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Tony Williams and Richard Tromans of Jomati share their thoughts on the Legal Services Act.

The full powers of the Legal Services Act 2007 (LSA) are finally coming into force this October and its impact is dividing the profession. The prospect of consumer-focused entities, such as Co-Op Legal, becoming Alternative Business Structures (ABS) and building a national law firm offering reserved legal services quite rightly scares High Street lawyers. But, in the City there is a different mood. For many firms whose clients are large, sophisticated and with a legal spend in the millions, the threat of ABSs seems quite distant.

Equally, the opportunities of public listing and external investment, perhaps from private equity funds, seem to hold little excitement for many large City firms. The reason given is brutally simple, but perhaps accurate: "Why would any equity partner wish to reduce their share of the profits?" This is because external investors will demand a proportion of the annual profits too. Even if partners can cash in their 'ownership shares' in the future, the thought of changing the full distribution model is anathema to many. Although there are currently significant tax advantages to partners receiving capital gains taxed at 10% (using Entrepreneur Relief) as opposed to income taxed at 52%, this does not appear to be sufficient incentive to top tier firms to consider outside equity. Some however are considering their own structures to convert income into capital gains.

Proponents of the benefits of corporatising partnerships and taking external capital stress that an ABS will incentivise partners to stay at the firm, as their 'ownership share' will – hopefully - grow in value. Others suggest large City firms will find it easier to gain the capital they need to expand, building 'war chests' to go out head hunting. That may be true, but with confidence slowly returning to banks and law firms, Top 30 firms with revenues in the hundreds of millions of pounds are unlikely to need to float to attract sufficient cash to expand. Moreover, what would they do with this cash? The merger of two law firms is not a corporate transaction – firm A does not buy firm B. There are integration costs, but again not sufficient to demand an IPO to cover it. Although, for serial acquirers or consolidators the need for capital may be more pressing.

Gaining funds for a headhunting campaign may hold more water, but again, would a firm really need to expand by lateral hires so quickly it needs tens of millions in extra cash right away? One might also ask whether such rampant partner hiring was strategically wise.

And then there is the issue of law firms offering more than the law – making use of the Legal Disciplinary Partnership (LDP) measures, which are already partly in force. As we all know, MDPs have been tried before and Enron and Sarbanes-Oxley saw an end to large scale accountancy-owned law firms competing for top tier work. At present around 300 law firms, mostly below 25 partners, have become LDPs. Many have done so to promote non-lawyer managers into the partnership. But, this is not market shaping activity.

Client push back

On face value, at least in the City, it seems the LSA is a damp squib and not a Big Bang. But, there is another side to the story and it concerns the clients. The push-back on fees and growing revolt against paying high rates for process work has created new conditions.

There are a growing number of business minded law firms, such as Plexus Law and Irwin Mitchell, that see a market opportunity to use investment and economies of scale to build large process-focussed capability that could eat away at top 70 corporate and commercial firms' routine work. Despite what many law firms may have once led their clients to believe, large segments of their work are reducible to a process and are not bespoke, or needing a Magic Circle partner to oversee it. This 'soft underbelly' of the top UK firms is painfully exposed to those that can credibly offer a more efficient alternative, and external investment may provide the funds for such competitors to emerge.

"The push-back on fees has created new conditions."

The evidence that there is exposure here is shown by clients increasingly using legal process outsourcing companies. In response, even the top City firms are building their own process centres, such as in Northern Ireland, to reduce their costs of offering 'client-friendly' fees. With external investment more mid-tier firms with experience of process work could expand across all legal segments, selling clients the same process capability at lower rates and with more efficient systems. Such firms will have few partners and many paralegals – making it easier to pass savings onto clients. External funding will permit investment in better IT, allowing speedier delivery and document creation. Business development budgets will also be swelled.

These process firms have everything to gain and little to lose – apart from their investors' money. With careful management and selling a compelling 'story' to clients, they may very well succeed. Therefore, the LSA will be very important for the City, but perhaps not in the way we all once expected.

Jomati Consultants LLP **is a leading UK-based international management consultancy specialising in the legal profession. Jomati's services are designed to support law firms, barristers chambers and in-house legal departments. Jomati was founded by principal, Tony Williams, the former managing partner of Clifford Chance and Andersen Legal. Richard Tromans is head of research and a consultant at Jomati.**