WHITE PAPER

FREE AGENT DYSFUNCTION:

MANAGEMENT REALPOLITIK FOR U.S. LAW FIRMS

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INTRODUCTION

Despite their overwhelming share of the industry's revenues and profit,[1] it is an odd fact that during the past 20 years major law firms have been closing at an accelerating pace.[2] In Darwinian terms, one would expect the disappearance of an industry's weaker players by dissolution or absorption by the strong. While this is no doubt true in the legal industry, what is unique is that the mighty are not only falling, but falling with increasing frequency, and, often precipitously and (apparently) without warning. There is, of course, no shortage of analysis of this phenomenon. Much of the discussion dwells on how to adjust various aspects of the existing large firm[3] business model to achieve success, e.g., offering alternative billing arrangements to clients; adjusting methods of training and advancing lawyers; re-thinking historical paradigms for the hiring/recruitment of lawyers and their tenure with the law firm (or lack thereof); adopting alternative associate and partner compensation schemes; and/or "tiered" partnerships. In our view, this dialogue pre-supposes the continuation of the existing business model (albeit tinkered at the edges), and carries with it a plethora of historical assumptions and biases as to how a law firm should "be." In our view, more radical thinking is needed to fully appreciate an ongoing industry-wide dysfunction: That management doesn't necessarily run things, and survival as a going concern lies in the hands of a small subset of free agent partners who may or may not even have a formal management role.

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1 Comprised of nearly 175,000 law firms, the legal industry employs some 1,100,000 people with an annual payroll of almost $85 billion. See Economic Fact Sheet, Selected Statistics from the 2007 Economic Census, NAICS Code 541110 (Offices of lawyers) <factfinder.census.gov/servlet/SAFFEconFacts?_event=&geo_id=01000US&_geoContext=01000US&_street=&_county=&_cityTown=&_state=&_zip=&_lang=en&_sse=on&ActiveGeoDiv=&_useEV=&pctxt=bg&pgsl=010&_submenuId=business_2&ds_name=&_ci_nbr=&qr_name=&reg=null%3Anull&_key> . The industry is strikingly top heavy: roughly 6% of US lawyers, practicing in only the top 50 law firms, account for 28% of all revenues and 43% of all pre-tax profits. **See** Harvard Law School, Program on the Legal Profession, Analysis of the Legal Profession and Law Firms – Statistics, <www.law.harvard.edu/programs/plp/pages/statistics.php>.

2 In our view, the most prescient work in this area was prepared by The Hildebrandt Institute: **See** "Anatomy of Law Firm Failures 1998 – 2004," The Hildebrandt Institute, March 2004, <www.hildebrandt.com/PublicDocs/Doc_ID_1739_492004850218.pdf> (the "**2004 Hildebrandt Report**"); and "Update: Anatomy of Law Firm Failures," The Hildebrandt Institute, January 2009, <www.hildebrandt.com/Documents.aspx?Doc_ID=2750> (the "**2009 Hildebrandt Report**," and together with the 2004 Hildebrandt Report, the "**Hildebrandt Report(s)**").

3 In this report we focus on large law firms headquartered in the United States. In general terms, we define "**large firm**" to mean a law firm that has appeared on the AmLaw 200 at any time during our study period. We count the latter as the 23-year period from 1987 (the year in which Finley Kumble Wagner Underber Manley Myerson & Casey collapsed) to 2010. The "**AmLaw 200, AmLaw 100 and AmLaw 50**" refer to the THE AMERICAN LAWYER'S annual rankings of the same names. For information on THE AMERICAN LAWYER – a monthly publication dealing with the business of the most successful law firms across the U.S. and around the world - **See** <www.alm.com>.

"I THINK FINLEY KUMBLE IS THE WAVE OF THE FUTURE"[4]

In 1987 Finley Kumble Wagner Underber Manley Myerson & Casey – then one of the largest, most profitable and most powerful law firms in the world – collapsed in spectacular fashion.[5] Twenty three years after the fact, and although it was not quite what he had in mind, we believe that Harvey Myerson got it right: Finley Kumble indeed remains the essential touchstone for understanding the U.S. legal industry today because it managed to change the fundamental metric of large firm success from lawyering skill to law firm profitability.

