

Pace University

DigitalCommons@Pace

Pace Law Faculty Publications

School of Law

1993

Law Firm Restructuring: The Big Picture

Gary A. Munneke
Pace Law School

Follow this and additional works at: <https://digitalcommons.pace.edu/lawfaculty>



Part of the [Legal Profession Commons](#)

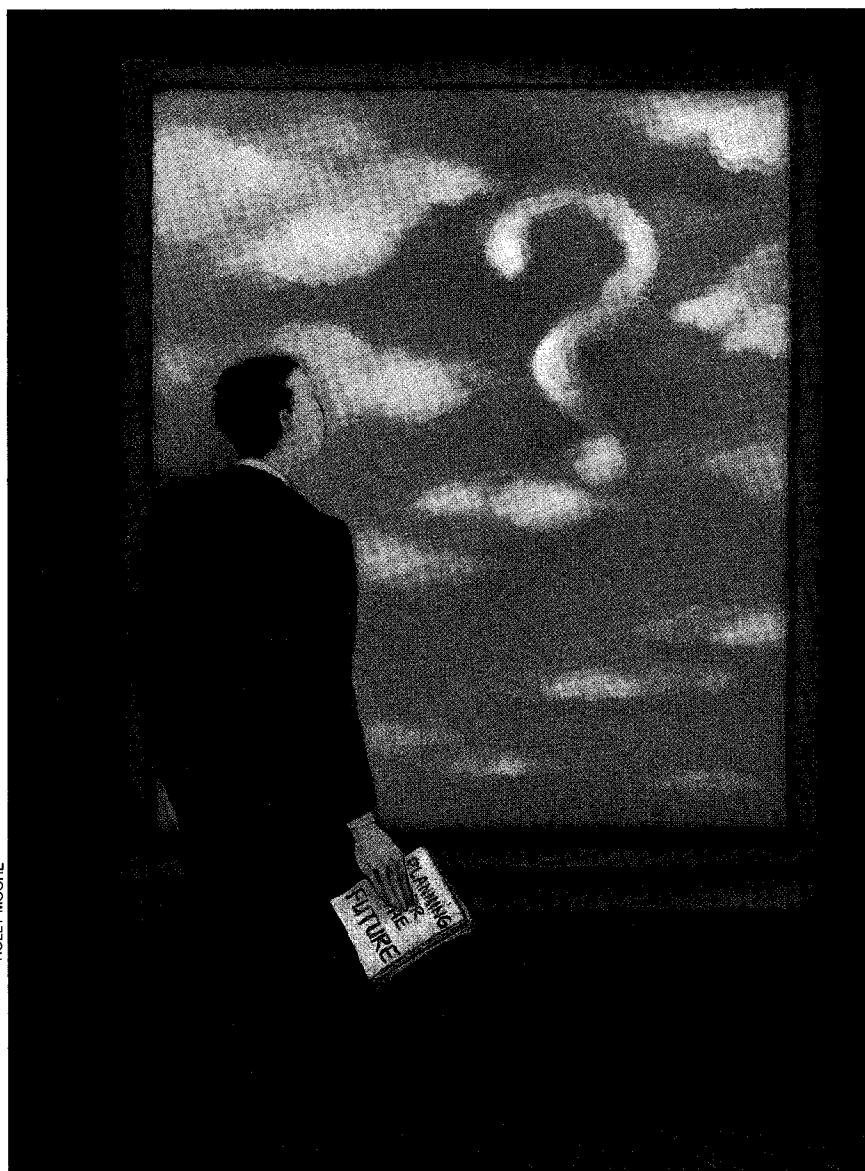
Recommended Citation

Gary A. Munneke, Law Firm Restructuring: The Big Picture, 19 Law Prac. Mgmt. 34 (1993),
<http://digitalcommons.pace.edu/lawfaculty/823/>.

This Article is brought to you for free and open access by the School of Law at DigitalCommons@Pace. It has been accepted for inclusion in Pace Law Faculty Publications by an authorized administrator of DigitalCommons@Pace. For more information, please contact dheller2@law.pace.edu.

Law Firm RESTRUCTURING: The Big Picture

The term “restructuring” has become a buzzword for law firm efforts to improve the bottom line by altering the composition of the firm’s personnel.



HOLLY MOORE

The term “restructuring” has become a buzzword for law firm efforts to improve the bottom line by altering the composition of the firm’s personnel. In many instances, this is accomplished by “downsizing,” a word more easily spoken than “firing.” As opportunities for ownership interest in law firms evaporate, firms talk about “nonequity partners” and “rainmaking” skills. Such euphemisms are often used to sugarcoat the bitter medicine of economic reality.

