for the current year is thus one of managing the expectations of partners while keeping an eye on the fundamentals of the firm's business. The key message that management needs to get out is that 2008 is likely to look a lot like 2001. This point was driven home recently by the managing partner of one major New York firm who observed that his firm's net income was up 25 percent in 2007, but that he expected net income in 2008 to decline by an almost equal amount.

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[10] By comparison, in Citi Private Bank's recent *Law Watch Managing Partner Confidence Index,* a measurement of the relative optimism of more than 100 managing partners of US law firms, respondents predicted overall revenue growth in 2008 in the 5 to 10 percent range and net income growth in the 3 to 5 percent range.

It is, of course, helpful to remember that the legal industry – like every other industry in a market economy – is subject to the swings of the business cycle. In the past, however, the legal market has been somewhat shielded from some of the worst effects of cyclical swings by offsetting practices – *e.g.*, with bankruptcy work or litigation replacing transactional work in periods of economic slowdowns. For a variety of reasons (as discussed above), those anti-cyclical factors may not be working as well in the current environment. Still, since the problem is one closely related to the business cycle, it is important to remember that it will not last forever. Thus, firms should be careful not to make rash or short-sighted decisions.

One area of temptation may be on the personnel side. While some firms may have to trim their associate ranks – and while many firms will undoubtedly ratchet up their performance standards in an effort to weed out "low performers" – cutting too deeply into the associate population can run the risk of leaving serious gaps that will have to be filled when the economy improves. And past history teaches that filling those gaps in an improving market can be a very costly proposition. Rather than trimming associate ranks, firms might consider (finally) redesigning associate compensation systems to be more incentive and merit based and to move away from the illogical "lock step" mentality of ever increasing levels of base compensation without differentiation for the firm's needs or individual performance. We have long observed that law firms are one of the few remaining professional service businesses that have not transitioned their employee professionals to genuine merit-based compensation systems, although we are now beginning to see some evidence of such transition, especially among small and mid-sized firms.

Some firms may also be tempted to accelerate their "de-equitization" programs (assuming they still have under-performing equity partners). In our view, this is usually a bad idea. First, another round of demoting partners will only expand the ranks of disengaged and disgruntled people – not a healthy scenario in economically challenged times. And second, as shown in Chart 3 above, the real problem in many firms is very low productivity in the ranks of income partners, counsel, and other permanent non-partner lawyers. In many cases, careful trimming in those existing ranks may be more likely to produce greater short-term and long-term benefits than further "de-equitizations."

In periods of economic downturn, there is always a temptation to cut expenses, and the first expenses to be trimmed in many law firms relate to marketing and client relations. While we believe that some marketing and branding efforts have been misguided and highly wasteful, a period of economic slowdown is, in our view, precisely the wrong time to be trimming marketing and client relations budgets. As noted below, the competition to win and keep clients is intensifying, notwithstanding the downturn, and firms would be well advised not to be "penny wise and pound foolish" in this area.