From humble beginnings in 1968, Finley Kumble exploded onto the legal landscape over the ensuing 19 years, leaving behind fixed and immutable changes in the profession. While memories always soften with time, it can nevertheless be said with some accuracy that the practice of law was a more genteel matter in the time before Finley Kumble. Concepts that are anachronisms by today's standards were in fact de rigueur in pre-Finley days: a lawyer joined a law partnership for life, partner compensation was based heavily on seniority, one did not "raid" or "poach" talented lawyers from competitive firms, and the law was, in general, more guild than business.[6]

During its relatively short lifespan, Finley Kumble changed all of the unspoken rules of the profession.[7] In doing so it reaped massive financial rewards, and became – simultaneously – the most reviled and

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4 Harvey Myerson, name partner of Finley Kumble Wagner Underber Manley Myerson & Casey, reported interview with authors, J. Nielsen and P. Langan, "An Upstart Law Firm Comes of Age," FORTUNE Magazine, September 29, 1986 ("**Nielson**") <money.cnn.com/magazines/fortune/fortune_archive/1986/09/29/68093/index.htm>.

5 E.R. Shipp, "Finley, Kumble, Major Law Firm, Facing Revamping or Dissolution," November 11, 1987, THE NEW YORK TIMES ("**Shipp**") <www.nytimes.com/1987/11/11/business/finley-kumble-major-law-firm-facing-revamping-or-dissolution.html>.

6 The "**Cravath Method**" – named for the preeminent Manhattan firm of Cravath Swaine & Moore that created it – was the gold standard: hire the top graduates from the top law schools, pay them top dollar, and provide them the best legal training available. Partners were to be made from within, not hired from another law firm where bad habits would have already been learned. Associates – although subject to a strict "up or out" system vis-à-vis partnership – were members of a fraternity for life. As a Cravath alumnus famously recalled:

> *"In the Cravath of 1952, I felt no pressure whatever concerning billable hours. All I knew was to keep a record of hours for specific clients and hours for "office general." I never even saw any annual totals. The only pressure was to complete an assignment on time. And despite the song about the partners' john, making partner was not such a big issue after all. We were all told that while few associates could expect to remain permanently at the firm itself, we could all count on well-paid future employment at one of the many corporate legal offices or regional law firms that had ongoing relationships with Cravath. The message was: Excellent work is expected, but the pressure is off. Associates were safely and comfortably on the inside for life. Inclusion was more important than competition."*

envied law firm of its day. To Mr. Myerson's prediction of so long ago, the Finley Kumble way is instantly recognizable (even if unspoken) in the strategic plan of every large firm today:

- ✓ Compensation of partners based with an overwhelming emphasis on rainmaking, not seniority;
- ✓ Acquisition of senior talent through the unabashed raiding of competitive firms;
- ✓ Acquisition of raw talent by offering starting salaries to new law school graduates vastly beyond historical norms;
- ✓ Systematic acquisition of smaller law firms to expand geographic reach and depth of expertise; and
- ✓ The valuation of lawyers according to their value to the business, and not according to either seniority or loyalty.

That said, in our view it would be incorrect to see Finley Kumble as the spark for a sea change in the profession. Instead, from the day Finley Kumble opened its doors in 1968, it was buffeted by evolutionary forces to which a fiercely competitive and profit-driven law firm was best suited:[8]

1. In the 1970's, growing in-house legal departments began to pull routine legal work away from outside counsel, materially and negatively affecting the competitive landscape;

2. In 1977, the U.S. Supreme Court's landmark decision in *Bates v. State Bar of Arizona*[9] opened the floodgates to attorney advertising;

C. Reich, "Cravath Veteran Recalls Law Firm Life of Yesteryear," THE AMERICAN LAWYER, December 17, 2007 (accessed July 22, 2010) <www.law.com/jsp/llf/PubArticleLLF.jsp?id=1197626690782>.

7 **See** Nielson, **supra** note 4: As stated by Mr. Underber in 1986:

> *"[Finley Kumble] wanted to bring in business and become an important part of the legal community. There are a lot of ways to do that, most of which take generations . . . Rather than wait for generations of associates to come of age, Kumble chose to grow a newfangled way. He raided other firms, offering star performers top dollar. Such a thing was unheard-of at the time. Gentlemanly firms did not take experienced attorneys -- and their clients -- away from other members of the club. A partner in a law firm was a partner for life."*

8 R. Lacayo, A. Constable and A. Sachs, "Law: Tremors In The Realm Of Giants," TIME Magazine, December 7, 1987, <www.time.com/time/magazine/article/0,9171,966155-1,00.html>.

9 433 U.S. 350 (1977).

