When Law Firms Fail

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I can never get this straight: Is it "grow or die" or "grow and die"? In late 2008, the Heller Ehrman and Thelen firms failed.[1] Heller Ehrman, founded in 1890, had 730 lawyers spread across fifteen offices in the U.S. and abroad. Thelen, dating from 1924, had more than 600 lawyers in offices on both the Atlantic and Pacific coasts and in Shanghai. In mid-February 2009, other large law firms terminated 1,100 lawyers and staffers in only two days.[2] A week or two later, Latham and Watkins, which had 2,300 lawyers in twenty-eight offices, terminated 190 lawyers and 250 members of its staff.[3] Over a six-month period in 2008, Cadwalader, Wickersham and Taft, a 206-year-old New York based firm, laid off 131 lawyers, 20% of the firm.[4] Cadwalader and Latham are both aggressively managed firms that have been among the most profitable in recent years.

Until last year, high-powered, high-priced consultants made money by advising law firms to invest in expansion, seek broader horizons, and jettison routine, high-volume, "commoditized" work. Firms were told that to prosper they had to double their size, move into new cities, open offices abroad serving multinational Fortune 500 clients, and specialize in high-end financial transactions. To hell with portfolio theory![5] That was an old-fashioned, outmoded strategy used by the faint at heart; not the way to make big money.

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1. *See, e.g.*, Jonathon D. Glater, *Big Law Firm May Vote to Dissolve*, N.Y. TIMES, Sept. 27, 2008, at B9; Nathan Koppel, *Recession Batters Law Firms, Triggering Layoffs, Closings*, WALL ST. J., Jan. 26, 2009, at A1; Peter Page, *Economy Delivers Gut-Punch to Some NLJ 250 Firms*, NAT'L L.J., Nov. 10, 2008, at S15; Ed Poll, *No Firm Is Too Big to Fail*, MASS. LAWYERS WEEKLY, Dec. 15, 2008, *available at* http://www.lawbiz.com/coachs_corner_12-15-08.html; *Shanghai, Dubai or Bye-Bye?*, THE ECONOMIST, Nov. 29, 2008, at 84.

2. Martha Neil, *February Free Fall: Major Law Firms Lay Off Another 2,000-Plus Attorneys and Staff*, A.B.A. J., Feb. 26, 2009, http://abajournal.com/news/february_freefall_firms_ax_attorneys_freeze_pay.

3. Martha Neil, *March Mayhem: Law Firm Layoffs in 1 Week Total Nearly 1,500*, A.B.A. J., Mar. 4, 2009, http://abajournal.com/news/march_mayhem_law_firm_layoffs_top_500_today_over_1200_since_friday.

4. Ashby Jones, *Cadwalader's Layoff Strategy*, WALL ST. J., Aug. 6, 2008, at B5.

5. "Portfolio theory" is the proposition that one can reduce risk by diversifying investment.

The deterioration in the culture of major law firms is an old story, and it is always seen as deterioration—a change from groups of colleagues, once characterized as "families" or "clubs," into corporate-style businesses governed by full-time managers, heartless and impersonal. A thousand lawyers wrote that old story, and it made for some good copy. Peter Megargee Brown, a former head of the litigation department at Cadwalader who resigned from the firm in an acrimonious dispute with management, said of his antagonists:

The nature and function of a law firm, they felt, was no different from an automobile company or a fish market. So-called professionalism was, they said, a cover for Dickensian inefficiency; professional values that had guided the partnership since 1818 were "old fashioned" and, in today's world, "irrelevant."[6]

Patrick Schiltz, an academic lawyer who was a partner at Faegre and Benson, gave this advice to law students:

If you are going into private practice—particularly private practice in a big firm—you are going to be immersed in a culture that is hostile to the values you now have . . . . You will work among lawyers who will talk about money constantly.[7]

But, so long as the money was rolling in, most lawyers were willing to tolerate the unpleasantness. They were well-compensated for the loss of afternoon tea. When the credit bubble burst, however, the absence of tradition, civility, solidarity, and goodwill was all too apparent.