It may be useful to look more closely at the phenomenon of restructuring, although cynics might say lawyers should look at structuring first. In either case, taking a look at the big picture of law firm restructuring may help resolve more immediate concerns. In the book *Megatrends*, author John Naisbitt points to the demise of the railroads as an example of a failure to address the long-term question, “What business are we really in?” To the railroads, their business was hauling people and goods by rail. Had they defined their business as “transportation,” we might be flying Union Pacific today, Naisbitt suggests.

Lawyers are in the business of resolving problems and representing others in disputes. Out of 800,000 lawyers in the United States, approximately 500,000 are engaged in private practice—they sell their services to clients on the open market. Out of these, about 200,000 (40 percent) are solo practitioners, while 300,000 practice in 20,000 law firms ranging in size from 2 to more than 1,000 lawyers. Considering that prior to 1950 nearly 70 percent of all attorneys practiced alone and the largest firms were small by today’s standards, the profession has undergone a rapid metamorphosis.

Restructuring has been a way of life. It is not something that emerged when the economy crashed at the end of the ’80s. Nor is it likely to disappear in the near future. Thus, it makes sense to view restructuring as an ongoing process. The term can be defined as changing organizational patterns in order to attain or maintain market competitiveness. Law firms, like other businesses in a free market economy, must remain profitable to survive, and to accomplish this they must evolve, even when economic cycles alter the practice landscape.

Individual practitioners and law firms should attempt to answer questions about how (not if) they should restructure over time. Admittedly, prognostication is an imprecise art. Who in 1989 would have believed the United States would fight a war in the Middle East within a year? Or the Soviet Union would disintegrate? It is fallacious logic to say that because we cannot predict the future, we should ignore it. We can prepare for change and at least anticipate alternative futures.

Forms of Restructuring

Law firms may experience restructuring in any of a number of ways, some within the firms and some externally. In some situations the restructuring is planned, while in others it is unanticipated. Since many firms fail to manage change, they must react to it—and sometimes unplanned change can take place cataclysmically.

One of the most common forms of restructuring is to alter the structure of a partnership itself. This may involve bringing in a lateral partner to bolster an existing practice area or to embark on a

**Restructuring
can be de-
fined as
changing or-
ganizational
patterns
in order to
attain or
maintain
market com-
petitiveness.**



new one. It may also necessitate the retirement of an older partner or, more painfully, the removal of a nonproductive or trouble-making partner. In recent years, many firms have begun to experiment with tiered equity. The result of such restructuring is that not all partners have an equal say in management or equal interest in the profits of the firm.

Although shifts in power are often related to income production and realization of profit, a growing number of firms are looking at capitalization to infuse cash into the organization. Law firms traditionally have been among the least capitalized businesses. Part of the reason is that a law practice does not require capital-intensive machinery or stock. Before the days of computers, a desk, telephone, typewriter, letterhead stationery, yellow pads, a few basic law books and a supply of pens were virtually the only investments a law office required. Today, the capital requirements have escalated dramatically. Law firms have begun to appreciate the value of retained reserves to weather the proverbial rainy day. Because lawyers are prohibited from accepting investments from nonlawyers (see *ABA Model Rules of Professional Conduct*, Rule 5.4d), they cannot make a public stock offering or seek a white knight investor. Thus, in order to raise capital, a firm must bring in new partners, increase capital requirements for existing partners or allocate a portion of the firm's profits as retained earnings dedicated to partners' capital accounts.

A second major area involving internal restructuring involves employees. By cutting back on hiring for new associates and reducing the size of summer clerkship programs while increasing billable hour requirements for current associates, firms can get more production for less money. There is evidence to indicate that lowered morale and increased turnover may offset the gains produced by hiring cuts. Many firms are looking seriously at the concept of permanent lawyer employees. Whether these individuals are called nonequity partners, staff attorneys, permanent associates or of counsel, the objective is the same: to retain experienced lawyers who are profitable to the firm but for whatever reason cannot be offered partnership. In many cases such a policy makes much more sense than "seven years up or out."

A significant change that is now sweeping the country involves the increased utilization of administrative personnel. Lawyers have never been completely comfortable as

managers, but until recently, many were reluctant to relinquish authority to nonpartners. First in large firms and then in smaller ones, lawyers began to hire professional staff to handle management responsibilities. Ceding power to administrators, who usually are not lawyers, can be disruptive, but slowly firms have accepted the need and recognized the cost-effectiveness of hiring personnel trained as managers to help them practice law.

