

Recent CLE program examined the collapse of big law firms

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In these uncertain and changing economic times, some of the largest and most venerable law firms in the country are finding they cannot survive. Since December, four notable law firms have failed — Brobeck Phleger & Harrison in San Francisco, Skjerven Morrill in San Jose, Hill & Barlow in Boston, and Peterson & Ross in Chicago.

As past times have shown, Minnesota is not immune to this phenomenon. Two large, well-known law firms collapsed in the 1990s — Popham Haik, and what had been the state's oldest law firm, Doherty Rumble & Butler.

The Practice Management and Marketing Section of the Minnesota State Bar Association (MSBA) recently sponsored a program designed to examine the factors that led to these law firm failures and provide suggestions for avoiding such failures in the future.

The continuing legal education seminar — “The Rise and Fall of the Brobeckian Empire and Other Stories of Law Firm Failures” — was held March 19 at the MSBA offices.

The featured speaker was Stephen M. Peterson, managing director of the Law Firm Business Institute. Peterson counsels firms on strategic planning and administrative structures and also spent 10 years as an attorney with Oppenheimer, Wolff and Donnelly in Minneapolis.

“It’s a challenging time for law firms today,” he told attendees. “There is an extraordinary amount of competition and ... a lot of that competition is quite unconventional.”

Challenges abound

Peterson explained that in addition to increasing competition there are many other challenges facing law firms today.

There is a lot of consolidation going on in the marketplace — not only among law firms but among clients, he said. In addition, for some law firms, clients’ needs are growing too large for their ability to service them, he added.

Increasing costs, like malpractice insurance, also play a role. “Premiums are going to be increasing from 35 to 75 percent a year,” Peterson said. “Even firms with a clean bill of health will probably experience a 35 percent increase.”

Other challenges facing law firms include charging appropriate legal fees, and retaining good attorneys, Peterson observed.

“I entered the legal profession back in 1987, and there wasn’t a lot of free agency back then,” he said. “People rarely left law firms.”

Unconventional competition

Turning specifically to the rise in competition and the erosion of the legal market, Peterson noted that the competition is becoming increasingly unconventional.

There are many more in-house legal departments today, he said. “[Clients] are not taking work in; they are reducing the amount of law firms that they are doing business with.”

In addition to in-house counsel, established law firms are vying for work with boutique firms — litigation boutiques, intellectual property boutiques or environmental boutiques, Peterson observed. “That impacts general practice firms.”

The formation of multidisciplinary practices is also affecting law firms. Pointing to large accounting firms in particular, Peterson observed: “It was only two years ago that Arthur Andersen was the second biggest law firm in the world — practicing law, not doing income taxes.”

Moreover, consulting firms — including those that handle environmental, human resource and retirement matters — are starting to take a considerable amount of work that has traditionally been done by lawyers, Peterson added.

Also affecting competition is eLawForum, which is “like an eBay for attorneys and clients,” Peterson noted. “Clients go out and register a [project on the Web] and law firms will go in and bid on that work.”

Peterson said one study revealed that as of last July, there were 170 or 180 corporations registered with the service and 1,500 law firms. Seventy-five percent of those law firms were among the 250 largest firms in the country.

“The goal of this is obviously to save the company money,” said Peterson. “The [site creators] maintain that clients ... will save 30 percent on average in legal fees by going through the bidding process.”

Brobeck’s rise and fall

Focusing on the “unfortunate demise” of the 900-attorney firm of Brobeck Phleger & Harrison, Peterson noted that the firm was 77 years old and was very successful during that time.

Attorney Tower Snow took the helm of the firm in 1998 as chairman and set out to focus on being the premier firm serving high-tech companies, Peterson explained. “[Snow] injected a much needed dynamic to the law firm planning.”

The firm became very successful. “It was ranked the number one law firm by the nation’s top 50 technology companies, like Microsoft, Intel, Cisco,” Peterson observed. “As a result of this focus, this incredible focus and strategy, they hit the bull’s eye.”

In 1999, the firm’s partners experienced a 44 percent increase in their compensation; in 2000, it went up another 56 percent to \$1.17 million per partner, which was the most of any California law firm.

In the year 2002, Fortune magazine ranked Brobeck among one of the best 100 companies to work for. At its peak, the firm employed over 900 attorneys, and was the 15th largest law firm in the country.