The mobility of lawyers among firms and the resulting changes in the culture of the firms have made it easier to terminate partners. In a firm with hundreds of lawyers, partners do not recognize one another on the street. According to one report, 48 percent of the lawyers who were made full partners in a sample of U.S. law firms between 2000 and 2006 were lateral transfers from other firms, not lawyers who had matured within the partnership.[8]

The clients have also made it easier for firms to make changes. Clients now move their work more often than in the past. Rapid turnover in the management teams at the companies also weakens ties between the businesses and their lawyers, and mergers among businesses mean that there are now simply fewer clients in many industries. Typically, the company's relationship (if there is a continuing one) is with a particular lawyer or set of lawyers, not with the firm. That is why lawyers are often able to take clients with them when they move from one firm to another.

But the most important changes in large law firms over the past decade or two were not matters of culture, style, or ambiance. Rather, they amounted to a

6. PETER M. BROWN, RASCALS: THE SELLING OF THE LEGAL PROFESSION 114 (1989).

7. Patrick J. Schiltz, *On Being a Happy, Healthy, and Ethical Member of an Unhappy, Unhealthy, and Unethical Profession*, 52 VAND. L. REV. 871, 912-13 (1999).

8. *See* Jerry Crimmins, *Firms 'Will Feel Pinch' From Economy Woes*, CHI. DAILY L. BULL., Jan. 31, 2008, at 1, citing the Citi Private Bank Law Watch survey.

fundamental restructuring of the firms and their markets. This was driven by what were seen as competitive imperatives. Top law firms compete for "bet the company" work, where the stakes are so high that the clients do not complain about top dollar fees. To attract clients with these big, make-or-break matters, the firms need to recruit and retain big name talent. When the fate of the company hangs in the balance, the client wants to hire The Best. Should the outcome be sour, the CEO can then tell the board: "But we used Sullivan & Cromwell!"

Competition among law firms was heightened during the last quarter of the twentieth century by ready access to comparative data concerning the business of the firms. The most important statistic, "profit per partner," is a straightforward measure of the profitability of a firm. James Holzhauer, the chairman of Mayer Brown, referred to it as "our 'stock price.'"[9] It has consequences. Partners are mobile; those who have relationships with valuable clients have opportunities to go to more profitable, higher-paying firms, quite possibly taking clients with them. Such "rainmakers" are the lifeblood of the practice. Thus, firms sometimes resort to extreme measures, including pay that is more than those partners are worth in the short run, ventured in the hope that the firm will end up in the winner's circle and collect the big prize. The partners who move often get guaranteed compensation for a couple of years—after which they can move again.

This competition for talent is both a cause and an effect of increasing inequality in the earnings of law firms. That is, to maximize profits per partner, firms must take risks. When the risks pay off, profits increase and lawyer recruitment is enhanced. The winning firms then get their pick of the ambitious lawyers, the rich get richer, and the gap between winners and losers widens. Some firms apparently believed that their very survival depended upon being among the biggest, most prestigious, most profitable firms doing high-end corporate work. Second best would not do.

In early 2007, Mayer Brown, a multinational firm based in Chicago, eliminated forty-five of its equity-holding partners. Its annual revenues at the time were over $1 billion, the highest in the firm's history, and according to the *American Lawyer* its profits per partner in 2005 were $955,000.[10] But this wasn't enough. Two other Chicago-based firms were doing better: Sidley Austin had profits per partner of $1.2 million and Kirkland Ellis earned $2.1 million per partner.[11] Mayer Brown concluded that it had to do better, and the fastest way to do that was to divide the available profit among a smaller number of partners. The chairman-elect of the firm said: "[E]ven though we've

9. *See* Nathan Koppel, *Partnership is No Longer a Tenured Position*, WALL ST. J., July 6, 2007, at B1; Jerry Crimmins, *Cuts Will Help Mayer Brown's Profits*, CHI. DAILY L. BULL., Mar. 5, 2007, at 1.

10. Stephanie Francis Ward, *'Mother Mayer' Becomes a Target*, A.B.A. J., Mar. 9, 2007, *available at* http://www.mlaglobal.com/articles/ABAMotherMayer3.09.pdf .

