MADRID REPORT 2010: REINVENTING THE LEGAL MARKET

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The Madrid legal market remains in transition, say the capital's lawyers. The past year has continued to be challenging, but firms have begun to put into effect strategies that they hope will see them overcome the economic downturn and leave them stronger, more streamlined and efficient for when the upturn comes.

El mercado jurídico en Madrid permanece activo aun con la prolongación de la crisis económica. Sin embargo, los socios directores afirman que hay mucha incertidumbre. Las firmas continúan adaptando su modelo de servicios jurídicos para mantener resultados. La presión en los honorarios es una constante, por lo que muchos están esforzándose en determinar dónde recae el valor añadido en las transacciones e incluso intentan definir a qué tipo de cuestiones quieren enfocar su práctica jurídica.

Firms face slow transactional markets, moribund capital markets and still difficult banking and finance markets. Managing Partners readily admit therefore to undertaking a period of reflection in order to attain the best shape and structure to enable their firms to adapt to the new market scenarios.

"There is clearly less international investor interest in Spain. Clients have reduced budgets and the market is experiencing a degree of fee pressure that has not been felt for many years," says Pedro Pérez-Llorca, Managing Partner of Pérez-Llorca.

But that is not to say that firms, or at at least some practices areas, are not busy. Almost all report that restructuring and finance, bankruptcy and insolvency, litigation and labour practices now dominate work loads, while areas such as IP, IT, public law, competition and tax are consistently busy.

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Management issues

Madrid remains Spain's hub for the business, financial and the public sectors, and a springboard for many European companies into Latin America, but all aspects of the economy – and firms' workloads – continue to be affected by the downturn, say Managing Partners.

"We have had to adjust to clients' situations by undertaking various strategies. At Garrigues we have gradually adapted a new cost structure but without the need however for extreme decisions – such as massive layoffs," says the firm's co-Managing Partner Fernando Vives.

Even while the economy was collapsing around them some law firms may have continued to post record revenues, as a result of ongoing mandates and delays in receiving payments for past work, but all law firms have now had to take a critical look at their management processes and to adapt to the reality outside their windows. As the tsunami hit the economy some firms were still posting record profits from the previous year's income – which may have delayed many from taking action quickly enough, say Managing Partners.

"The key is to adapt to the prevailing economic environment, align partners' objectives and remain focused on the needs of clients. This is an issue that should not change. The most important thing for any company – and we are not an exception – is to have a strategy. But this is only half of the challenge, obviously. Once you have the strategy, it has to be implemented," says Manuel Martín, Managing Partner of Gómez-Acebo & Pombo.

His firm, like most, is now focused on maintaining work levels, the right practice balance, managing costs, utilisation rates and lock up, and to maintain optimum levels of profitability. The crisis has not therefore fundamentally changed the way law firms operate but it has made certain issues more acute.

In line with prior market trends, the predominant management emphasis is largely twofold, says Luis de Carlos, Co-Managing Partner of Uría Menéndez.

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“First, as companies are being put under increasing pressure due to the economic downturn, law firms have more than ever had to boost the quality of their legal advice and provide value-added services, and second, continue to attract and maintain talent as one of the main drivers to any firm's success.”

Office size is an important factor in the current market, say many. Large firms may have sought to reduce numbers tactfully, through natural attrition and encouraging some junior lawyers or partners to join clients or retire, but this may still leave some with too many lawyers, or at least too many of the wrong type of lawyer.

Some suggest they are therefore in a more fortunate position. “We have found ourselves in a unique situation. We were able to build up an office with the size and shape we believe adequate in the current environment. As a result, we are not facing the same management issues that others may be experiencing,” says Nicolás Martín a Partner with Herbert Smith in Madrid, which opened in Madrid in early 2009.

Broseta is another firm that has expanded in a shrinking market. Having opened in Madrid at the start of the crisis in 2007, it now counts around 30 lawyers including five partners. “Small and medium-sized firms need to become stronger and bigger, either to be prepared for new and future challenges or as a defensive move in the current market environment,” says partner Julio Veloso.

A prevailing belief is that in more cost-conscious times smaller firms, of sufficient quality, are able to offer clients more efficient services and maintain better utilisation rates given their reduced overheads and lower cost structure. However some question whether this is in fact happening as company lawyers retain a preference for large law firms or the best-known brands.

“Executives would prefer to remain in the comfort zone even though they know that there are alternatives. It's easier to say respond ‘what else could I do, we hired the “best” firm out there’,” says Calvin Hamilton of boutique Hamilton Abogados.

At the same time, General Counsel suggest, off the record, that it is the biggest firms that are heavily reducing their prices. Cost is clearly relevant but ultimately the issue for smaller firms, especially those relatively new in the market, is one of trust.

“It is not only a matter of lowering rates, which larger law firm are already doing, but rather a question of closeness to the clients' real problems,” says Pedro Hernandez-Echevarría, lead partner at Hernández-Echevarría Abogados, formed in 2009 by former Cuatrecasas and Clifford Chance Senior Associates. “You must also offer full-time dedication to the client and his case, by the partner

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and at reasonable fees, and not only concentrate on the big transactions."

