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The End of Partnership?

Fundamental changes are turning firms from collegial to corporate

By Victor Li

Consultant CATHY MICHAELSON notes that "like businesses, law firms have merged and some have even failed. It's not a good or bad thing. It's just law firms evolving to meet the wider demands of their environment."

PHOTOGRAPH BY LEN IRISH

"[This decision] warrants industrywide reconsideration of how New York law firms should be organized and whether the term *partner* is an outdated job title that carries more pitfalls than prestige."

Last November, Schnader Harrison Segal & Lewis bankruptcy partner Paul Jasper spoke these words to the *New York Law Journal* in response to a decision affecting one of his clients.

But those words have a powerful importance outside the context of New York, bankruptcy courts or one court's decision. The question of whether or not lawyers should accept an equity partnership could easily apply throughout the United States. And yet for most lawyers, becoming an equity partner at a large firm is the ultimate dream.

Or at least it was.

For those lawyers who entered the legal profession 20 to 30 years ago, becoming partner at a major law firm was like entering into marriage. The (admittedly romanticized) notion that held sway back then centered on the view that law firm partners were true partners. They ran the firm together and made business decisions together, and when they weren't in the office, they would hit the golf course together. If a partner had a problem or wasn't doing his or her best, others rallied around and helped. Kicking a nonproductive partner to the curb was unheard of.

Most importantly, partners all believed that their firms were the best and couldn't imagine themselves working anywhere else.

"When I graduated from law school and started at Bracewell & Patterson, my fellow associates and I all assumed we'd be there the rest of our lives," says Andrew Edison, who left what's now Bracewell & Giuliani in 2009 to start his own firm. "No one thought of it as stepping-stone to something else."

'TIL DEATH DO THEY PART

Much like the way divorce rates have skyrocketed, the bonds between law firm partners have been torn asunder. As law firms have become global Goliaths employing thousands of lawyers around the world, it's become impossible to run such firms by general consensus.

Instead, like most corporate entities, firms now have managers, boards or committees to make the decisions, leaving most individual partners to the task of representing clients and generating business.

Meanwhile, many firms have fueled their growth by picking off lateral partners from their competitors, or tried to stave off financial problems by firing partners or demoting them to income partners.

It was clear to many current partners interviewed for this article that the halcyon days when partners knew and supported one another and stayed at one place for their entire careers were never going to last once law firms started rapidly expanding and lawyers started keeping change-of-address forms in their briefcases. As large firms began to operate more as businesses, they've had to adopt methods and practices that have taken them further away from the traditional law partnership.

"Law firms have become very savvy over the last 30 years in terms of behaving like businesses," says Cathy Michaelson, founder of the legal recruiting company Michaelson Associates LLC. "Like businesses, law firms have merged and some have even failed. It's not a good or bad thing. It's just law firms evolving to meet the wider demands of their environment."

But others warn that the fraying bonds of legal partnerships will lead to instability and volatility in the legal industry. Law firms like to talk about the importance of preserving culture, but as lawyers and practice groups leave at the drop of a dollar for a better deal elsewhere, a firm's culture will inevitably begin to disappear.

Like Dewey & LeBoeuf and Howrey before them, firms that can't compensate for a mass exodus of partners risk being forced to close up shop or wait for another firm to swoop in and acquire them.

"The real modern law firm is the practice group," says Robert Hillman, a law professor at the University of California at Davis and author of *Law Firm Breakups: The Law and Ethics of Grabbing and Leaving*. "Sure, there are exceptions, but very often practice groups are the single most cohesive parts of law firms, and they often move as a unit from one firm to another. You might view the modern law firm as a loose confederation of practice groups."

Meanwhile, having so many new and unfamiliar faces at work—with some new arrivals guaranteed higher pay to lure them in—can lead to friction.

"There's a lot of research to support the idea that when firms grow very quickly through mergers or through lateral partner acquisitions, it leads to a deterioration in things like trust between partners," says Heidi Gardner, a distinguished fellow at Harvard Law School's Center on the Legal Profession.