11. *Id.*

had recent record revenues and profits, our profits are not as strong as they need to be to attract the best lateral candidates and retain the best people at our firm."[12] American lawyers have a keen eye for hierarchy.

In part, Mayer Brown was engaged in manipulation of the criterion used by the *American Lawyer* in its computations of profit. Only partners holding equity in the firm count in determining the rate per partner. Lawyers who are "income partners," or "of counsel," or "special counsel" are not included. Only about half of the Mayer Brown partners who were "de-equitized" (in the professional patois) had to leave the firm—the others kept their jobs, with some other title.[13] But profits per partner increased. This is a typical example of the tactics used by firms to make their numbers look better.

The gap between lawyers at the top firms and lawyers practicing anywhere else has been referred to as a "winner-take-all" market. Serious scholarly work on the concept began, I think, with a 1981 article by the late Sherwin Rosen, an economist at the University of Chicago. Rosen noted that "[i]n certain kinds of economic activity there is a concentration of output among a few individuals, marked skewness in the distribution of income and very large rewards at the top."[14] But there is considerable dispute among economists about what a winner-take-all market really is, or how we would know it if we saw one.[15]

Mere income inequality does not define winner-take-all. Wage inequality is ubiquitous within occupations, and it is often pronounced. Rather, a winner-take-all market is one that values relative position rather than simply absolute returns. In such a market, it makes all the difference whether you get 51 percent or 49 percent of what is at stake. Thus, it is imperative to play to win. This incentivizes risky strategies. Having a profit will not suffice; it must be a profit higher than the next firm's. Thus, winners cannot just use the standard safe formula or do the usual thing.

In some circumstances, going for broke may actually be economically rational behavior rather than simply being motivated by a desire to beat the other guy. If we think of a normal distribution of profits, a "bell curve," with the highest returns in the right-hand tail of the distribution, the lowest on the left, and most cases falling in the middle, then the winning strategies are in the right tail, and firms that pursue speculative, hazardous initiatives may have a better chance of getting there (although they also have a higher chance of failure). James March, a polymath social scientist at Stanford, has observed:

If payoffs and preferences are such that finishing near the top matters a great deal, those organizations with performance distributions characterized by comparatively low means [*i.e.*, lower average returns] will (if they can) be

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12. *Id.*

13. *Id.*

14. Sherman Rosen, *The Economics of Superstars*, 71 AM. ECON. REV. 845, 845 (1981).

15. *See The Wages of Stardom: Law and the Winner-Take-All Society: A Debate*, U. CHIC. L. SCH. ROUNDTABLE 1 (1999).

willing to sacrifice average performance in order to augment the right-hand tails of their performance distributions. In this way, they improve their chances of winning, thus force their more talented competitors to do likewise, and thereby convert the competition into a right-hand tail "race" in which average performance (due to ability and effort) becomes irrelevant.[16]

Because the ventures in the right tail of the distribution are those with the highest returns, those strategies are likely to be emulated in the future, both within the firm and by other players.[17] But, of course, there is no guarantee that the gamble will continue to pay. What succeeds today may fail tomorrow. Context matters, and chance has a role. When the market for corporate legal services is booming, firms may have enough profit margin to be able to afford some risky ventures. But most law firms are thinly capitalized. Many now find themselves overextended.

Of course, it is not literally true that the notably successful law firms, the "winners," ever take all of the available profits. Many firms survive very nicely on regular if unspectacular earnings. These firms do smaller cases and relatively routine "commoditized" work, such as insurance defense. A lawyer in such a firm might make $300,000 or $500,000 per year, but not $2,000,000. Many lawyers, however, decided that they wanted the millions. And management consultants were available to tell them how to get it. If they wanted to play in the big leagues where the big money is, the consultants said, the firms had to grow, specialize in high value work, and move beyond their customary regional market. Risk seems not to have been uppermost in their minds. Demand for corporate legal services had grown spectacularly for several decades, and few consultants or law firms perceived significant limits on potential future growth.

