Pillsbury Winthrop Shaw Pittman LLP

## Insolvency & Restructuring

**Richard Epling**
+1.212.858.1649
richard.epling@pillsburylaw.com

*Richard Epling is a New York partner in Pillsbury's Insolvency & Restructuring practice and a member of the firm's management board.*



This article first appeared in slightly modified form on
**Law.com**
March 5, 2008

# How Law Firms Can Stay Afloat When a Recession Strikes

by Richard Epling

No two recessions are ever alike, but the latest data suggests that a "perfect storm" may soon be upon us, leaving both clients and law firms seeking safe harbor in which to moor.

The recession of the mid-1970s occurred as a result of several factors: The U.S. government had racked up a trillion dollars in debt to pay for the Vietnam War, millions of manufacturing jobs were disappearing as the first signs of globalization emerged and gasoline shortages led to rationing and spiraling commodity prices. Shortages of basic commodities led to crippling inflation that did not abate fully until 1983.

Leveraged buyouts of large corporations at inflated prices financed by junk bonds were a trigger of the 1989 recession, putting thousands of Wall Street employees out of work. And while few lawyers may recall it now, subprime loans back then also played a role in the 2000 recession -- though, ultimately, the exposure of the credit markets to these instruments was relatively small and only marginally impacted the overall economy, which was more widely affected by overinvestment in dot-coms and other startup technology ventures.

So what's different about the downturn of 2008? Why are the problems in housing and mortgage-related markets spreading so fast and with such impact on the rest of the economy? Partly because globalization of the financial markets is now a fact of life and because corporate and investment banks are now one and the same. Thus, when lenders who plunged into Collateralized Debt Obligations (CDOs) were required to write those assets down or reserve against them on their balance sheets, the result was an impairment of the banks' capital, which led to a curtailment of liquidity for traditional lending activities in other sectors. The banks now must either raise new capital or seriously cut back on their lending activities generally, which is precisely what has occurred.

At the same time, monoline insurers of corporate and tax-exempt bonds had underpriced the risk of issuing credit enhancement guarantees to the CDO lenders and bondholders. The capital of these monoline insurers also has become impaired, resulting in a risk of downgrade of their credit rating by Moodys and Standard & Poor's. Such a downgrade of the insurers will cause a downgrade of all the insured bonds, including high-grade municipal and tax-exempt bonds in non-real estate sectors of the economy. The risk of unexpected deterioration in the credit quality of unrelated bonds hurts both the bond markets and bond investors. This uncertainty in the muni (and AAA corporate) bond markets spills over into the larger public bond markets, making it difficult for companies to sell new issues of corporate bonds or to roll over maturing bond debt, potentially creating defaults in business sectors far removed from real estate.

Law firms, particularly those whose revenues are closely tied to Wall Street, thus may find themselves wondering about the best way to weather (and even profit from) the storm. As a restructuring and insolvency attorney, I suggest law firms ask themselves the same questions I generally ask my clients facing a serious liquidity squeeze, as they apply equally well:

**Do we have the right business model?** In a downturn, it's good to have significant capabilities in practice areas not exposed to the capital markets or serve businesses that are relatively recession-proof. Energy and other commodity businesses are excellent during low markets, as demand for their products is relatively constant. Fields such as environmental law and intellectual property also continue relatively unaffected by upheavals in the capital markets, and of course countercyclical practices such as insolvency and workouts generally thrive.

**Are we diversified enough in our offerings?** At Pillsbury, we have one of the strongest real estate practices in the nation, and while we have seen a decline in some work in this sector, our experience advising universities, government entities and other clients less affected by the downturn on not only real estate but land use, preservation and related environmental matters continues to keep us busy. We also launched the nation's first multidisciplinary subprime mortgage industry group nearly a year ago, anticipating the significance of the meltdown, and we now are working with clients who are involved in related litigation, restructuring and investigations. The challenge, of course, lies in having built those capabilities prior to the downturn; otherwise, firms may find themselves trying to play catch-up, not an ideal position to be in given the increasingly competitive marketplace.

**Where can we cut costs or reduce overhead?** Do we have space we can rent out? Can we save money by changing vendors or outsourcing certain functions? Pillsbury is fortunate to have the world's top-ranked sourcing practice, and in 2007, we were able to draw on that team in helping us to outsource the firm's mail delivery, printing, reproduction and scanning services. We managed to keep those services in our physical offices for convenience, but transferred the work to an outside vendor, reducing costs by 28 percent. Recession or not, finding creative ways to reduce costs not only better positions firms in a downturn but also results in a steady rise in profitability.

**Are lawyers properly deployed in the correct business sectors?** To preserve service capabilities, you may be able to transition some lawyers to other practice areas. For example, corporate M&A or finance lawyers are quite valuable in restructuring if a troubled company is refinanced by its creditors or shareholders. Moreover, as the U.S. credit crunch grows worse, other markets are still doing well. At Pillsbury, for example, we have not only relocated some of our U.S. lawyers to our London office but, indeed, have hired new laterals and will continue to hire partners in London to meet ongoing demand in that marketplace and throughout the European Union.

According to a December 2007 Am Law Firm Leaders Survey, for the first time in five years, many law firm leaders anticipated declining revenues in 2008. While considering some of the questions above may limit such declines, it's



In a downturn, it's good to have significant capabilities in practice areas not exposed to the capital markets or serve businesses that are relatively recession-proof.

important to remember that while recessions may not all be the same -- and this one looks likely to have staying power and, therefore, be particularly challenging -- history demonstrates that the market always eventually bounces back and, in many instances, reaches new heights.

## How Law Firms Can Stay Afloat When a Recession Strikes