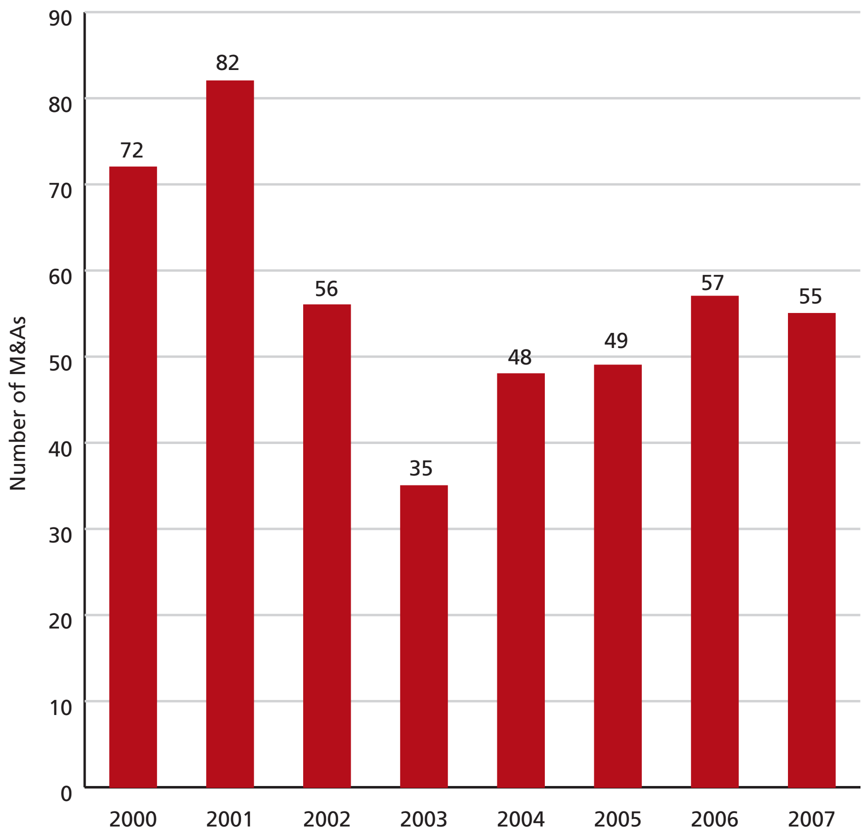
The final area where firms should resist the temptation for major cost cutting is in talent management. As noted below, the challenge of managing the human capital of law firms remains as serious as ever, and law firms continue to trail most other professional service businesses in both their training commitment and investment in human resources. Professional development will become even more important as generational changes kick in over the next few years. Particularly with the high number of laterals in most firms today, attention to enhancing the "glue" that holds people together – particularly in times of economic challenge – is more important than ever.

Other Key Trends and Observations

While the primary attention of the legal market in 2008 will be focused on the economic concerns described above, four other areas deserve special mention.

Continued Consolidation and Segmentation of the Market. During 2007, consolidation activity continued apace in the legal market, and it seems likely that this will continue in 2008. Indeed, there are signs that some firms may be adopting a merger strategy in an effort to grow their way into profitability. Chart 7 below shows the merger activity in the US legal market during 2007 and compares it to similar activity over the past few years. As indicated, there were 55 mergers involving US law firms during the past year, roughly similar to the preceding three years – 48 in 2004, 49 in 2005, and 57 in 2006 – though considerably less than in 2000 and 2001.

Chart 7 – Completed US Law Firm Mergers & Acquisitions (2000-2007)*



* Includes mergers where smaller firm had at least five lawyers.

Source: Hildebrandt International

There were 19 reported dissolutions of law firms in the US during 2007, up from the 9 reported in 2006, and the highest number we have seen in recent years. We may well see a further upturn in that number during 2008, as firms struggle with changing economic realities and the dynamics of a rapidly segmenting market. Of course, some firms may elect to merge (*i.e.* to be acquired) instead of dissolving, resulting in a *de facto* dissolution. But the point remains that, going into the year, we have seen a number of firms struggling to maintain profitability that has been propped up in the past by dubious practices and suspect growth strategies that will be very hard to maintain in 2008.

And as regards segmentation, there is strong evidence that the market continued to segment during 2007, with large firms growing more quickly and with the most profitable firms continuing to pull away from others across markets. From 1997 through 2007, the size of the average NLJ 250 firm grew by 70 percent, from 302 to 513. During that same period, however, the average size of the largest 20 US firms increased by 113 percent, from 815 to 1,739.[11] Of course, size per se does not guarantee either quality or profitability (though some firms appear to believe it does), but these figures do suggest that the gap between the largest firms and the next tier down is expanding rapidly and that firms not already competitive at the top level will find it increasingly difficult to move up into that tier.