A senior partner in a large Chicago firm told me that, until a few months ago, hiring more associates and more paralegals was "like printing money." A larger number of subordinates per partner provides "leverage" for the partner's assets. The firms bill the clients considerably more than the firms pay for the time of these employees. More lawyers, more staff, and more offices were also seen as providing an "improved platform" (in the jargon), meaning that competitive position would be enhanced. (When lawyers leave one firm to go to another, they typically say that they are seeking an improved platform, which appears to be regarded as less tacky than saying that they are looking for more money.) Growth came at no cost; the firms could not lose. Or so they thought. In 2006, Clifford Chance employed 2,432 lawyers. Not big enough! By 2008,

16. *See* James G. March, *Exploration and Exploitation in Organizational Learning*, 2 ORG. SCI. 71, 84-85 (1991).

17. Note that the right-hand tail strategy makes sense only if there are many competitors and if relative position is what matters. Both of these conditions were probably present in the competition among large law firms.

it had added 396 more, a 16 percent increase in just two years.[18] Before its recent layoffs, DLA Piper had 3,600 lawyers in sixty-four offices across twenty-five countries.[19] Much of its growth resulted from mergers of existing firms. Caldwalader was reported to be the most highly leveraged U.S. law firm, at 8.49 lawyers per equity partner, and Thelen ranked fourth on that list, at 6.13.[20] In 2007, the Caldwalader firm's profits per partner were $2.73 million, placing it in sixth place nationally, according to the rankings computed by the *American Lawyer*.[21] Eight months later, the firm had discharged one in every five lawyers.

It is not clear to what extent the managers of law firms do a systematic assessment of risk. I'm told that most of them have relied heavily on consultants to perform that analysis. But the consultants' reports that I have seen are long on boilerplate advice and short on evaluation of consequences in an economic downturn. An article in the McKinsey Quarterly in 2001 said that a leading firm (what they called a "shaper")

> will have upward of 2,000 attorneys and (like Skadden, Arps) a broad but coherent set of practices and locales permitting it to command a significant premium by helping large clients with their most lucrative legal issues, such as cross-practice and cross-border support in the M&A and capital-markets arenas. To play this role, the megafirms will . . . have to increase their resources by making significant acquisitions or mergers in a number of countries relatively soon. The winners will therefore have to be skilled at negotiating and structuring deals and at integrating and governing a large, diverse, and highly dispersed group of attorneys.[22]

More recently, the recommended firm size grew beyond 2,000 lawyers, but the overall strategy remained the same: focus on high-value financial transactions work. Now, however, that is exactly where the biggest losses are occurring. Transactions lawyers are looking for other work. In the past, easy credit bred transactions, but the bust of the credit bubble has meant that lawyers who "do deals" are increasingly under-employed.

The obvious move for a business that has more employees than it needs is to get rid of some of them. But there are costs associated with shedding lawyers. Apart from the usual termination costs (severance packages, buyouts, etc.), the partnership agreements at most law firms provide that departing equity partners take with them their investment in the firm. The payout may occur over an extended period, and many firms impose a limit or "cap" on the total that the

18. Margaret Taylor, *Clifford Chance to Cut Partners in Firmwide Reshaping*, THE LAWYER, Feb. 4, 2009, http://www.thelawyer.com/clifford-chance-to-cut-partners-in-firmwide-reshaping/136594.article.

19. Pat Milhizer, *Eight Jump to DLA Piper*, CHI. DAILY L. BULL., Feb. 22, 2008, at 3.

20. Susan Beck, *Past the Tipping Point: Is the Law Firm Pyramid an Unstable Structure?*, AMERICAN LAWYER, Jan. 1, 2009, at 16, available at http://www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202426909972.

21. *See* Jones, *supra* note 4.

22. Wendy M. Becker, et. al., *Lawyers Get Down to Business*, MCKINSEY Q., 2001, No. 2, at 45, 54.

firm will pay to departing partners in any one year, but partner defections may result in a loss of operating capital. Because clients seldom pay their law firms in advance, or even immediately after the work is performed, the firms carry substantial accounts receivable, and they have lines of credit at banks to permit them to meet expenses while they are waiting for clients to pay. In an economic downturn, when the clients are strapped for cash, payments are slow and the firms' collection cycles lengthen.