Gardner names two forms of trust that are crucially important for firms to thrive: Partners need to trust each other to perform their tasks competently, and they need to trust that they won't try to sabotage one another to look better or steal a client.

"That trust is much harder to come by in a firm that's growing so quickly, especially for firms that rapidly expand internationally, because cross-cultural issues interfere with trust, too," says Gardner.

With that in mind, many small firms have held on to the traditional partnership model, and some of the largest firms in the country have tried to keep as many features of it as possible.

Meanwhile, others have called law firm partnerships archaic and outmoded, and they advocate for radical changes that would reform or even eliminate the partnership structure as it has existed for decades.

Whichever side you're on, it's hard to deny that the shape of partnership has been warped by the pressure of laterals and the drive for more money, the limited liability partnership model, and the two-tiered (or multitiered) partnership.

LATERAL HIRING

For many decades, most law firms were content not to upset the status quo. Then Finley Kumble came along.

Known officially as Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey when it collapsed in 1987, the firm was one of the first to operate more like a business corporation than a traditional law firm partnership. Finley Kumble undertook an aggressive expansion policy fueled by lateral hires and adopted a then-novel compensation system that shunned the traditional lockstep method and gave greater portions of the profits pie to the rainmakers who brought in the most business.

In its 19 years of existence, the firm went from eight lawyers to nearly 700, and it was, at one time, the second-largest law firm in the United States by headcount. The firm also had a reputation as a nice landing spot for onetime politicians, employing former New York Gov. Hugh Carey, former New York City Mayor Robert Wagner Jr., and former U.S. Sens. Joseph Tydings, Paul Laxalt and Russell Long.

Finley Kumble, however, was a paper giant that had incurred massive debts as a means to fund its radical expansion. When it collapsed, it was more than $100 million in the red and, according to *The American Lawyer*, some 1,600 lawyers and support staffers were left looking for work.

But its legacy has lived on at the firms it once competed against.

"Finley really changed the mold," Hillman says. "Lateral mobility continued to increase over the next 10 to 15 years. Nowadays it's an accepted part of the profession."

Hillman notes that when he first published *Law Firm Breakups* in 1990, lateral partner movement was still taboo. "When my book came out, people told me that they would have it sent to their homes because they didn't want to be seen with it at work," says Hillman.

How things change. According to a 2013 Bloomberg Law article, "lateral hiring/acquisition is—by far—the No. 1 strategy used by the majority of major law firms to increase revenues." In fact, laterals are so common, some firms are even led by partners who started their careers elsewhere.

Take Jackson Lewis, one of the largest labor and employment law firms in the country. "I might have been one of the first laterals that came to Jackson Lewis," says Vincent Cino, now chairman of the firm. "Back then, firms were never the size they are now. In 1990, when I joined the firm, we had 120 attorneys. Now we have 790. It's an evolutionary process."

Cino—who joined Jackson Lewis after nearly a dozen years in both public and private practice—acknowledges that these days lawyers are looking to move around, and his firm has been able to take advantage of this, adding 30 offices and nearly 500 lawyers since 2006.

Jackson Lewis is hardly the only firm that has helped itself to lateral partners. In the years since the Great Recession, lateral hiring has steadily increased as firms have found that buying lawyers is often the quickest way to grow.

According to *The American Lawyer*, lateral partner movement within the 200 largest firms by revenue in the U.S. has been at a frenzied pace since 2009, with an average of 2,532 lateral partner moves per year. Kinney Recruiting came to a similar conclusion in a 2014 study, which showed "a sustained upswing in the lateral partner market over the past three years."

The Kinney study also warned that "the sheer volume of lateral partner hiring is not always a sign of economic health." Indeed, both the Kinney and *American Lawyer* numbers encompass firm closures and collapses, including Dewey in 2012 and Howrey in 2011. And aggressive lateral hiring was one of the major causes of Dewey's collapse as the firm used big-money guarantees to lure rainmaking partners, alienating veterans who felt unappreciated and underpaid.