3. In 1979, The American Lawyer Magazine was founded and began the then-shocking practice of reporting law firm gross revenues, profits-per-equity-partner and like financial indicators;

4. In the 1980's, a spate of corporate merger/takeover activity generated large streams of billing insensitive, high-margin legal work to which pyramidal teams in large firms were best suited;

5. With routine work internalized and expensive, individual transactions sent outside, throughout the 1980's, 1990's and 2000's, "one-off" shopping for counsel became an integral part of the industry landscape; and

6. In line with a relentless (and still ongoing) march towards a world economy, large firms were (and continue to be) forced to match the increasing sophistication and globalization of their client base.

It would be hard to overstate the role of one of the foregoing factors in the transformation of the industry - that of The American Lawyer. Today, The American Lawyer ranks best corporate practices, best litigation practices, best summer associate programs, happiest mid-level associates, biggest pro bono commitment and a variety of other law firm statistics. Key among these indicators: the fabled AmLaw 50, AmLaw 100 and AmLaw 200 lists,[10] and the newer, but equally coveted "A-List."[11] In a proverbial

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10 The AmLaw listings of the top 50, 100 and 200 U.S. law firms is compiled by THE AMERICAN LAWYER and its corporate affiliates. Financial data that is accumulated, scored and analyzed includes gross revenue, breakdown of "equity" and "non-equity" partners, number of employed non-partner lawyers, revenue per lawyer ("**RPL**") and profits per partner ("**PPP**," also referred to as "profits per equity partner" ("**PPEP**")). Not surprisingly, large firm cooperation is ordinary course:

> *"Most law firms provide their financials voluntarily for this report. Some choose not to cooperate, so we call partners and calculate revenue and profits."*

"Our Methodology," AMERICANLAWYER.COM, April 29, 2009 <www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202430184950>.

11 The AmLaw "A-List" is compiled from an analysis of data from the AmLaw 200:

> *"Since 2003, the American Lawyer magazine has published what it calls the "A-List,"[in an attempt to, in its own words] "*measure *and quantify the qualities that define an elite law firm, making an effort to look beyond profits." The A-List looks at four factors — revenue per lawyer, commitment to pro bono, diversity among lawyers, and associate training and satisfaction — swirls them all up in a formula, and spits out a numeric score. We like the A-List, or at least the spirit behind the A-List, because it rewards firms for more than just ringing up the billables in a way that we think would be helpful to law students, aspiring laterals, recruiters, and the like."*

case of the tail wagging the dog, the AmLaw rankings are today a driver of large firm management thinking and one of the dominant metrics for the evaluation of a law firm's prestige and success. Viewed in this context, Finley Kumble was the product of shifting economic forces to which the legal industry was not immune: more transitional fossil than catalyst, and the prototype for the large firm struggling to adapt to a changing world economy.

THE DEATH SPIRAL

If you define the "closure" of a large firm broadly – including both dissolutions and mergers of necessity" (i.e., merger as the sole practicable alternative to dissolution) – then by our count at least 38 large firms have closed in the 23 years since Finley Kumble's spectacular collapse.[12] While the sheer numbers are noteworthy – we are talking about an average of between one and two major law firm failures per year in the post-Finley era - more telling is the distribution of those closures over time. For example, there was not a single large firm closure between 1987 and 1994, roughly one-third of the period in question. Conversely, a shocking 29 of those 37 law firms – nearly 80% of them – have closed since 1999, the last half of the period. This latter half of the period is itself back-end loaded: 45% of the large firm closures occurred in the last five years and 18% took place in the last two years of the study period.