Firms that require partners to put up more of their own capital have an advantage in the profit-per-partner sweepstakes. The firms, in effect, get a return on that capital—i.e., they save the cost of interest that they would otherwise pay to a bank to finance their operations. The managers of those firms can say, "We are doing better than the firm across the street." But their partners are financing it.

The banks, of course, attach conditions to their loans. Loan agreements commonly include covenants providing that the bank has discretion to call the loan if the law firm's capital falls below a specified amount or if a certain number or percentage of the partners leave the firm. A covenant of this kind reportedly precipitated the demise of Heller Ehrman. Its revenue declined and several partners then left, putting the firm in breach of the loan agreement.[23] Once partners start leaving, others see them go and may follow their lead. No one wants to be left holding the empty bag—*or* the lawyers start to flee the sinking ship, *or* start a run on the bank—pick your metaphor. Heller Ehrman failed less than two years after having made record profits. Many law firms are now asking their partners to contribute additional capital to keep the firms viable.

Brobeck, Phleger and Harrison, another prestigious San Francisco firm, grew rapidly after new management took over the firm in 1998. From 400 lawyers that year, it more than doubled in size in just three years, growing to over 900 lawyers in 2001. At its peak, annual profits per partner were $1.17 million. But then, in 2002, profits per partner fell to $550,000 and the number of lawyers dropped to 493.[24] Boom and then bust (if you can call a $550,000 income "bust"). What happened? The Silicon Valley tech bubble burst. Brobeck had taken stock in tech startup companies as a substantial portion of its fees. The startups failed, and so did Brobeck.

The rapid expansion of many large law firms now appears improvident, given the economic crisis. The recent layoffs represent the sacrifice of a very considerable investment in recruitment and training, perhaps on the order of $250,000 per lawyer. At that rate, Latham & Watkins's dismissal of 190 lawyers wrote off an investment of $47,500,000. But law firms are more adaptable than are enterprises that are capital-intensive. Law firms can bulk-up

23. *See* Koppel, *supra* note 1.

24. JOHN P. HEINZ ET. AL., URBAN LAWYERS: THE NEW SOCIAL STRUCTURE OF THE BAR 309 (2005).

and slim down more quickly and inexpensively than manufacturers, agribusiness, or many mercantile companies—but not at less pain to those who lose their jobs. If the firms can shed lawyers and support staff at low enough cost, and if, as the Chicago senior partner said, hiring associates and paralegals was "like printing money," then the firms may be able to retain at least a substantial part of the revenue they gained during their expansionary phase. By one consultant's estimate, the law firms that laid off 800 lawyers and staff on February 12, 2009, will save $100 million annually in salaries and benefits.[25] After firing a fifth of the firm's lawyers, the chairman of Caldwalader said, "There was a bubble, we rode that bubble, it contracted, and we adjusted. Even knowing what I know now, I wouldn't have changed a thing."[26] But the payroll is not the only expense associated with size. The growing firms acquired expensive leases that will burden them for years. In October 2006, less than two years before its big layoffs, Caldwalader leased an additional 53,000 square feet of New York office space.[27] In a declining economy, it is not easy to sublease space. Moreover, many of the firms took on substantial debt to finance expansion. It is difficult for a firm of 500 lawyers to handle a debt load premised on a firm of 1,000. Rapid growth is not a low-risk strategy.

The second article of faith was that profit would increase if the firm concentrated on high-value work and got rid of relatively routine, workmanlike tasks. So long as there was sufficient demand for the lucrative work, that seemed to make sense. But, if all of the big firms shoot for the same bundle of high-end transactions in structured finance, while at the same time trying to become even bigger, the result is likely to be overcrowding. When there is an economic downturn with a consequent decline in demand for transactional services, this becomes apparent. Thacher Proffitt & Wood, a 160-year-old New York firm that specialized in securitizations, is now gone.[28] Half of the lawyers were acquired by the Sonnenschein firm—but only half.[29] Cadwalader built up its strength in mortgage-backed securities and commercial real estate work by adding lawyers in those areas, and those are the lawyers now cut loose. Like many other businesses, law firms did not see the downturn coming, but the consequence of a severe decline in economic activity was certainly predictable. When banks are unwilling to finance commercial transactions, when no mergers and acquisitions are taking place, and when there is no market for mortgages bundled into securities, lawyers who did that sort of work must look for something else to do.