Michaelson, however, argues Dewey was more an example of poor management and less an example of the destabilizing effect of lateral partners. "Some firms rarely hire lateral partners, while others use [laterals] as an important part of their growth strategy," she says. "It's more important for management to focus on integrating new partners into the firm; otherwise it won't work. The well-managed firms do this very well."

But has behaving like businesses caused law firms to forfeit their individual identities and cultures?

"Firms are really just shells of what they once were," Hillman says. "It's almost impossible to distinguish the cultures of most top urban firms. Whatever culture they say they have today won't be relevant tomorrow when they lose an entire practice group."

THE MONEY GAME

Hillman is blunt about what's driving lateral partners or practice groups to depart for greener pastures: "It usually comes down to money in one form or another. There may be other reasons people say [for why] they move, like to increase the scope of their practice or because of personal or professional conflicts. But if you have to look to one reason, it's money."

Money is something Bradford Malt knows plenty about. The chair of Ropes & Gray since 2004, Malt is perhaps better known as the lawyer who oversaw Republican presidential nominee Mitt Romney's blind trust. When Romney released his most recent tax returns during the 2012 campaign, it was Malt who had prepared the documents and was out front answering questions about Romney's myriad investments, funds and bank accounts, both at home and abroad.

When it comes to his firm, however, Malt says the culture is one that does not put the almighty dollar front and center.

"What we say is: 'Where would you rather practice law?' " says Malt, who notes that Ropes & Gray is routinely among the top 25 firms in terms of overall compensation. "If a law firm X is offering the biggest check, that's nice. But what we have is a more satisfying combination of an exceptional platform from which to practice law, a great working environment, an enduring culture and attractive economics.

"At a certain point, you have to ask yourself: 'How much money do I really need?' "

Malt says that the firm has always projected stability and predictability, and that it was one of only a few Am Law 100 firms that grew in headcount and profits per partner during the Great Recession.

Maintaining the firm's culture is extremely important to Malt. And to that end, while it has traditionally relied on lateral recruiting, the firm has always taken a very conservative approach when it comes to acquiring partners.

As chair, Malt says that "you have to promote a culture where people know that culture is valued and it's something they devote time and energy to maintaining. In our case," he adds, "we constantly reiterate the value we place on teamwork and a one firm mentality."

Malt notes that it's impossible in a firm like his, with more than 1,000 lawyers, to consult every partner on every matter. "If we put every one of our partners in a room and gave them time to speak," says Malt, "we'd be there for weeks."

However, when it comes to naming new partners, he says, Ropes recognizes how important it is to make sure the firm gets it right. Every year, Malt states, he and other members of the policy committee divide up the firm's 300 partners, and each committee member speaks about prospective partners with a group of current partners to ensure that the entire partnership has been consulted, one by one.

"The old romanticized version of law firm partnerships is something that is largely gone in the legal profession, but it is still very true here," says Malt, who started at Ropes in 1979. "The whole profession isn't that way, but there are still firms where you can make a lifetime career of building something instead of jumping around for the biggest paycheck."

THE LIMITED LIABILITY MODEL

It's very easy for lawyers to get distracted or overawed when they first set foot inside the U.S. Bankruptcy Court for the Southern District of New York. The court is located inside the ornate historical landmark known as the Alexander Hamilton U.S. Custom House and shares its space with an American Indian museum and the National Archives at New York City. A lawyer who gets off on the wrong floor on the way to a bankruptcy hearing could easily get lost amid the historical relics, artifacts or documents.

Thus it was perhaps fitting that it was in this building in November 2014 that a group of lawyers litigating the largest law firm bankruptcy in U.S. history were hit with a decision that could put the very foundation of the legal industry inside a museum display case to be studied by future generations of scientists and historians. It was here where Paul Jasper and other attorneys representing various ex-Dewey partners were stunned into disbelief when U.S. Bankruptcy Judge Martin Glenn handed down a ruling that seemingly flew in the face of precedent regarding a law partner's obligation to repay money earned during the time the partner's law firm was insolvent.

