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Leases and Law Firm Mergers

Law Firm Management

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When it comes to law firm mergers, the focus often is on a "book of business," with real estate viewed as a mop-up item. But law firm mergers frequently occur in a business climate of high rents and costly tenant improvements. And office space has always been a significant component of law firm overhead, second only to salaries.

With significant resources tied up in a firm's office space, the financial success of a merger (or downsizing) can hinge on how the real estate pencils out. The impact can be dramatic: Getting the real estate value wrong can hurt a firm's future profitability, if not destroy it entirely. Taking a systematic approach to the issue will help produce a successful outcome. The sooner people know an established methodology will be used, the sooner they can join in the process. The evaluation should take into account a number of factors: Can either (or both) of the existing locations accommodate the larger merged entity? Does the site have sufficient expansion capability to accommodate growth throughout the term of the existing lease? Will the takeover of an existing lease constitute a sublease or an assignment under the terms of the lease? Are there any disposition issues associated with any sites that must be vacated?

If a consolidated occupancy is feasible, the parties must engage in detailed analysis of the logistics of fitting the merged firm into the space. This occupancy analysis should include a floor-by-floor plan of the building and an assessment of expansion possibilities. This should be followed by a thorough examination of the infrastructure at the existing site and a detailed study of the fit-out costs to accommodate the merged entity. Only after all these matters have been addressed can the new firm decide if remaining in the current site is truly optimal.
If neither location can house the new entity, the parties must search for new quarters. Such a search starts with developing a list of requirements, which may present a significant challenge for a brand new firm with no baseline of historical growth. Thus the parties need to make considered projections for three-, five-, and ten-year growth scenarios, and adjust the search for sites that meet those criteria, no matter how speculative the exercise.

Once a relatively accurate program is arrived at, the succeeding phases can proceed in straightforward fashion, with site surveys, tours, test fits, infrastructure analysis, occupancy-cost comparisons, and negotiation of a final deal. Key players in the process will face the inevitable temptation to find shortcuts in an effort to secure a deal quickly. But that temptation should be resisted: Merged entity or not, the new firm will live with the consequences of a poorly executed site strategy for the life of the new lease--and perhaps beyond.

The merged entity also needs to develop a disposition strategy for any surplus space. The cost of carrying unproductive space can easily outstrip the savings generated by consolidation and elimination of redundant operations and personnel. Several critical questions need to be answered: Will the landlord consider terminating the lease(s)? Are there cancellation provisions in the lease(s) for the disposition property? Are there associated penalties? How much sublease

income can be generated by this space given market conditions? These issues should be investigated with the landlord prior to implementing a disposition plan.

The parties may also encounter personnel issues that affect space planning. For example, consider a midsize law firm that had recently outgrown its current location in a downtown metropolitan area--and also needed to find enough space to accommodate several new practice groups. Though the new site was perfectly suited for the space needs of the growing law firm, it did not have enough corner offices to accommodate the now larger number of senior partners. The resulting "space squeeze" created quite a stir during the planning and design stage. The solution? The planners converted all corner office space into conference rooms to make "corner office competition" a nonissue. With none for any of the senior partners, the move went smoothly.

For the people assigned to oversee the real estate aspect of a merger, taking the necessary steps will help promote profitability and produce reasonable, defendable decisions, both of which are necessary when dealing with a large number of equity partners. If the real estate consolidation plan is formulated and executed correctly, a new firm can be well on the road to success from day one.

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