Exaggerated

The Spanish economy may still be suffering but it has not experienced the "meltdown" that some had predicted following the Greek crisis last year. Law firm leaders emphasise that while the crisis affects everyone its impact should not be exaggerated.

"The comparison between Greece and Spain has never been realistic. It has been more of a media creation than a reflection of the economic reality," says Manuel Martin at Gómez-Acebo & Pombo.

This is not the first crisis that Madrid's law firms have faced, say many. Despite the day-to-day challenges firms have to maintain a strategy and believe that they can see light at the end of the tunnel. Some are however more optimistic than others over the prospect of economic improvement happening sooner rather than later.

"The economy is expected to grow in 2011. There are signs of recovery although we are not exempt of uncertainties. The M&A market, for instance, has shown signs of improvement in the first quarter of 2010 and even greater movement has been seen again in recent weeks," says Vives at Garrigues.

Spain has over the past year seen the merger of many of its savings banks (cajas de ahorro), as they have sought comfort or rescue in the face of heavy exposure to the collapse of Spain's real estate market and company insolvencies, which has brought transactional and regulatory mandates to many firms. This process has however been predominantly auditor rather than law firm-led, with the winners evidently the legal arms of the accountancy firms and some national giants – particularly Garrigues – but also a number of finance and tax-led practices, such as Freshfields Bruckhaus Deringer.

Others point also to more positive signs of private equity activity. "We are noticing a gradual recovery in the market with key players such as the private equity houses moving again to new investments and acquisitions. Notwithstanding this, the recovery remains relatively weak and slow with sharp changes from one month to another," says Juan Barona, partner with Allen & Overy in Madrid.

The strength of the downturn and the prospect of continuing difficult times ahead for companies, as well as the need for some funds to realise existing investments, mean that sellers are more readily appearing in the market, says Francisco Pérez-Crespo, who leads the Madrid office of Cuatrecasas Gonçalves Pereira.

"Alongside industrial companies in transactions we now see private equity buyers emerging . There is a sense that companies are getting cheaper and that the opportunity exists for some private equity houses to again look to build up their portfolios."

Others though remain more pessimistic about the rate of Spain's economic recovery. "The economy is indeed going through a difficult and challenging period. It is most probable that we won't see significant growth at least until 2012," says Luis de Carlos, Co-Managing Partner of Uría Menéndez.

Even more difficult times may yet be around the corner, believe others. "The second half of this year is going to be the worst so far. Spain has not yet suffered the full impact of the crisis because wrong policy measures had the effect of merely postponing and aggravating it," says Carlos Pazos, Mananging Partner of SJ Berwin in Madrid.

Michael J. Willisch, Head of the Madrid Office of Davis Polk & Wardwell, agrees: "In the coming months we´ll see whether the market decides if the Spanish Government's austerity plan is nothing more than a Potemkin village. If it does, I fear the nascent recovery currently underway could come to a halt."

New business

The challenge for law firms therefore remains to seek out new business and to maintain sufficiently close, and flexible, ties to existing clients. For many this means re-orientating from a past focus on inbound foreign clients to a more domestic focus, with others investing in sales training for their lawyers for the first time.

"In some practices we are 50% busier than we were last year and across the board our utilisation rates are 10% up. I am not however sure that all of this is the result of a general market upturn. We have had to refocus our practices and what this tells me is that we are doing something right," says Pérez-Llorca.

Firms may be seeing lawyers getting busier but this is not necessarily reflected in higher revenues. Most companies have reviewed their legal processes, are reducing the number of external advisers, and are asking those that remain to work more closely with in-house legal teams and for more innovative pricing systems. The final bill should relate more closely to the value of the transaction or the level of advice given by lawyers.

But despite the acuteness of the issue, fee pressure has always been apparent, say Managing Partners.

"If we agree that it is only now when we are seeing pressure then we are also saying that we were not doing a proper job during the years of prosperity," says Martín at Gómez-Acebo & Pombo.

But law firms have had to rethink the way they do things and to search for new tools and methodologies to work more efficiently and to demonstrate that they can add something more than mere legal advice to clients' operations. Many are emphasising however that it is much easier to be flexible with clients when there is a longstanding relationship.

"Our view is that clients are not just there for 'one deal' but are business partners for whom we want to advise for many years," says Luis Riesgo, Managing Partner at Jones Day in Madrid, who will soon relocate to launch the firm's Brazil operations.

The downturn has however prompted some firms to make significant investments in information technology and client management systems, to provide more efficient services and to better cost legal work. "Clients want to be pretty sure of the final cost of any service. This requires that law firms adopt state-of-the-art project management tools and change their mind frame.

Instead of thinking in terms of billable hours they must think in terms of project management and costs control," says Serena Argente Escartín, who manages the Madrid office of Portuguese firm Raposo Bernardo.

Baker & McKenzie is among those making such investments. The firm has created work logs to more accurately price work and has established new global pricing arrangements to cover cross-border services, says the firm's Madrid Managing Partner Luis Briones.