In the very messy wake of Dewey's collapse (see "Dewey's Judgment Day," February), bankruptcy trustee Alan Jacobs reached a $71.5 million deal in October 2012 with some 400 former Dewey partners to claw back money they received after the firm became insolvent. Attorneys representing seven former Dewey partners who had chosen not to join in the settlement argued partners in a limited liability partnership were exempt from having to repay money earned during insolvency. Additionally, the former Dewey partners invoked a common defense in clawback cases—that whatever they owed was offset by the value they'd added to the insolvent firm's estate that it would not have otherwise had.

Glenn, however, swatted those arguments aside and held that lawyers had a strict liability to repay any money earned during the firm's insolvency, regardless of whether or not that attorney knew the firm was insolvent.

Jasper had represented one of the affected ex-partners, John Altorelli, who was on the hook for a $12.9 million clawback claim filed by the Dewey trustee. Jasper was shocked by the ruling and called it both unprecedented and draconian. When he spoke to the *ABA Journal* about the ruling months later, he was still upset and concerned enough about the decision's potential impact to warn attorneys to think twice before grabbing the brass ring.

"At this point," Jasper says, "partners need to think long and hard before accepting an equity partnership position in a large New York law firm—particularly if the firm's financial strength is in doubt."

The ruling "defeats the entire purpose of an LLP," says Jasper, who withdrew as Altorelli's attorney in November after Altorelli said in a court filing that he no longer wished to incur attorney fees from Jasper and his firm. "The whole goal was to limit liability so that professionals could focus on work and not be worried about being left holding the bag if the firm failed."

The limited liability partnership was created as a response to the collapse of several savings and loan institutions in Texas in the late '80s. Unsatisfied with the meager amounts they had recovered from the S&Ls, government entities began to go after the law firms that had advised those institutions.

In one well-known case, the government sued Laurence Vineyard Jr., then a Jenkens & Gilchrist partner, for fraud related to Vineyard's role in advising three failed S&Ls. The law firm eventually agreed to pony up $18 million in a settlement, but it did not admit liability.

LLP laws started popping up throughout the states as a means to protect lawyers and law firms from these types of situations, and law firms started moving to the LLP model during the 1990s.

But LLPs also had the effect of facilitating partner departures. Hillman explains that, free from individual liability to their firms, partners were able to jump to other firms more easily. There was no risk that they'd carry that liability over to their new firms.

"Law firms are essentially frictionless planes," says Joel Henning, a Chicago-based law firm consultant. "There's no friction to hold partners to the firm anymore."

Jasper warns that Glenn's decision could make a frictionless plane even more slippery. He warns that the ruling could cause lawyers to start leaving their firms at the first sign of trouble rather than stay and try to fix the problems at the risk of being hit with a clawback suit.

"When a law firm has financial difficulties, a mass exodus of partners will lead to its failure," he says. "The firm's survival depends on whether the partners are motivated to stick together, make sacrifices and work together to save the firm that they built together."

TWO-TIER TROUBLES

Being part of a failed law firm can also wreak havoc on a partner's personal finances, as Jasper learned both personally and professionally. Promoted to partner at Dewey during the firm's last year of existence, Jasper was hit with a clawback suit after Dewey's dissolution.

Luckily for him, he hadn't been paid much since he had been so junior and lacked a book of business.

"I was making less than some senior associates," Jasper notes. He says that had he been a more senior partner at Dewey and forced to pay back several years' worth of compensation, he'd probably have to declare bankruptcy. Indeed, his former client, Altorelli, did just that in November, shortly after Jasper's withdrawal.

Nonequity partners, however, don't have to worry about any of this because they are paid a salary and don't share in the firm's profits.

According to the National Association for Law Placement, the number of law offices that have used a two-tiered system of partners has risen dramatically over the last 20 years. NALP reported in 1995 that approximately 35 percent of law offices had nonequity and equity partners. That figure rose to 47 percent in 2001 and 67 percent in 2009. NALP also found that, in 2009, about three-fourths of law offices with between 101 and 500 lawyers had a two-tiered partnership system.