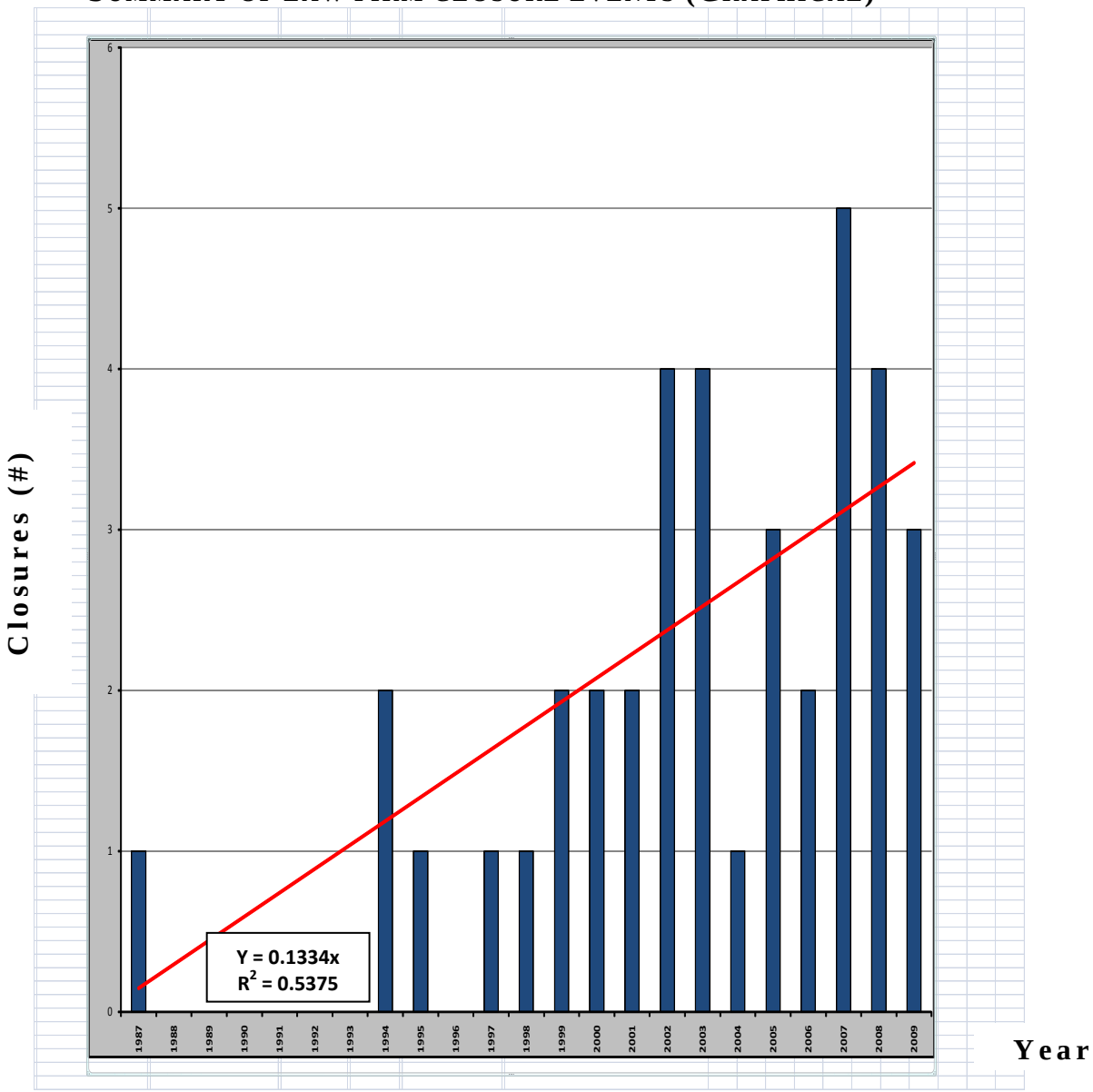
A. Jones, "Munger Tolles Tops AmLaw's A-List, Once Again," WSJ LAW BLOG, June 30, 2009 <blogs.wsj.com/law/2009/06/30/munger-tolles-tops-amlaws-a-list-once-again/tab/article/>.

12 **See** Table 1A and Table 1B **infra**.

TABLE 1A
SUMMARY OF LAW FIRM CLOSURE EVENTS (TABULAR)

Total Events in the Study Period (#)	38
Years in the Study Period	23
Average No. Events Per Year During Study Period	1.7
% Occurring in the Past Two Years (2008 - 2009 inclusive)	18%
% Occurring in the Past Five Years (2005 - 2009 inclusive)	45%
% Occurring in the Past Ten Years (2000 - 2009 inclusive)	79%

TABLE 1B
SUMMARY OF LAW FIRM CLOSURE EVENTS (GRAPHICAL)



Equally revealing in our view is the fact that large firms unravel in an almost formulaic manner. Generally speaking, the downward spiral is triggered when a number of partners with material portable business – "revenue controlling partners" - become disaffected with leadership, and conclude that their own interests are no longer coincident with the direction of the law firm. Disaffection can arise from, among other things, a loss of confidence in the competence of management; loss of respect for management on personal or professional grounds; the absence of a transition plan by which current management (even if good) can be replaced; a belief that management is setting the firm's business strategy according to political/personal agendas rather than sound business principles; and/or declining PPEP relative to an omnipresent greener pasture.