"From a pricing point of view, new software and databases provide our lawyers with economic information regarding similar cases, which enables us to better identify cost comparisons and controls. Budgeting tools also allow us to provide clients with more precise cost estimates and different pricing models, as well as to monitor where deviations might occur."

Reinvention

The Capital's law firms have had to reinvent themselves in order to survive the downturn, and to ensure that they remain relevant when the upturn eventually comes. "We have been changing as little as we can, and as much as we have to," says Cliff Hendel at Araoz & Rueda.

The past year has continued to see mergers among small and medium-size law firms as well as the expansion into Madrid of international firms.

Gómez-Acebo & Pombo has been among those to add small teams to boost in-demand practices but has also expanded in Barcelona and launched in Lisbon earlier this year. "All these operations took place according to our established strategic plan, which has helped us to review our lines of business in both the medium- and long-term," says Manuel Martín.

Barcelona remains an area of emphasis for Madrid firms, as a number have looked to expand nationally and build a more solid – and perhaps more balanced – national platform. Corporate boutique Dutilh merged with Vialegis before the summer, to create a new 90-lawyer firm Vialegis Dutilh. Madrid's based technology-focused firm Ecija has also expanded its presence in the city with the integration of local firm Legal Link.

Such a move not only represents an opportunity to expand its capabilities in Spain's technology centre but is more fundamentally is recognition that the firm's niche remains in strong demand, says Álvaro Écija, co-Managing Partner of Ecija.

"We are seeing in Spain and worldwide that the clear winners emerging out of the current situation are those companies related to the technology, media and telecoms, life sciences and fast-moving consumer goods sectors. They have been enjoying steady growth in spite of the global economic situation and I believe they will continue to play a key role in the future."

Global law firm changes are also having an impact locally in Madrid. UK firm Lovells merged with US-based Hogan & Hartson, to create Hogan Lovells in May and subsequently the firm's Head of Dispute Resolution, José Luis Huerta, has taken over from José Maria Balaña who had led the office since its launch in 2004.

International interest is linked both to Spanish corporates' increased international expansion and a recognition that Madrid is now a major global business centre, connecting Europe and Latin America.

Hammonds is also currently in merger negotiations with US-based Squire Sanders & Dempsey. Certainly the market will see further consolidation, says Rafael Alonso, Managing Partner of Hammonds in Madrid. "Our multinational clients want to work with fewer firms, and much more with those that can demonstrate global depth and breadth. For that reason firms try to search for complementary unions that give comfort in all practices and offer a geographic spread – and obviously, from a finance point mergers also contribute to making us more competitive in terms of costs."

UK firm Watson Farley & Williams also this past year launched in Madrid, with a focus on project finance and renewables, as more recently has media and commercial firm Olswang.

Some lawyers question however whether these developments indicate that deep market changes are taking place. "In Spain there haven't been any significant structural changes among law firms that have affected the current legal market nor do we believe they will take place in the near future," says de Carlos at Uria Menendez. Carlos Pazos at SJ Berwin agrees: "More firms are moving wrongly to the low margin/high volume model which in my view is already overcrowded."

Attraction

The downturn may therefore be prompting Managing Partners to look more critically at their own businesses but many believe that major market changes will not come as a direct result of the current economic crisis.

“In the coming years we will see relevant changes but these will not be a consequence of the crisis, or at least not just because of the crisis, but a direct result of the natural evolution of the legal sector and the applicable regulations,” says Vives at Garrigues.

Market uncertainty is however the prevailing sentiment both within and outside of firms. Maintaining the motivation of firms’ junior lawyers is a recurring issue. “It can be a difficult task to manage unrest in teams due to low utilisation. The better the stallion is, the more nervous it gets when idle,” says Pazos, at SJ Berwin.

Firms have also to maintain the right balance between retaining confidence in their strengths but also to be open to new businesses and practice areas, says Iñaki Gabilondo, who this summer took over the Managing Partner at Freshfields Bruckhaus Deringer in Madrid, from Miguel Klingenberg. “In order to do this effectively, retaining the right people is key.”

Recruitment at the junior level remains however slow with consistent movement only evident in those anti-cyclical practices that most reflect the current economic mood. Off the record, some firms even admit to stopping new hires completely – a decision that some within them think may come to haunt them in better times.

“Our choice has been to maintain our best asset, our people. We have continued recruiting the same number of junior lawyers as during the good years. The lawyers that we educate now will be our senior lawyers and partners of the future,” says Ivan Delgado, corporate partner at Pérez-Llorca.

Madrid’s law firms may now be more streamlined, financials retreated to less sensational levels, and client mandates may be taking more effort to realise, but many Managing Partners take comfort that at least their structures are likely to be more sustainable.

“The situation in Spain has improved compared to a year ago. The economy is showing signs of growth and we are becoming more optimistic about the future. In addition, neighbouring countries are growing too, but any recovery will take longer than any of us would like,” says Luis Fernando Guerra, Managing Partner of Deloitte Abogados y Asesores Tributarios.

Challenges clearly remain, in ensuring that the bonds that hold both firm clients and lawyers together remains strong, but Managing Partners have proved ready and willing to make the changes that the market has demanded. The times continue to change and Madrid’s law firms with it.