"Historically, being an income partner has been seen as less prestigious than being an equity partner," Jasper says. "But in this post-Dewey environment, thoughtful lawyers should consider it."

And there is another area where nonequity partners have, arguably, an advantage over equity partners: Because they are considered employees, they have certain protections under state and federal law. But that distinction has drawn challenges that have also questioned the existence of partnership in modern times.

Many law firms have mandatory retirement ages for equity partners and will bump them down to nonequity status or demote them to of counsel. In a 2007 study by law firm consultant Altman Weil, half of responding law firms had some sort of mandatory retirement policy. In 2014, Altman Weil consultant James Cotterman was quoted by news media as saying several firms had gotten rid of their mandatory retirement policies since the 2007 study, but that many remained in place.

There have been two high-profile legal challenges to mandatory retirement policies for partners over the years. In 2005, the Equal Employment Opportunity Commission brought suit against Sidley Austin on behalf of 32 former equity partners forced into retirement. The case settled, but not before Judge Richard Posner of the 7th U.S. Circuit Court of Appeals at Chicago authored an opinion that dissected Sidley Austin's partnership.

"The firm is controlled by a self-perpetuating executive committee," Posner wrote. "Partners who are not members of the committee have some powers delegated to them by it with respect to the hiring, firing, promotion and compensation of their subordinates; but so far as their own status is concerned, they are at the committee's mercy."

Posner wrote that this level of control could mean that the retired partners in question had been employees in a corporation rather than partners in a firm. The opinion, however, did not make any findings about whether or not an employee-employer relationship had occurred because the question before the court was whether or not the case could proceed.

Sidley settled before the case could go to trial.

In 2010, Kelley Drye & Warren's mandatory retirement policy came under scrutiny when the EEOC brought suit on behalf of partner Eugene D'Ablemont. The case settled in 2012 after the firm stated that it had removed its policy.

SEARCH FOR SOLUTIONS

Georgetown University law professor Jonathan Molot thinks many of the problems facing law firm partnerships could be addressed by allowing nonlawyer ownership of law firms, an alternative business structure that has been controversial in legal circles for years.

But for some, the very idea of nonlawyer ownership of firms is anathema. In a 2012 letter to the American Bar Association, general counsel from nine major companies—including DuPont, IBM, Intel and Verizon—voiced their disapproval of the idea. "We believe that allowing any form of nonlawyer ownership of law firms will harm the core values of the American legal profession." The GCs also wrote that they had watched with dismay how a "thirst for profits" has led law firms to ignore the once sacrosanct rule that the client's interests came first by combining with other firms without regard to conflicts of interest.

"We are deeply troubled by a proposed change that would only further undermine the tradition that law is a profession rather than a business," the GCs wrote. "Taking a step that will encourage a firm's partners to place an even higher premium on profit and wealth can only exacerbate a problem that is already threatening lawyers' sense of professionalism."

To Molot and others who support nonlawyer ownership, law firms have been businesses for a while, and it would be beneficial for the legal industry to embrace the concept.

"It is no wonder that law firms favor current revenues at the expense of long-term value," Molot wrote in the *Southern California Law Review*. "Law firms are structured to be nothing more than transitory associations of individuals who happen to practice law under the same roof for a particular period of time."

Instead, Molot argued, it is important to incentivize lawyers to create long-term value at their firms: "The law firm fails to maximize long-term profitability when it fails to satisfy client demands for fixed-fee billing; when it fires associates or turns down partnership candidates during lean times even though those lawyers would contribute value over their careers; and when it forces productive partners into retirement so as to free up profits to distribute to the rest of the partnership."

Molot said that the capital contribution equity partners put into a law firm has no correlation with how they are compensated. Instead, partners get paid based on the firm's current profits and the partner's individual productivity. By giving them stock in a corporation-style law firm, he argued, lawyers would have an incentive to generate long-term profits while making their compensation commensurate with their ownership stake.