The spiral begins in earnest when the disaffected revenue controlling partners leave the law firm for what they perceive to be a better managed, better run, and therefore superior platform. Defection, in turn, creates financial distress that manifests immediately. The departing partners (1) strip out their capital (immediately or through a balance sheet adjustment), (2) take with them as many of their paying client accounts as possible, (3) render their outstanding receivables less collectible, and (4) leave behind overhead in the form of vacant offices, and unnecessary associates and staff. Being cash-constrained, Sisyphean businesses to begin with – all are incentivized to distribute the maximum practicable amount of cash at year end to keep PPEP at competitive levels - a law firm will experience immediate cash flow pressure as a result of any material defection.

Accordingly, unless the affected firm can quickly fill the revenue gap created by the defection – by lateral hiring or increased revenue generation by remaining partners – projected PPEP is jeopardized, as well as the organization's ability to service previously manageable lease or debt levels. In such cases, some degree of "right-sizing" or "strategic re-alignment" is inevitable as the firm struggles to make the anticipated year end partner distributions. How much of either is of course a function of the firm's ability to replace the revenue lost to defection. In any case, "falling profits," "right-sizing" and "strategic re-alignment" in the hallway lexicon of a law firm is akin to yelling "fire" in a crowded theater. More revenue controlling partners will question leadership, and more will defect, resulting in still more financial stress and fear. If not contained, the foregoing cycle repeats like a closed feedback loop with no "off" switch until the financial stress overwhelms the business and forces closure.

Thus, in the final analysis, it is our view that a large firm's death spiral is triggered in the first instance by a loss of confidence among revenue controlling partners in the future of the firm to succeed vis-à-vis themselves. This point cannot be overstated. The transformation from profession/guild to business has made all lawyers - particularly the revenue controlling partners – free agents who move freely and frequently from platform to platform.

FREE AGENT DYSFUNCTION

While the accelerating rate of failure of large firms is a fact, the reasons for this trend remain murky and the subject of considerable debate. A prevalent theory is that the 2000's, which sport a remarkable 79% of the total Closures, is a decade bracketed by more generalized economic dysfunction, i.e., the dot-com bust of 2000, and the "Great Recession" of 2009.[13] We neither support nor attack such ideas here, and simply suggest that there is a management dynamic afoot that must be factored into any analysis of the industry.

In our view, the fragility of today's large law firms arises from what we think of as a "structural" obsolescence. In many cases, large firms today are organizations with the attributes of a corporate, for-profit business – management professionals, governing committees, strategic plans, financial controls, marketing strategies, and management consultants of every flavor - superimposed on an entity that is both technically and philosophically a partnership. This gives rise to the core paradox of such firms' management structure: a professionally managed, for-profit veneer atop a partnership of free agents, the most powerful of which – the revenue controlling partners - may or may not even be on the formally elected/appointed management team.

In our view, the AmLaw 200 is heavily – but not, of course, uniformly – populated by businesses sporting an obsolete, essentially flat management design trying to adapt to new macroeconomic realities through the piecemeal addition of loosely connected business practices: Dinosaurs, if you will, putting on a crazy quilt of feathers as the days grow colder. A lucrative industry sells the latter in bulk: formulaic solutions such as processes, efficiencies, flow charts, org charts, technologies and decision trees. Our view is that such things, along with the blizzard of conferences, panels, and management-speak that pervades industry dialogue, are chaff that distract from the real issue, i.e., that the industry's challenge is a cultural/philosophical one (putting feathers on a dinosaur, in our lexicon), and not a process/systems matter (finding better feathers).

Said another way, a law firm can put in place the biggest, most expensive management structures and processes available, and they will serve the business well while the sailing is smooth and enough money is being made. However, in our own study of the post-Finley closures we see ample evidence that the

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13 **See e.g.**, B. Hildebrandt, "Unprecedented," THE NATIONAL LAW JOURNAL, December 21, 2009 <www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202436981418&rss=nlj>; D. DiPietro, "The Am Law 100 2009: Recession and Repair," THE AMLAW DAILY, April 29, 2009 <amlawdaily.typepad.com/amlawdaily/2009/04/the-am-law-100-2009-recession-and-repair.html>; A. Press, "Legal Professionals Role-Play the Future of Big Law," THE AMERICAN LAWYER, April 21, 2009 <www.law.com/jsp/article.jsp?id=1202430052156>; 2008 Client Advisory, Hildebrandt International and CitiPrivate Bank, January 2008 <www.hildebrandt.com/PublicDocs/2008_Client_Advisory_013008.pdf>.

management wisdom du jour is irrelevant when something "really" matters or when enterprise survival is at stake. In the latter case, the reality of the law business is that the revenue controlling partners can and do decide the firm's fate regardless of whether they have any "management" role whatsoever.