One interesting side story relating to law firm expansion during the past year was the lifting of restrictions on non-lawyer ownership of equity interests in law firms in Australia and the United Kingdom. In Australia, the national personal injury firm Slater & Gordon became the first law firm in the world to be listed on a public stock exchange, an event made possible by changes in the laws governing the legal profession in the states of Victoria, New South Wales, Western Australia, and (soon) Queensland. And, in October 2007, Royal Assent was given to a new legal services statute that opens law firms in the UK to outside ownership as well. Whether firms elect to take advantage of these new opportunities remains to be seen, and whether the changes will have any impact on the US legal market is far from certain. But the changes themselves provide further evidence that the traditional law firm model continues to evolve to meet changing market conditions.

Continued Global Expansion. The push toward globalization continued unabated in 2007. Although the number of US firms with foreign offices remained fairly stable – 106 among NLJ 250 firms as compared to 105 in both 2005 and 2006 — there were 35 new international offices opened by NLJ 250 firms during the year.[12] More importantly, however, there was an 11 percent increase in the total number of lawyers practicing in foreign offices of NLJ 250 firms – 15,231 in 2007, compared to 13,707 in 2006.[13] We expect that this push toward globalization will continue apace during 2008, in part stimulated

[11] Sources: NLJ 250 (1997 and 2007), and Hildebrandt International.

[12] Sources: NLJ 250 (2005, 2006, and 2007).

[13] *Id.*

by the economic downturn in the US domestic market and the growing attractiveness of a number of foreign markets, including China in particular.

Interestingly, in the most successful firms, the drive for globalization is shifting into a new dimension – true integration of services and standards on a worldwide basis in genuine efforts to create the "one-firm firm." This reflects the important realization that such integration is critical to meeting the needs and expectations of clients and that accomplishing it is no easy matter. There is growing recognition that achieving true integration across global offices is not about trying to impose a single culture, but rather harmonizing many cultures around a shared sense of core values and a consistent approach to client service. Firms that are able to accomplish integration in this sense will have a significant competitive advantage in the global market.

And speaking of competitive advantage, for the first time this year, we have begun to see *some* evidence of the potential economic benefits of global geographic diversity. If you consider the 58 "higher profit firms" covered by the Citi Private Bank Law Watch,[14] and break those firms into three groups – "superior performers" (those firms that, in aggregate, grew PPEP by 12.6 percent per annum since 2000), "average performers" (those firms that, in aggregate, grew PPEP by 6.2 percent per annum since 2000), and "under performers" (those firms that, in aggregate, grew PPEP by 3.5 percent per annum since 2000) – an analysis of their geographic diversity is quite interesting. Among the "superior performer" firms, on average, 17 percent of their lawyers are based outside the US, whereas among the "average performers" that number is 14 percent, and among the "under performers" it is 7 percent.

While these numbers certainly do not prove that geographic diversity in global markets causes higher law firm profits, they do indicate a positive correlation between such diversity and profitability, and logic would suggest that geographic diversity in a firm's practice could provide a cushion against economic slowdowns in particular countries. This is a factor that we will be watching closely in 2008.

[14] For the definition of "higher profit firms," see note 3 above.

Client Demands and Expectations. Corporate general counsels participating in the 2007 Hildebrandt Law Department Survey[15] ("HLDS") reported an increase in legal spending of 6 percent (the low end of the 6 to 7 percent range reported in each of the past few years). At the same time, respondents reported an overall decline in the number of matters handled by outside counsel, reflecting ongoing convergence efforts.