Then came the collapse of the high-tech market the firm had focused on so intently, Peterson said. He explained that much of the firm’s downfall was due to its failure to adequately invest in

other practice areas and market sectors.

Another aggravating factor in the firm's collapse was its debt — \$90 million at its peak. In addition, rather than retrenching or changing its focus, the firm continued to spend.

According to Peterson, Snow would not resort to layoffs, and the firm continued its costly television advertisements, as well as its expansive and expensive new facilities in other large cities.

Finally, following the closing of airports after the Sept. 11 tragedy, the firm's executive committee ended up stranded in Colorado, Peterson said. Succession plans were incubated on the committee's long drive home to San Francisco, he said. In November, Snow stepped down as chair and in May 2002 was ousted by his partners.

"The new leadership was largely ineffective," said Peterson. "The partners were not kept informed. ... The new management and leaders were very uncomfortable in their role."

More partners began leaving, taking clients with them; about 60 partners left prior to the collapse, resulting in significant revenue loss while the overhead stayed constant, Peterson observed. "The future was getting very bleak."

There were several things the firm could have done, Peterson opined. "If it had downsized earlier as a measured reaction to the economy, I think things would have been a little bit better. They would have broadcast a strong message that good management was in place and that the situation was under control, instead of the highly publicized infighting."

Brobeck did undergo some last ditch merger discussions, but talks broke off and the firm announced its closure at the end of January 2003, Peterson said. "The last days were described as a total meltdown, mass chaos."

Commonalities

Peterson then turned to a discussion of some of the more common characteristics of firms in danger of collapsing.

"A lot of it is ineffective leadership and poor succession planning," he said, adding that a similar problem is a lack of strategy or a failure to execute on strategy.

Poor compensation policies are also widespread among firms in trouble, according to Peterson.

"A lot of the failures of East Coast firms resulted from lockstep compensation systems which reward seniority more than anything else," he said. "So when the younger partners start bringing in business, they are subsidizing the older partners. ... That creates an awful lot of bickering."

Also common in troubled firms is a lack of trust among partners, which creates a lot of internal strife and cultural imbalance, Peterson pointed out.

Many firms also have an internal rather than external focus, Peterson continued, explaining that they don't pay enough attention to what's going on around them, particularly with clients.

Another commonality of firms at risk is excessive client loyalty to particular individuals.

"This is probably the most difficult thing for law firms to come to grips with and handle effectively," Peterson observed. "Most of the time, clients follow a very good lawyer."

Peterson stressed the need for firms to introduce more than one good lawyer to a client, thereby

putting “more hooks in that client” and making it difficult for that client to follow any one person.

“That doesn’t happen an awful lot,” he said. “[Instead] it’s excessive client loyalty to individuals. When they go, that business goes.”

Other classic warning signs of firms in danger of collapse include:

- owners acting like employees — with a 9-to-5 mentality;
- lack of cross-selling;
- a slowdown in new file openings;
- partners hoarding work, leading to layoffs of associates;
- a significant increase in aging of work in process; and
- a significant increase in accounts receivable and accounts payable.

Remain upbeat

In discussing the steps firms can take when they are in danger of folding, Peterson stressed the importance of having a clear strategy and implementation plan to overcome the difficulties.

“Then I think it’s helpful to perform an economic assessment,” he suggested. “Determine what resources are needed for the focus of business [you] currently have, and maybe the focus of business [you] think [you] may have in the next 12 months.”

Partners must also be held accountable for their performance, according to Peterson.

“Maintain a good chemistry of core values — a culture of trust, common philosophies and similar work ethic,” Peterson advised. “That’s probably the most important.”

Peterson also explained that in a slump, a loss of jobs and benefits affects morale throughout the firm, so it’s essential that management and partners “remain upbeat and keep focused” on their practice.

Reassess your strategy and review your practice segments in anticipation of changing market conditions, Peterson recommended. Place greater emphasis and investment on professional development activities, including marketing. “Never give up on marketing,” he said. “Market while you are busy, not while you are slow.”

In addition, review lateral hires carefully, Peterson advised, adding that the success of a firm is not based solely on economics, but on culture as well.

Finally, he said, work on client relationships. “Your clients want you to know their business and treat them as ‘firm’ clients.”

— **Michelle Lore**

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