25. Debra Cassens Weiss, *Last Week's Layoffs Saved Law Firms an Estimated $100M*, A.B.A. J., Feb. 17, 2009 (citing an estimate by Thomas Clay of Altman Weil).

26. Jones, *supra* note 4 (quoting W. Christopher White).

27. Dan Slater, *Cadwalader Sheds 96 Lawyers*, WALL ST. J., July 31, 2008, at C3.

28. *Thacher Proffitt & Wood: Bitter End*, THE LAWYER, Jan. 19, 2009, at 14, available at http://www.thelawyer.com/thacher-proffitt-and-wood-bitter-end/136364.article.

29. *Id.*

Is the current crisis likely to have lasting consequences for the ways in which law firms do business? Given the pressures, both internal and external, on large firms, there will certainly be adjustments—clearly, those are already occurring—but will the firms revert to their old ways as soon as the crisis abates?

Having experienced the overcrowding in structured finance, the firms may now find a balanced portfolio of varying types of legal work more attractive. Firms are aggregations of specialists, and the big ones traditionally sought to provide all of the types of expertise that their corporate clientele might want. This gave clients the convenience of "one-stop shopping" and, for the law firm, it minimized the risk that the client would turn to another firm to get the advice it needed.

The range of specialties that can be covered by a firm is related to size, of course, up to a point. That is, a firm of thirty or forty lawyers is not big enough to provide the full complement of services, but growth beyond 200 or 300 lawyers is not motivated by a need to cover all of the specialties. Megafirms were created to establish brand name dominance and a broad presence in major markets. Growth was also motivated by leverage—i.e., by the desire of partners to exploit the labor of a larger number of subordinates. But subordinates who must be paid even when there is no work for them to do are a drag.

Corporations are now less likely to see one-stop shopping for legal services as a substantial advantage. Advances in information technology and the increasing sophistication and power of corporate house counsel make it possible for them to identify experts in a full range of fields and to assess their merits. House counsel exchange e-mail evaluating the performance of law firms and particular lawyers (with praise or criticism). Mike Dillon, general counsel of Sun Microsystems, says, "We are increasingly able to identify and engage specific legal talent directly."[30] If clients are able to put together their own teams of specialists, there is less need for law firms to perform this function.

The lawyers who run the legal departments of major corporations now find themselves in a buyer's market, and they plan to take advantage of it.[31] Because law firms are hungry for work, they are much more willing to bargain on price than they have been in the past. Many firms are, in fact, bidding for work. The professional association representing lawyers employed within companies, the Association of Corporate Counsel, sees this as an opportune

30. Mike Dillon, *The Way of the Mastodon*, THE LEGAL THING, May 22, 2007, http://blogs.sun.com/dillon/date/20070522.

31. Martha Neil, *Some Lawyers are Reducing Fees as Corporations Seek Discounts*, A.B.A. J., Nov. 4. 2008, http://abajournal.com/news/some_lawyers_are_reducing_fees_as_corporations_seek_discounts; Michael Tierney, *Billable Rates Now Under Siege Due to Recession*, NAT'L L.J., Mar. 18, 2009, *available at* http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202429165987.

time to bring pressure to bear on law firms to change billing practices that the companies have complained about for years, notably billing by the hour.[32] The Association is now asking the firms "to reconnect value and costs for legal services," and it suggests "metrics," "tools," and "benchmarks" to assess "value-driven legal services."[33] A proposed "covenant" with outside counsel asks the firms to "proactively offer value-based alternative fee structures" and to "provide budgets and estimates for specific engagements upfront and advise . . . immediately if there may be any material changes."[34] If corporate inside counsel prevail, large law firms will clearly have less freedom of action in the future, even in major matters.