Key points of interest emerging from the 2007 HLDS included the following:

- Over half of the survey respondents (54 percent) reported that they are engaged in convergence activities. Some 24 percent indicated that they have recently completed convergence programs, another 24 percent said they have such programs in progress, and 6 percent reported that they are planning such programs.
- Interestingly, nearly 40 percent of HLDS respondents anticipated an increase in demand for international legal services, with many noting a particular demand for securities and antitrust services in Europe. An increase in international litigation demand (including arbitration) was also mentioned.
- Other areas where corporate general counsels expect growth include contracts, M&A, general regulatory, and IP (particularly patent litigation).
- HLDS respondents reported more use of off-shore providers for various kinds of legal processes, including discovery management.
- Respondents also reported a serious move toward e-billing and a newly declared willingness to experiment with alternative pricing and fee arrangements. (Although we remain skeptical that clients will really be willing to move significantly away from the traditional billable hour model, it is possible that economic pressures in 2008 will make corporate counsel more amenable to considering alternative pricing strategies.)

We suspect that in 2008, firms will see their corporate clients continue to push back on rate increases – through use of volume, matter, and activity-based discounts; blended hourly rates; and multi-year fee arrangements. We may

[15] The annual *Hildebrandt Law Department Survey* covers more large US law departments than any other benchmarking survey. It provides a comprehensive view of trends involving law department spending, staffing, management, and compensation. The 2007 Survey included 202 companies, of which 66 percent had annual revenues of $6 billion or more. The median-sized company included in the Survey had over $10 billion in annual revenues, some 20,000 employees, and a US law department with nearly 30 lawyers and 60 total staff, incurring almost $30 million in total legal spending. Data for HLDS is collected from March through June every year, with the results being released in September. Accordingly, the information included in the 2007 HLDS reflects year-end 2006 data of the companies reporting.

also see a push toward project pricing, which has become a growing trend in Europe and Asia even for complex transactional matters such as M&A work. That said, however, we also expect that there will be another round of significant rate increases in the US and that, at the end of the day, most clients will accept them.

Managing Human Capital. During the past year, firms continued to struggle with the challenge of managing their human capital, and that task is not likely to be easier in 2008. Indeed, as previously noted, managing expectations and maintaining the "glue" that holds firms together are more challenging than ever in times of economic slowdown. The current year is a time for firm leaders to remember that, despite their growing size and complexity, law firms are still essentially "partnerships" (whatever their formal structures) made up of highly independent and autonomously minded individuals who cannot be treated as employees in a "corporate" organization. The keys to managing successfully through the current year will likely include frequent and open communication with partners, setting realistic expectations based on economic realities, providing reassurance to partners whose practices may be hard hit by the current downturn, reminding everyone that no phase of the business cycle lasts forever, and maintaining the flexibility to take advantage of new practice opportunities that may arise.

Conclusion

While this is our first "downbeat" Client Advisory since we predicted the economic slowdown of 1998, it is important to keep the present report in perspective. The legal profession is extremely resilient, and the demand for legal services will undoubtedly continue to grow, albeit perhaps at a somewhat slower pace. The growth rates that we predict for 2008 – 6 to 8 percent for overall revenues and 3 to 5 percent for net income – are by no means bad. Indeed, as noted earlier, they would be viewed as quite healthy in most industries. It is only against the extraordinary run of the last six years in the legal market (with overall double-digit growth on an annual basis) that these figures may seem somewhat disappointing.

Certainly, the current year will have its challenges. Competition at all levels – global, domestic, regional, and local – will continue to intensify. Some firms that have grown too fast or opened offices in locations with challenging economics may be forced to make painful adjustments. And a number of firms may find it necessary to address continuing issues of low productivity, particularly within the ranks of permanent non-equity partner lawyers. But, with careful and sensitive management and with particular attention to "people issues," we believe that most firms will experience a relatively good year, even if overall annual revenue and profit growth is less than in the immediate past.

As always, we stand ready to assist our clients in meeting these challenges. Best wishes to you and your firm for a successful 2008.

For additional information:

For Hildebrandt International – please visit **hildebrandt.com** or call **800-223-0937** (US) or **+44 (0) 207 307 0600** (UK).

For the Law Firm Group of Citi Private Bank, please contact Dan DiPietro, Client Head at 212-559-8645 or dan.dipietro@citi.com.

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