"A true equity partner in a law firm," he wrote, " one who has permanent equity and wants to maximize the value of that equity—would have strong incentives not to squeeze every penny out of the business in the current year, and instead to favor decisions that place the business on a growth trajectory for the future."

This divisive issue is one the ABA continues to struggle with. ABA President William C. Hubbard created the Commission on the Future of Legal Services, and non-lawyer ownership is one of the issues the commission discussed during its May summit at Stanford University.

Laura Empson, a professor at the Cass Business School in London, offers another option. Empson points out that many of the issues confronting the legal industry are ones that auditing firms dealt with as the largest firms became even larger through mergers and acquisitions.

Empson serves on the public interest committee of KPMG in the United Kingdom as an independent nonexecutive. Under U.K. law, large auditing firms are required to have a committee of nonexecutives to ensure that the firms work in the best interests of the public.

"A public interest committee is different from an advisory board," Empson says. "Public interest committees consist of people with lots of external experience who have real influence inside the firm and who can act as highly effective independent nonexecutives."

Empson believes law firms would benefit from having a public interest committee in place to help guide their decision-making. "In the U.K., it's in the public interest to maintain strong auditing firms. It's in no one's interest for any of the major firms to go under," she says.

"At the moment, there isn't much push to have public interest committees at law firms," Empson says. "I think the major law firms believe that advisory boards are sufficient. Or maybe they're worried about allowing outsiders to have too much influence."

GOING SMALL

Some lawyers have devised their own solution—keeping partnership traditions by keeping the numbers down.

When Robin Gibbs left Vinson & Elkins in 1974, he did so despite knowing that he could have been partner if he had stuck around.

Gibbs recalls that, as he was leaving, he had a meeting with A. Frank Smith, who was at that time the managing partner. "He told me that if I stayed, I'd have a bright future," Gibbs says. "I appreciated that, and my decision had little to do with the quality of work and life at Vinson. I just wanted to build my own firm and control my own destiny. He said, 'You're the first person around here that I've seen that wanted to jump off the train just to see if you could catch it again.' "

Gibbs could also see what was coming. "I wanted to practice in an old-fashioned partnership," says Gibbs, who formed Wood, Campbell, Moody & Gibbs in 1974 before spinning off into his own firm, now called Gibbs & Bruns, in 1983. "Large firms were already becoming like big businesses, and that wasn't for me."

Gibbs & Bruns, a Houston firm with only 16 partners, can function as a true partnership because of its size and lack of bureaucracy, Gibbs says. "The biggest cultural aspect of our firm is that it is based on the old-fashioned partnership. We're partners first and business colleagues second."

Edison, the hiring partner at Houston-based Bracewell & Giuliani before starting Edison, McDowell & Hetherington in 2009, notes that being in a smaller firm allows him and his partners to make decisions more quickly.

He also points out that being in a smaller firm can be an attractive option for today's associates, who are finding it harder to make partner at large firms. The old rule of thumb was that associates would come up for partner after six or seven years of good work. In 2012, the Young Advocates Committee for the ABA noted that the modern partnership track had been extended to "eight, nine, 10 or even 11 years." That same year, *The American Lawyer* found that, within the Am Law 100, the average waiting time for associates was 10 years.

"Part of it is generational. A lot of people were willing to work harder back then," says Edison. "The perception was that if you worked hard and you did well, there would be a spot for you at the firm as a partner. For people today, you could be great and still might not make partner."

ON THE LINE

Many people in the industry agree that having firms straddle the line between the traditional partnership model and the corporate shareholder structure benefits no one.

Law firm consultant Patrick McKenna of Edmonton, Alberta, knows the old days when partners supported one another like family are long gone, but he adds that many lawyers and firms still believe in that ethos.

"Now we have a corporate structure that's not a true corporate structure," says McKenna. "A lot of partners are simply shareholders in a corporation, but unlike a shareholder at General Electric, they believe they should have a say over everything. That's really hurt some firms.

"It's almost like we've got the worst of both worlds." ■