The Lawyer's Tale
A successful firm got caught up in expansion, only to discover it had lost its soul

By Barry Lawrence
Kaye Scholer LLP

"What has gone wrong?" thought the gray-haired managing partner of one of America's, now the world's, premiere law firms as he stared out of his Manhattan office window. He was trying to figure out how what once had sounded so good had turned out so badly and had brought his firm to the brink of disaster. Why couldn't he replicate at his firm the successful business models of other professional service companies? Why couldn't his law firm follow the lead of the once privately held investment banking firms that had turned themselves into profitable public companies on Wall Street?

The experts had been saying since 1980 that globalization would force law firms to be much larger, that they would have thousands of lawyers and offices in New York, London, Brussels, Tokyo and everywhere else where "value-added" work would "pay the freight." While "pay the freight" made sense at the time, he knew that you couldn't call what had been traditionally a very personal service between an attorney and a client, "freight."

But that's what the experts called it, as if it were a commodity. The firm had to become dominant in every market where it operated. The buzz on the everyone's lips was that there would be a small number of firms that would dominate the world. These global behemoths also would need to provide "synergistic" non-legal business consulting services. This was all now called "value-added growth."

The American Bar Association recently had changed the rules to permit lawyers to join with other business consultants. With the addition of a group of lawyers in Chicago who specialized in exotic financial transaction structuring, he soon orchestrated bringing into the firm a boutique hedge fund advisory group of very talented people - the firm's first non-lawyer advisory group.

By deploying the firm's and some of its well-heeled clients' capital, he believed he had a winner. It started out well enough and was very profitable. These people seemed to make money in environments of rising and falling markets. It was magic.

He then recalled that, after a five-year debate, the ABA began allowing law firms to go public as long as their board of directors comprised at least two-thirds lawyers and lawyers owned the majority of the stock.

For years, lawyers had watched jealously the wealth their clients created by going public. If his firm stayed private, he knew his partners, who had spent a lifetime building up a practice, would have nothing to sell when they retired. He wanted these partners to be able to "monatize" their life's work in some manner.

It was relatively easy for his law firm to reach 1,000 lawyers. This had been his first goal. He had to have the numbers, for he truly believed that a few firms would dominate the planet, and he wanted his law firm to be there. So from the base of New York, he quickly merged with a London firm. He soon moved to Brussels. Easy.

Tokyo was much more difficult. It had been an expensive move. For fillers, he acquired firms in Washington D.C., Chicago and Los Angeles. While he liked the LA folks, he never understood what was in the air out there that made them act so differently from New Yorkers.

It was around that time that his biggest client, an investment banking firm, CD First Chicago, convinced him to take his law firm public. What a great day - to be the first law firm to go public and, of course, on the New York Stock Exchange. With all the years of taking clients public as a corporate finance lawyer, he couldn't believe that he was standing above the floor of the New York Stock Exchange, with the bell in hand, to usher in the day's trading.

That evening, he was on a number of the TV business shows, talking about the adventure. Look how far he and his law firm had come in just 5 years. But soon after the firm went public, its profits started to decline. It had been so hard to integrate all of these cities, all of the new practice groups, all of the different cultures.

By going public, the firm had to scrap what had been a relatively simple accounting system for a private firm with 5 offices with one that required the firm to account for everything in its now 20 offices. He found himself having to meet with his accountants constantly, in meetings that often ended in screaming matches, because they wanted the firm to reserve for every conceivable potential loss known to man.

Companies referred to this as the fall-out to the "Enron Syndrome." While a private law firm, it was under the radar screen from a Wall Street point of view. Now, it was in the spotlight which resulted in substantially higher malpractice insurance costs and nearly every other cost. There was terrible pressure and scrutiny to reserve for potential losses of all kinds.

Then there was the constant pressure of meeting analysts' expectations each quarter. While he watched it for years, he thought he understood the pressures placed on his clients who were publicly traded to meet these quarterly thresholds. Analysts now were asking constant questions about why his law firm's stock, which was $20 when they went public, now had dropped to $1.25.

The anger and disappointment he felt then turned to introspection. The growth in all numbers -- lawyers, revenues and profits, as demanded by Wall Street -- could not be sustained in a continuous manner because of the ebbs and flows of the geographic economies in which the firm's offices were located. Soon, the firm had to close its offices in "low margin" cities.

The sheer size of the firm had caused constant conflicts of interest between its existing clients and potential clients. The consulting groups, which had their own separate pressures to create profits while enthusiastically and creatively designing new financial instruments and other methodologies of doing business for the firm's clients, were consistently running into the conservative side of the firm who were deal-killers.

These naysayer lawyers, particularly from the tax and corporate finance departments, regularly were shooting down the schemes designed by the consulting groups. This lack of harmony ultimately caused the consulting groups to seek legal advice outside the law firm frequently.

And then he had to deal with the horribly plummeting stock price. He had grown to believe that the firm's existing and potential clients ultimately judged his law firm's prestige and worthiness on the performance of the price of its shares. The mere fact of the falling stock price was damaging the firm's terrific brand name for legal services. In order to boost the price, the firm had to take actions to increase its business and profits. It had to take risks.

So the firm began taking clients who had spotty financial performance records, including the occasional restatements of earnings. This ultimately caused significant write-offs of fees and his firm being involved in shareholder litigation when some of its clients went into bankruptcy.

The sum of all of this, he concluded, was that this "New World Order," "the World is Flat," "globalization," in law firms was incredibly difficult to execute upon and make work. And what his law firm was required to do in this new environment was not compatible with the interests of the clients, the shareholders and, ultimately, the law firm itself.

Click! On went the clock radio. It all had been a dream -- a nightmare. His thoughts went to his father, also a lawyer, who had warned him about what he called the "excessives" of the "legal business" - a term that reflected the law firm's change from a personal service profession to a big business which only thought about "profits per partner."

While still in sweat, he was so pleased to begin starting the day without the terribly heavy burden of the nightmare. As managing partner, he soon would be chairing his firm's weekend partner retreat to discuss the possible expansion of his highly prestigious 300-lawyer "blue chip" firm where he was constantly being told it was too small and the wrong size, and not global enough.

Barry H. Lawrence *is Chairman of the Real Estate Department in the Los Angeles office of Kaye Scholer LLP, where his law practice consists of representing clients in various real estate industry matters, including merchant bankers who provide corporate financing, underwriters, REIT's, real estate developers and entrepreneurs, financial institutions and builders. Mr. Lawrence can be reached at 310.788.1010 or blawrence@kayescholer.com.*