Thus, it is not that the plethora of management solutions in circulation are necessarily wrong, it's that they are applied if, when and to the extent a functionally flat management structure allows. Further, it is not that we have some exotic new management formula, it is that even if we did, firms would implement them in the same hodge-podge way. We articulate the inconvenient truth as follows: There are no formulaic solutions for building a bigger, faster, richer, more stable law firm, and there is no "success-in-a-box" that can be purchased at the latest management conference. In the end, spending millions per year on executive management does not mean that a firm is a well run business. It simply means that the firm is spending a lot of money.

Further, because their existence hinges on the personal choices of a relatively few individuals, law firms are exquisitely fragile organizations by their nature. No traditional law firm – regardless of size, prestige, years in business, practice focus, size or geography – is immune from that reality. This naked truth means that the practice of law is an industry in which every member – even the very strongest among them – teeters on the knife-edge of bankruptcy. While law firms were once relatively secure, held together by the strong glue of loyalty to firm, loyalty among partners, firm identity and sense of guild, this is simply no longer true in a new day in which profitability, compensation and market share are king. Today, that glue is greatly weakened or entirely gone, leaving behind an industry of eggshells, many of whom have yet to appreciate their fragility.

SHADOW GOVERNMENT

Because revenue controlling partners have functional control of the business without accountability for its success (or lack thereof), instability is a deep and intractable part of the business of law. Importantly, though, such instability does not equate to economic failure. In fact, there is absolutely nothing wrong per se about vesting enterprise control with one or more revenue controlling partners operating beneath a veneer of professional management. Such firms can be successful, profitable and long-lived. What they are, however, is fragile. A modicum of business rigor can be applied to keep the ship sailing straight, but the fact of the matter is that the boat has a large hole with an easily removable cork. It is for precisely this reason that a law firm can go from the AmLaw 50 to "out of business" in a dizzying 12 or 18 months. No amount of management consulting will "fix" or change this economic reality. However, as long as the partners remain cognizant of this fact, and buy into the high risk/high reward calculus involved, then as a business matter the approach is both rational and sound.

Instead, the core industry dysfunction – that management doesn't necessarily run things, and survival as a going concern lies in the hands of a small subset of free agent partners who may or may not even have a formal management role - manifests only under two circumstances: (1) when partners forget, ignore or are oblivious to the fact that their platform is fragile for the reasons described, or (2) when partners appreciate the fragility of the firm and seek bona fide enterprise stability. As to the former, we say only that a law firm unable to look at its business fundamentals in the cold, harsh light of day faces extinction, probably in the spectacular, headline-grabbing fashion to which the industry has become accustomed. As to the latter, however, we believe that bona fide law firm stability not only exists within the AmLaw 50, 100 and 200, but that it can also be created by thoughtful and prescient management.

That said, eliminating a shadow government of free agent, revenue controlling partners is no small matter in a profession in which the latter are lionized by both press and peers. Our view is that stability is a process – a consistent pattern of action over an extended period of time – rather than a destination for which there are road maps, instructions or guides. We see several things woven into the cultural fabric of genuinely stable law firms, all of them simple, even self-evident, in concept but inordinately difficult for lawyers to do on a consistent basis:

First, diversify. Although garden leave agreements have begun to take root in various parts of the U.S. workforce, their use against lawyers in the U.S. remains forbidden.[14] Thus, the only practicable option for U.S. firms is to blunt the power of individual revenue controlling partners through diversification of the firm's revenue stream. Like a one-product company that minimizes risk by increasing the number and variety of its product offerings, law firms can find bona fide stability only through the systematic retention of a large number of relatively equal revenue generators spread across geographic and practice sectors. Such diversification not only smoothes out the firm's revenue stream as

14 Wholly independent of large firm politics and profits, U.S. law deems lawyer "free agency" essential to the administration of justice. Under rules applicable to the practice of law in the United States, if a lawyer is contractually barred from practicing then the pool of lawyers available to serve the public becomes smaller thus diminishing access to justice. **See** ABA MODEL RULES OF PROFESSIONAL CONDUCT, Rule 5.6 ("Restrictions on Right to Practice"); **See also** CALIFORNIA RULES OF PROFESSIONAL CONDUCT, Rule 1-500 ("Agreements Restricting a Member's Practice").