Conflicts of interest may also influence the size and growth of law firms. As corporate bankruptcies become more frequent, large law firms are finding it more difficult to manage conflicts. As Milton Regan has observed, "Any large corporate bankruptcy may involve thousands of parties with claims on the debtor. It's almost certain that clients of large law firms will be among them."[35] Although conflicts are often waived in commercial transactions, the practice is more stringent in bankruptcy proceedings.[36] Partners who do transactional work are now feeling pressure from their partners in the bankruptcy department to drop long-standing clients in order to avoid conflicts that would prevent the firm from taking bankruptcy work, one of the few fields that is busy at present. The larger the firm, the greater the likelihood of such stresses created by conflicts, and the greater the likelihood that clients must be turned away because of them. Large law firms spend millions of dollars trying to monitor potential conflicts. Expensive senior lawyers must devote their time to decisions about how to handle both the substance and the relationships—i.e., relationships among partners within the firm and relationships with important clients. Partners who have become unhappy about being instructed to drop a major client have in some cases dropped the firm instead; they have left, taking their client with them. It is certainly possible that more firms may come apart in the next year or two, both because of these stresses and because the value of size has become less clear.

Developments in other countries are also likely to affect the ways in which firms do business here. The British Parliament has adopted legislation that will permit law firms in England and Wales to have outside investors by 2012. Advocates of outside investment argued that it would stimulate innovation in the firms, making them more efficient and reducing the cost of legal services,

32. ACC Value Challenge, Association of Corporate Counsel, http://www.acc.com/advocacy/value challenge (last visited Apr. 28, 2009).

33. *Id.*

34. *Id.*

35. *See* MILTON C. REGAN, EAT WHAT YOU KILL: THE FALL OF A WALL STREET LAWYER 326 (2004).

36. *Id.* at 322.

thus benefitting clients.[37] In 2007, an Australian law firm, Slater & Gordon, sold shares in the firm in a public offering.[38] It is now listed on the Australian stock exchange.

American law firms are already expressing concern about their ability to compete with firms that have access to outside capital. If British firms are permitted to use outside investment while U.S. firms are not, the former would have an advantage in financing expansion, moving into new markets, acquiring new technology, and generally taking on greater risk. At that point, U.S. firms would surely seek to level the playing field. This could be done either by permitting non-lawyer investment in all firms operating in the U.S.—foreign and domestic—or, more problematically, by denying the U.S. branches of foreign law firms the advantages of outside capital and permitting U.S.-based firms to use such capital in their operations abroad, thus enabling U.S. firms to compete with others on the same terms. To pursue the latter course would require an effective mechanism separating the U.S. operations of all law firms from their affiliates in other countries.[39] To comply with present U.S. rules, a law firm operating in the U.S. must be both "fiscally and managerially separate" from firms that have non-lawyer investors.[40] But the separation, in fact as well as in form, may be difficult to ascertain. State supreme courts, which regulate the profession in the U.S., are almost certainly incapable of conducting the factual inquiries that would be necessary in order to enforce the restriction. Lawyers would surely be able to find means through which resources might flow from their affiliates located in jurisdictions that permit outside investment to offices located within the United States. If that is the case, what would the restriction accomplish?

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37. *See* Milton C. Regan, *Lawyers, Symbols, and Money: Outside Investment in Law Firms*, 27 PENN ST. INT'L. L. REV. 407, 409-15 (2009); *see also* Michael Peel, *Law Firms Gear Up for 'Big Bang'*, FIN. TIMES, Nov. 8, 2007, http://www.ft.com/cms/s/0/2c818892-8e25-11dc-8591-0000779fd2ac.html?nclick_check=1; Milton Regan, Jr., Commentary, *Nonlawyer Ownership of Law Firms Might Not Cause the Sky to Fall*, THE AMERICAN LAWYER, Aug. 14, 2007, *available at* http://www.law.com/jsp/law/international/LawArticleIntl.jsp?id=900005488567.

