THE LAW FIRM PARADIGM: RELEVANT OR RELIC?

by

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The second half of the 20th Century witnessed remarkable growth and consolidation in the legal profession. In contrast to small, stable partnerships of the 1950s and 1960s, the number of lawyers and the size of law firms exploded in the last quarter of the 20th Century. In the mid-60s, less than two dozen law firms exceeded 100 lawyers. Today there are two dozen law firms with 1,000 lawyers or more, some exceed 2,500 lawyers. And, at least for the present, there is an excess of lawyers.

There are a myriad of reasons for the current "state" of the legal profession. As a result, some advocate reformation of the ABA Rules of Practice to permit American law firms to compete on a level playing field with their European counterparts (with whom American companies routinely engage) by eliminating restrictions on "multidisciplinary" practices. These proponents argue that accounting firms and law firms should be permitted to merge. Others see an immediate need to revisit the ABA constraints which limit the ability of firms to restrict the mobility of lawyers who leave a firm and siphon off clients, essentially with impunity.

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Last year, 2009, a remarkable number of law firms across the country spent more time reducing the number of their lawyers than recruiting law school graduates. This article seeks to describe the factors which led law firms to "manage" themselves into this conundrum.

A variety of circumstances contributed to the creation of the "mega" firms. While these firms provide many benefits to clients and law firm partners, their shear size has resulted in a serious loss of institutional cohesion. Moreover, once firms identified the value of associate leverage to maximize revenues, law firm managers began to focus mostly (and successfully) on increasing profits. And law firm profits rose dramatically in the past two decades.

At the same time, institutional loyalty and firm culture became more of a marketing representation than a reality. An eminent professor at the George Washington University Law School recently noted, in a provocative lecture on the legal profession, that we are in the last days of the "American lawyer" as we once knew that profession. According to Professor Morgan, we should "pay homage to that model, but then bury it."[2]

Institutional cohesion began to diminish with the recruitment, promotion and reliance on "star" performers, much along the lines of investment banks. Lateral acquisition of partners and practice groups (later mergers) became the driver of law firm growth and revenues. The "old fashioned" virtues of firm loyalty and partner collaboration got lost in the rush for growth and revenues. Law firms became an aggregation of independent and distinct practice groups. Partners often saw themselves as free agents.

In hindsight, the advent of *American Lawyers'* annual survey of the top 100 most profitable law firms in the 1980s precipitated a profound change in the profession of law. Firms became

[2] Thomas D. Morgan, Oppenheim Professor of Antitrust and Trade Regulation Law, George Washington University Law School,, at the "Lane Foundation Lecture," Creighton Law School, October 1, 2009.

obsessed with the rankings for "profits per partner" ("PPP"). A firm's ranking was a selling point for recruiting law graduates, as well as an enticement for partners considering offers from more "successful" firms. And it became increasingly clear to law firm managers that the easiest way to increase PPP was to increase the size of the firm and associate leverage. As the ratio of associates to partners increased, so did the PPP. These same factors caused the relationship between partners and their elected (or designated) managers to undergo change.

In the "mega" firms, partners rarely have a voice in the policies or direction of their firms. Typically, a small cadre of partners manage the myriad of financial and operational tasks that partnerships (as a whole) are unable and (mostly) disinterested in performing. The nature of partnerships, inexorably, shifted in favor of a "corporate governance" model. Like their corporate clients, law firms placed increased emphasis on the "bottom line".

The price of profitability, it turns out, was the dilution of institutional pride, professional self-respect and collegiality. This "bottom line" focus also created an inherent tension between what was in the client's best interests and the drive to accumulate ever more "billable hours". The "profession of law," where the firm's cohesion and stability was anchored, suffered the consequences.

The question posed here is whether the business model that has evolved over the years in the mega firms is sustainable, for lawyers and clients.

So what caused this conundrum; why the mega firm? At one level, it was inevitable. As the American economy began to expand after World War II, some law firm growth was inevitable. In the mid 50s, the concept of growth as an objective in and of itself was nonexistent. In the 70s, growth became a goal. Government increasingly was playing a role in the expanding economy, corporations were growing in scope and revenues, and the need for legal advice was rapidly evolving. With that growth, legal statements to clients increasingly became based entirely on hourly billing rates. Instead of negotiating the fee in advance or at the end of an assignment, partners and clients came to prefer the simplicity of negotiating the hourly rate.