"**Garden Leave**" is an employment law concept in the U.K. under which an employee who leaves a job – voluntarily or involuntarily - remains on the payroll for some specified notice period with instructions to stay away from the workplace. Its purpose is to extend the life of confidentiality and like agreements, and to prevent employees from defecting with current, competitive information. **See** Directgov, "Employment, Handing in or receiving your notice," <www.direct.gov.uk/en/Employment/RedundancyAndLeavingYourJob/Resigningorretiring/DG_175835>.

a purely financial matter, but of equal importance is the fact that it disperses political power and influence across the organization to produce a modicum of structural stability.[15]

Second, select leaders that lead. The position of managing partner or chief executive is not a status symbol for the biggest ego and/or the biggest book of business in the firm, nor is it a trophy for savvy firm politicians. Likewise, the governing committee must be populated with people who possess the skills to manage a multi-million or multi-billion dollar business. A law firm that is not selecting leadership according to demonstrable business and leadership talent is guessing as to that individual's success, and, therefore, as to its own survival. Further, once management is selected, they must be held accountable for results. Firm leaders that do not advance the strategic objectives of the partnership (whatever those might be) must be removed, not rewarded with more years at the helm. Indeed, management that lacks the confidence, respect and trust of the partnership at large will not be successful, and, if such individuals attempt to entrench themselves they will succeed only in creating a poisonous, bunker mentality within the organization. Such an atmosphere saps morale, incites gossip and balkanization, and will ultimately render the institutional fabric.

Third, maximize enterprise value, not PPEP. The management of large firms is systematically and famously myopic: How much will the equity partners take home at the end of the current fiscal year? It is axiomatic that a business is not built to endure if it consistently manages to short term profit-taking. Sadly, it is equally true that many law firms manage themselves in precisely this manner. For example, "cost control" in law firm parlance is in most cases a tool for maximizing partners' year end distribution in a down year and not, necessarily, an exercise in genuine financial rigor. Half-measures that temporarily inflate profits without effecting any fundamental financial reform are generally the order of the day: staff layoffs, associate and special counsel layoffs, trimming or eliminating lavish partner retreats, practice group "off-sites," and firmwide seasonal parties, reducing or eliminating perks (e.g., cell phone reimbursements, or summer associate lunches), and rescinding offers of employment made to incoming "fall associates," to name a few. Notable by their absence: restructuring compensation to align with enterprise success, withdrawing from geographic areas and/or practice sectors which neither show nor promise to show some demonstrable financial or strategic value, and similar "tough" decisions. We

15 The ability of individual revenue controlling partners to derail the execution of an otherwise shared strategic vision is perhaps the single most destabilizing – and intractable - aspect of any law firm. A revenue controlling partner's power flows from his or her ability to leave the firm at any time along with their book of "portable business," i.e., their client base and its appurtenant revenue stream. Depending on the size of that revenue stream relative to the economics of the law firm, a revenue controlling partner may be able to inflict anything from short-term inconvenience to mortal injury to the organization. Thus, from a personal standpoint, revenue controlling partners have power without accountability, a lucrative position few are willing to relinquish.

see the use of cost control as a competitive weapon in all markets, up and down as one hallmark of genuinely stable law firm, successfully adapted to the business realities of the day.

Recent events at 2,000 lawyer Latham & Watkins are apropos: In February 2009, and despite being excoriated by industry watchers, Latham laid off 190 associates (comprising roughly 12 percent of the firm's associate base) along with 250 nonlegal staff, stunning numbers relative to actions by its AmLaw 100 peers.[16] Most shocking? The fact that Latham took the road less traveled by systematically targeting first year associates for termination – an act that would generate the most negative industry commentary despite the fact that it involved the most expensive, least productive lawyers in the organization.[17] While reasonable people can differ on the extent of a causal link, in our view it is not a coincidence that Latham's rigorous, unique, and unpopular moves were followed by equally unique, bona fide success:

- ✓ Late in 2009, the year of the layoffs, Latham admitted a relatively large number of associates into the partnership;[18]
- ✓ As 2010 began, Latham has announced that it would not just unfreeze but "true up" associate salaries;[19]
- ✓ Also in the new year, Latham made an opportunistic move into the Houston market by luring significant lateral talent from local firms;[20] and

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16 R. Lloyd, "Latham to Cut 190 Associates, 250 Staff," THE AMLAW DAILY, February 27, 2009, < amlawdaily.typepad.com/amlawdaily/2009/02/official-latham-to-cut-190-associates-250-staff-.html>.