38. Slater & Gordon, http://www.slatergordon.com.au/pages/history.aspx (last visited Apr. 28, 2009).

39. Megan E. Vetula, *From the Big Four to Big Law: The Swiss Verein and the Global Law Firm*, 22 GEO. J. LEGAL ETHICS (forthcoming 2009). At present, the Baker & McKenzie and DLA Piper firms, which practice both in the U.S. and abroad, employ the "Swiss verein" for this purpose. Large, multinational accounting firms also use this legal form to permit them to adapt to the differing regulatory rules of the countries in which they do business.

The Swiss verein is an association of firms. It brings together a set of partnerships and/or corporations under a common brand name. DLA Piper's website says, "DLA Piper is a global organisation ("Organisation"), the members of which are legal practices and other entities, each member . . . being a separate and distinct legal entity." DLA Piper, www.dlapiper.com/global/termsconditions (last visited Apr. 28, 2009). Baker & McKenzie says that it is "a Swiss verein with member law firms around the world." Press Release, Baker & McKenzie, Baker & McKenzie Adopts New Legal Structure (July 2, 2004), http://www.bakernet.com/BakerNet/News/Archive/2004/newlegalstructurebm.htm.

40. *See* ABA Comm. on Ethics and Prof. Responsibility, Formal Op. 96-401 (1996); ABA Comm. on Ethics and Prof. Responsibility, Formal Op. 94-388 (1994).

The issue could, however, precipitate a split within the legal profession.[41] There have, for some time, been tensions between lawyers serving major corporations or other large organizations, on the one hand, and lawyers serving individuals and small businesses, on the other—categories that some scholars have referred to as "the two hemispheres of the legal profession." The Law Society of England and Wales, the body that regulates solicitors in those two countries, is considering the adoption of a separate regulatory system for large law firms.[42] It may be time for the U.S. to recognize, formally, that all lawyers are not in fact pursuing the same line of work. That reality has been apparent to many lawyers for some time.

"If you want big rewards, you have to take big risks." Well, that may be true, usually, but it does not tell us what level of reward suffices. Are profits per partner of $1,000,000 satisfactory? Or does each partner need $2,000,000? More? How systematic is the assessment of the tradeoff between income and risk? How solid is the information necessary for that assessment? Did the partners who were doing the clients' work, while others were minding the store, have the answers to these questions? Did they even ask them?

Law firms are now receiving advice about how to do business in the future. Mostly, they are told that they must be "more efficient." And how is this to be accomplished? The recommendations are notably lacking in specificity: the firms must "work smarter," "embrace emerging technologies," and "seek to reduce costs creatively." The firms that do this, we are told, will prosper. This reminds me of the advice I was given by my high school track coach: "Heinz, do you want to know how to win races? Take longer steps faster!"

41. In the early 1980s, a committee of the ABA proposed that the ethical rules of the profession be relaxed to permit non-lawyer ownership of U.S. law firms. In debate on the proposal in the ABA House of Delegates, the committee was asked whether the change would permit Sears to sell legal services. Upon being informed that it would, the House resoundingly defeated the proposal. See James R. DeBuse, *Opening at $25 1/2 is Big Firm U.S.A.: Why America May Eventually Have A Publicly Traded Law Firm, And Why Law Firms Can Succeed Without Going Public*, 34 J. CORP. L. 317, 325-26, nn.70-79 (2008). *See generally* Rita Henley Jensen, *Ethics Row Looms on Affiliates*, NAT'L. L.J., Feb. 20, 1989. Tradition, self-image—or a concern about new competitors? Lawyers from small firms and rural areas are powerfully represented in the ABA, and in the past they have not been notably solicitous of the concerns of the large, multinational firms. But large law firms have their own political assets. Their corporate clients are, potentially, formidable allies. If the big firms were able to mobilize the lobbying strength of the business community in support of their interests, the ABA might become irrelevant.

42. *See generally* Nick Smedley, *Review of the Regulation of Corporate Legal Work*, LAW SOCIETY COMMISSION REPORT (Mar. 31, 2009), available at http://www.legalregulationreview.org.uk/files/report_smedleyfinal.pdf.