Firms soon came to appreciate that their incomes would depend more on hours billed on a matter than on the value added by an attorney's performance. Partners came to understand that the more associates they had working on a client project, the greater revenue for the firm, as well as the amount of "collections" in the partner's column. In a nutshell, the coin of the realm was billable (and collected) hours. Law firms came to realize that if they wanted to increase their profits, they had to find more clients and more projects (and billable hours) from the clients they had.

Clients are not innocent in this paradigm shift in billing procedures. As the days of "for services rendered" came to a conclusion in the 60s, clients demanded to know the names of attorneys working on their projects and their hourly rate. And they got what they asked for, but in numbers of attorneys and hours per project they did not expect.

As corporations merged and expanded nationally and internationally, the competition for clients intensified. Clients lost by mergers needed to be replaced and clients that established subsidiaries in different states and countries had to be protected by opening new offices in those new locations.

The almost universal response of law firm managers was an insatiable appetite for growth. And that growth forced fundamental changes in firm structure and performance. Nothing was left off the table, including the ability (or need) to support less productive partners. As a result of this new focus, partners reluctantly acquiesced to constraints on practice prerogatives and the imposition of detailed billing procedures in exchange for the perceived need of their firms to be "competitive". And, of course, the promise of increasing levels of compensation. The checks and balances of partnership agreements were vitiated as firms morphed into business enterprises.

The firms' focus on the "business" of law was a resounding success. The growth of revenues and profits among the leading law firms was astounding. At one time, only a few law firms could boast of profits per partner in excess of $1 million. Today, there are dozens of firms which report such profits, and many firms pay some partners multiple millions.

Once partners realized that compensation in seven figures was achievable, there was no turning back. The promise of increased profits enabled law firm managers to accumulate the power and authority to enforce rules of "practice management" and to slash "perks" to which partners had grown accustomed. Managers also insisted upon and secured compliance with billing and collection "realization" goals and expense management. Partners began focusing more on "work-in-process" and "aging accounts receivable" reports than mentoring and training associates in the substance and practice of law.

Expense management at law firms is not complicated. Without doubt, most law firms were in need of stronger management focus. Expenses incurred by partners previously deemed inviolate, such as club dues and permissive "client development" expenditures, became easy targets for extinction. The ratio of professional staff to attorneys was adjusted virtually every year. Few partners were permitted "one on one" secretarial assignments. Three or four (or more) associates were paired with a single secretary. Rudimentary business concepts, like budgets, billable hours and revenue goals, became the mantra for law firms.

Managers were surprised how easily profit margins increased once partners became convinced that they (many of them at least) were the beneficiaries of this business focus. The impact of reduced staff levels and less infrastructure support for the associates generating much of the work product was of little consequence. After all, associates were well paid in this new competitive environment. Thus, associates were expected to do more with less, including (in some instances) typing their own work product to meet a deadline. Associates became disenchanted. Most partners went along "for the ride" with this new business focus. Therein lies the seed of the disintegration of the law firm "paradigm".

The agility of law firm managers to adjust their significant variable costs (attorneys and staff), and the seemingly unfettered ability of law firms to increase billable rates, lured firms into a sense of security. The operating model of law firms appeared largely immune from the exigencies of business cycles. There always was a need for outside counsel, whether for mergers and acquisitions, bankruptcies, restructurings, intellectual property, creditors' rights or the "gravy train" of litigation. After all, clients were always filing claims or being sued.

Firm managers began to hire professional COOs, CFOs, Marketing Directors and HR Directors, all well-trained in consolidating systems, financial data and managing "head count", but who knew little about the "profession of law" or the dynamics of the "practice of law." Partnership votes were few and far between. Even "management" committees acceded to the need to evaluate firm initiatives through the prism of profitability. The perceived independence of partners within a partnership diminished, gradually but ever so significantly.

Like the capital markets, the legal profession embarked on an intense effort to increase the scope of their practices and geographic presence. Such expansion required ever-increasing revenues and profits. The "raison d'être" for increased PPP was the clear need to prevent top performing partners (and their teams) from entertaining offers from competing firms. This obsession on PPP tended to dislodge the focus of law firms from their most distinctive assets – professionalism, collegiality and team work.

Nevertheless, it was an auspicious time for successful partners. Partners jumped from firm to firm as competitive offers grew ever more attractive. Lateral partners often were compensated significantly more than "born and bred" partners despite tenure and equally successful practices and revenues. Law firms invariably accepted the representation that a "book of business" with major clients would move with the lateral partner. Many miscalculations were made. The laterals often proved to be disruptive and insensitive to certain traditions and practices at the new firm. In effect, a lateral "traded up" for a larger compensation package. In return, the firms expected increased profits from the clients the lateral would bring along.