17 See E. Mystal, "Latham & Watkins: We Have Good News," abovethelaw.com, December 21, 2009, < abovethelaw.com/2009/12/latham_watkins_good_news.php>:

> *"It has not been a great year for Latham & Watkins. Everybody knows that the firm laid off a ton of people — 440, to be exact — in February. But it was the firm's decision to fire first-years who had been at the firm for just a few months that seemed to shock the conscience of Above the Law readers. The firm took a major hit in the Vault prestige rankings, plummeting from #7 to #17. And we've heard anecdotal evidence that Latham had a rough go of it on the recruiting trail this fall."*

18 J. Jeffrey, "Latham & Watkins Promotes 23 to Partner, Six in D.C.," THE BLT: THE BLOG OF LEGAL TIMES, November 05, 2009, <legaltimes.typepad.com/blt/2009/11/latham-watkins-promotes-23-to-partner-six-in-dc.html>.

19 E. Mystal, "Latham & Watkins: True-Up Raises Are Official," ABOVETHELAW.COM, January 4, 2010, <abovethelaw.com/2010/01/latham_watkins_true-up_raises.php>.

20 See "Latham & Watkins Bounce Back In 2010; Open Houston Office," JDJOURNAL, January 11, 2010, <www.jdjournal.com/2010/01/11/latham-watkins-bounce-back-in-2010-open-houston-office/>; and F. Gunter, "Latham

- ✓ Likewise, in what has been described as "one of the most spectacular lateral raids in recent years," Latham recently pulled 13 partners from across New York, London and the Middle East from a competitor.[21]

Some industry observers see the foregoing as evidence that "Latham may finally be trying to buy its way back into the light," after "a year in the Biglaw doghouse." While that may, of course, be the case, we disagree. We see Latham's moves as the actions of a savvy, forward thinking business in response to a shifting economy: "At first glance, the Latham layoffs are a big deal simply because of the raw numbers. Dig deeper, however, and they may suggest that big firms have made the complete move from professional shops to [businesses]."[22] As to some of them, we concur.

Finally, articulate a bona fide vision. A coherent, realistic and achievable business plan that reflects a genuine shared vision of the partners is a prerequisite to the stability and success of a law firm, as is its faithful, methodical execution. A variation on "going global as quickly as possible / so as to get the highest quality, highest paying, and highest margin work / all to be done with the most highly compensated lawyers" is not a business plan, although it is nevertheless the core strategic vision of many large firms. Instead, partner expectations – in terms of compensation and scope of platform - must be managed accordingly to ensure commitment to a common vision. The converse cannot be overstated: If partners cannot find a common vision, then a business failure of the law firm is inevitable. Exactly when that failure occurs will be a function of a particular firm's circumstances. For example, if legal work is freely available in a "hot" economy, then money tends to cover all evils and the firm can conduct business in an apparently normal – even financially successful - fashion. However, should the market tighten such that limited revenue finally forces prudent planning and spending, the absence of a common vision for the business will create divisiveness, competitive factions, and, if a whiff of economic collapse is in the air, a race for the door.

Watkins hits gusher in local energy legal market," HOUSTON BUSINESS JOURNAL, January 22, 2010, <www.bizjournals.com/houston/stories/2010/01/25/story6.html)>.

21 R. Lloyd, "Reeling From Latham Raid, White & Case Redeploys Key Partners," THE AMLAW DAILY, February 12, 2010, <amlawdaily.typepad.com/amlawdaily/2010/02/whitecaseuk.html>.

22 D. Filler, "Latham & Watkins Layoffs Suggest A New Big Law World," THE FACULTY LOUNGE, February 27, 2009, <www.thefacultylounge.org/2009/02/latham-watkins-layoffs-suggest-a-new-big-law-world.html>.

FINAL THOUGHTS

We reach four conclusions from our lengthy study of failed and successful law firms alike:

1. Law firms are by their nature exquisitely fragile and unstable businesses.

2. Just because they are fragile and unstable does not mean that law firms cannot be profitable or even long-lived; it simply means that they will collapse easily under the right circumstances.

3. There is nothing inherently wrong with running a fragile and unstable law firm platform. As a business matter the approach is both rational and sound provided that the partners buy into the high risk/high reward calculus involved. Dysfunction manifests only if and when the partners fail to understand – or choose to ignore - the core instability of the business.

4. Just because they are fragile and unstable in nature does not mean that law firms cannot be stabilized. However, stability is a process – a consistent pattern of action over an extended period of time – not something acquired from consultants. Stability arises from the organizational culture, and manifests in the way partners distribute power, choose leaders, manage their finances and envision their practice.

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