Resentment followed, and partners became competitors rather than collaborators. Managers were quick to jettison non-performing laterals, but the ingress and egress of laterals (and other partners) made all partners insecure and fueled the "self-preservation" mentality of "institutional" partners.

This "business of law" focus led to a very fluid and turbulent marketplace for partners and associates. It seemed that there was no limit to the number of times a successful partner could switch firms. In retrospect it is not clear whether law firms or clients were beneficiaries of this "competitive" marketplace. Sometimes both. Sometimes neither. Sometimes just the switching partner. But rarely "just" the client or the firm.

This growth and success of the "corporate law model" for law firms carried predictable consequences. Morale and professional pride diminished as the "coin of the realm" became hours billed and revenues collected. The loss of institutional loyalty and firm "culture" became an acceptable cost in the drive for ever higher PPP. Law firms competed as aggressively for higher PPP rankings in *American Lawyer* as they did for clients.

In the face of this competition, law firms began to merge, particularly as clients were presumed to expect that their law firms would be "where they were." Even "preeminent" firms saw the value -- or need -- to grow by merger or acquisition. Many firms, once perceived as powerful institutions, closed their doors, unable to keep pace with the competition to pay associates and partners more and more. Very few law firms were immune from threats by partners to leave - - or the growing discontent among associates with the failed promises by those very profitable law firms.

Clients bear a significant share of responsibility for the reorientation of the business practices at their law firms. Client loyalty to firms became tenuous. Clients relied more on partner relationships than law firm reputations and loyalty. As consolidation among law firms accelerated, virtually every major firm offered competitive services. The competition for new business among law firms (as anyone should have anticipated) was insane. Naturally, clients used that competition to their advantage. Studies show that corporations switched law firms routinely. These studies reinforced the strategy of firms who sought to grow by lateral acquisitions.

Pressure on law firms grew even more intense as the number of "approved" law firms was reduced by virtually every major client, down from dozens to as few as five (or less). The pressure for law firms to acquire and retain clients was palpable. Partners (or laterals) with strong client relations became essential assets, even though it was the "partnership" that provided the underlying infrastructure and professional support for the "star's" client relationship and success. Of course, the "stars" insisted on taking care of their "teams". If young lawyers were assigned to a practice groups without a star, their career paths were in doubt.

Not surprisingly, major clients had the leverage and insisted upon conditions for "approved" law firm status. Client relationship partners (and firm managers) readily acceded to such conditions, including fee discounts, free training for in-house counsel and "prior" approval of rate increases. Some clients demanded prior approval before recent law school graduates were assigned to their projects. These client demands for "critical client" discounts served only to increase the pressure on managers to reduce other costs (*i.e.*, staff, library and infrastructure) and increase billable hour targets to offset those "critical" discounts.

Associates suffered most under the new business model. Associates were expected to bill more hours while an increasing number of partners struggled to "survive", mostly by "hording" billable hours. Partners often put a "limit" on the number of "chargeable" hours from associates for particular projects to impress clients with their management skills. Associates, of course, were expected to put in whatever hours were required to produce the "perfect" work product. Associates soon found themselves putting in twice as many hours as they were "allowed" to bill.

A total disconnect came to exist between partners and associates. Meeting billable hour targets effectively put a ceiling on the time allocated by partners for training, mentoring and development of associates. Associates came to resent mandatory training because it impeded their billable hour targets.

The most unfortunate consequence of the corporate management model was the abdication by partners of their responsibility to convey to firm managers the frustration and the tenor of associates (as well as partners) disaffected by the loss of firm culture -- and a collegial working environment -- in the drive for increased profits. Partners would complain among themselves but, with rare exception, accepted their fate. The increased number of "separations" or termination of associates (and partners) was greeted by those remaining with frustration and embarrassment, but little push back.

The path to survival in the new law firm environment was to keep one's "head low" and hang on to billable hours. When it came to compensation, little credit was actually assigned to training, mentoring, writing articles, community pro bono work, and administrative contributions. Law firms effectively became silos of practice specialties. Practice group leaders and "stars" arrogated unto themselves prerogatives not constrained by "partnerly" conduct or even firm management. The rest of the partnership understood the new "rules of the road".

In my experience, law firms are not particularly adept at distinguishing between leaders and managers. Over the past two decades, law firm "leaders" came to believe that corporate and business management skills were more important than vision and institutional culture. The present law firm "leader" paradigm was well captured by a USC Professor of Business Administration.

> *Leader or manager? Most operations are over-managed and under-led. Key differences: The leader innovates...the manager administers. The leader focuses on people...the manager on systems and structures. The leader inspires trust...the manager relies on control. The leader has a long-range perspective...the manager a short-range view. The leader originates and innovates...the manager imitates and executes. Leaders ask "what" and "why"...managers ask "how" and "when." Leaders keep their eyes on the future...managers keep their eyes on the bottom line.* Warren Dennis, then a

Distinguished Professor of Business Administration at the University of Southern California, published in the Executive Excellence, Provo, Utah.

Historically, lawyers took pride in their independence. Virtually every lawyer is confident that he or she is best qualified to lead their peers and manage their firm or practice. The new law firm business model suffocated that independence. As law firms grew more profitable, the machinations and intrigue for power and authority among the “stars” and practice group leaders were not subtle. Management became centralized and held the power of promotion and compensation. Key practice groups became power centers within themselves and any remaining viability of a “partnership” (in contrast to practice group economic power) became all but extinct.

Partners effectively were disenfranchised and compensation was tilted in favor of the “billing” partners with the most collections. Battles over “origination” credit ensued; collaboration and cooperation among partners became the exception. Partners hesitated to invite one of the “stars” (or almost any partner) to a client development “pitch” in fear of being forced to share origination credit. Some firms felt compelled to adopt policies prohibiting firm managers and practice group leaders from “accepting” (or insisting) on shared credit with originating partners. The competition among partners for origination credit became an impediment to developing new clients and additional client projects.

In hindsight, partners with leadership skills unfortunately are not always the best business developers. On the other hand, successful business developers are not necessarily managers or leaders. Yet one criterion became the tiebreaker. Client relationships and collections trumped vision and culture. The substitution of “business managers” for firm culture all but eliminated the need to create consensus for change among the partnership. Managers viewed improved PPP as the definition of "success".

Today's economic environment will surely force a re-evaluation of the present "business" paradigm. Many law firms now are announcing new strategic plans. Fixed fee arrangements will become more common and more effort will be devoted to "new" billing methods that will compensate firms for the value of their service rather than the hours they spend. Inevitably, leverage will become less important and the quality and performance of lawyers most important. Some firms held on to such traditions and their success (and profitability) did not required growth for the sake of growth. My examples would be Williams & Connolly and Munger, Tolles & Olson. There obviously are others.

Today, firms are "reorganizing" internal structures to reduce redundancy and consolidate practice groups. Law firms also are responding to this recession, as in the past, by reducing staff and attorneys. Some firms offered to pay the 2009 class of associates a percent of their compensation to stay away for a year. Others are increasing the costs to associates for health benefits. A few firms have ceased recruiting at law schools. Most other firms have reduced the number of "summer associates". People -- associates, staff and partners -- are variable costs. Law firms know how to protect the bottom line. They have become profit-enhancing enterprises.

The effect of these developments, from my perspective, has made the "old" law firm paradigm -- recruiting, retention, institutional loyalty and collegiality -- largely a slogan. The leading law firms all recruit at the same law schools and compete for the same Law Review members. Associate compensation is on a national scale, essential for any law firm which aspires to compete for the "best and the brightest" (all of whom apparently attend the Top 20 law schools).

Compensation of associates is lock step, as are hourly rates, although the present economy has made both concepts subject to reconsideration and debate. Until the current recession, associate leverage was seen as an essential strategy to maximize revenues and profits. That assumption also is now open to question. Fundamentally, law firm management analysis was more about costs and capacity than client performance or institutional success.

The PPP, of course, measures the putative compensation of "equity" partners. That measurement simply reflects the level of profits allocated among a fixed number of equity partners. The PPP is easily manipulated simply by reducing the number of equity partners. Therein lies the dilemma. There is an inherent tension between the need to promote the "best" associates and maintain a ratio of equity partners to "budgeted" profits. In order to successfully recruit, firms need to promote a certain number of associates. In order to promote new partners, firms must "weed out" less productive partners every year. The "partnerships" today understand that a percent of equity partners will be disenfranchised each year. Management of a firm's PPP requires it to reduce the number of equity partners by a number no less than the number of associates promoted. This is not an environment that engenders trust or confidence.

The net effect is that firms promote fewer associates each year, under the guise that the firm is simply "raising the bar" for promotion. Some firms make it simple. If an associate does not have a "book" of business of a designated size, promotion (unless assigned to a "star") is unlikely. Ironically, the new "higher" standards of promotion are making available to other firms talented and experienced associates fed up with the "price" of promotion.

Firms continue to claim an equity model in which all partners are equal (although some are more equal than others), except in compensation and management authority. In the present equity model, fewer associates become partners, and fewer “partners” remain with a firm for their entire careers. Turnover in law firms is at an all time high. Firm managers understand that they always can increase PPP simply by reducing the number of equity partners. I would suggest that there are better solutions.

Daily commentary on associate blogs is a distressing reflection of the disparity between law firm business and profitability goals and what was once a collegial, professional working environment for staff and lawyers. *Vault* surveys of associates underscore the disenchantment and lack of respect for current law firm business strategies. The law firm business model has been a windfall for many partners, but a “Gordian knot” for law firms. And the “model” has essentially eviscerated associate and staff confidence and loyalty.

The new generation of lawyers, however, are not enamored with increasing billable hour targets to secure increasing profits for equity partners. Even the promise of future remuneration does not incentivize recent law graduates - - a stunning shock to many law firm managers. Despite the cost and substantial effort to recruit the “best” associates, the reality of their future career path diminishes their enthusiasm soon after graduates join a law firm. There is little “joy” in the current practice of law.

Law firm managers are finding it difficult to deal with the reality that the current generation of lawyers place greater value on personal and professional fulfillment than the promise of increased compensation for higher billable hours and “future” partnership. With less leverage and fewer associates anxious to bill 2200 hours or more, something will have to give. Most likely it will be firm profits. The associate (or partner) hours are not there to support the profits to which many firms (and their partners) have become accustom.

The “business” of law, from my perspective, paid insufficient attention to the “practice” and the “practitioners” of the law. There is a palpable level of frustration by associates and partners (who are not the top fee generators) at their seeming irrelevance. The likelihood of promotion and advancement, let alone a career with a single law firm, has diminished in direct correlation to the push for higher PPP. Partners not part of the management team (or in the first tier of partner compensation) are distinguishable from associates only because they bill somewhat fewer hours (but at much higher rates). The seeds of distrust have been sown, and are now being reaped.

When the economy recovers, there will be a price to pay by firms who maintained profitability on the backs of terminated lawyers. The current “survivors” at law firms are looking for exits constantly. The economic and corporate crash resulting from the parallel self-destructive policies of Wall Street financial institutions suggests that the transformation of the legal profession into successful financial enterprises may also have reached the point of diminishing returns.

It turns out that the “competition” among law firms for profits is no substitute for the quality and training of the lawyers firms recruit. Regardless of PPP, a firm’s ultimate survival depends on the success and the quality of its professional service. The only true criterion for success remains a reputation for excellence. There are a large number of great if not brilliant, lawyers who will never be business generators. A firm cannot survive on “business generators” alone. At least one National Firm has announced that it no longer will report its “PPP”, in an obvious but rational effort to get back to “basics”.

The past two decades has shown that enormous compensation packages for the few is not a guarantee of the success of the whole. Firms will need to place more emphasis on the "competitive advantage" of reinvesting in themselves, that is in their attorneys and practice specialties. That strategy, in and of itself, will enhance retention. But that also will mean less "profits per partner". Firms have tended to ignore the need to invest in themselves (whether for training or technology) if the consequence was less PPP.

There was a reason why firm culture mattered. A number of firms will need to reacquaint themselves with the notion that they have an enormous stake in retaining the talent they recruit -- and maintaining an environment conducive to the practice of law and the professional development of its young lawyers. A firm reputation of quality client practice teams, with relevant practice specialties and industry expertise, invariably will attract talent and retain clients. A reputation of a firm – its "brand" – conveys a power of performance that is more likely to assure its institutional reputation than the acquisition of a new lateral group. Laterals can be temporary. A firm's reputation and "brand" should not be.

When the turmoil of the present recession settles, law firms inevitably will compete to "reinvent" themselves, ever more cognizant of the need to recruit lawyers committed to the "practice of law" and the "old fashion" reputation for success and performance. The trick is building a community of interest within the firm, much like the old "partnerships", to attract and retain the talent to achieve that institutional goal. Changes are coming, whether law firm managers see it or not.