Another type of employee to appear in some law firms is the professional who offers nonlegal services to the law firm's clients, or special expertise to the firm itself. Although the question of external ancillary business has been a controversial one in the American Bar Association, no one has suggested that a law firm may not hire a professional (e.g., psychologist, accountant, economic analyst) to support the law firm in providing legal services to clients. The cost of in-house expertise will inevitably be less than expertise purchased on the open market, so if a firm has enough work, it makes sense to utilize in-house nonlegal help.

Another aspect of internal restructuring has been the slow but steady movement toward specialization. Although lawyers have resisted the medical model of specialization, the complexity of modern law, the incidence of legal malpractice and the financial incentives of higher fee structures for specialty work have pushed law firms in the direction of *de facto* specialization. This has promoted departmentalization for smaller and smaller firms and more client-focused marketing efforts for all firms. In terms of personnel, specialization has led many lawyers to change jobs in order to find a better practice mix, and has prompted some firms to dismiss lawyers who do not practice in a profitable specialty.

A final form of internal restructuring has become the buzzword of the '90s: downsizing. In simple terms, when a firm's profitability and/or workload decline too much, the organization cannot continue to support the same level of personnel. Neither support staff, associates nor partners are immune from personnel cuts in the current recession. Some firms accomplish downsizing through the merger process, but often they must resort to old-fashioned layoffs and firings. The Association of the Bar of the City of New York even advised New York firms not to dismiss lawyers for allegedly poor performance when the real reason was economic. Without a doubt, downsizing is the most drastic and painful form of restructur-

When a firm's profitability and/or workload decline too much, the organization cannot continue to support the same level of personnel.

ing, and should be considered only as a last resort.

External Restructuring

Restructuring is also accomplished externally, by recasting the identity of the firm itself. Such restructuring may be planned or spontaneous, voluntary or involuntary, minor or major. In every case, however, external restructuring results in presenting a new face to the outside world. In contrast, internal restructuring often can be accomplished with minimal outward indication of what has occurred.

Splintering is not new to the legal profession. For generations, senior associates and junior partners have left their law firms to start practice on their own. Lawyers may choose to leave their firms for a variety of reasons, but the leading one is probably a desire to make more money than they receive in their existing practice arrangements. Splintering also may occur when a firm sheds unproductive partners or associates. In recent years, many law firms have lost significant numbers of lawyers—in some cases, entire departments—to split-offs. Splintering seems to occur in both good and bad economic times, and is not likely to diminish in the future.

Mergers represent planned restructuring through the integration of two or more formerly distinct law practices. Some mergers are more properly called acquisitions, since one firm, usually the larger one, swallows the institutional identity of the other. A number of management consultants have developed a particular expertise in orchestrating law firm mergers. Frequently, the merger of two firms may also produce some secondary splintering, as not all of the lawyers working for the merging firms fit into the new organization. The topic of mergers is addressed in *Anatomy of a Law Firm Merger* by Gerry Malone and Howard Mudrick of Hildebrandt, Inc., recently released by the LPM Section. (See ad on p. 25.)

Breakups are the cataclysmic demise of existing firms that cannot maintain economic and/or organizational viability. Breakups are more dramatic than major splits, because the original law firm ceases to exist. The legal press has chronicled the demise of significant law firms in most major American cities during the past decade. Students of the legal profession speculate on the causes of these catastrophes, often citing the firms' inability to remain competitive in a changing marketplace. Robert Hillman, in his book *Law Firm*

Breakups, suggests that greed has been the dominant factor in recent law firm dissolutions.

The least visible external restructuring pattern involves law firms developing new delivery systems. A delivery system may be defined as a unique organized approach to delivering particular legal services to particular clients. The classic examples of innovative delivery systems are group and prepaid legal services and legal clinics. In recent years, newer delivery systems have appeared on the scene as lawyers seek to find more cost-effective ways to compete for clients.

Considerable controversy has been focused on the issue of ancillary business activities by law firms, where the firms create subsidiaries to provide nonlegal services to clients. Additionally, some lawyers are experimenting with multiprofessional offices, where law is but one of a number of services offered. Law firms that elect to develop ancillary businesses or multiprofessional offices often find themselves at odds with firms that pursue the practice of law in a more traditional way. Aside from the ethical concerns associated with business entanglements with nonlawyers, these efforts may be viewed as attempts to deliver legal services more efficiently and profitably. If these lawyers prove to be successful, other practitioners undoubtedly will follow.

Another new delivery system is a product of mass litigation such as civil rights and antitrust class actions, toxic torts and mass disasters. This is the "ad hoc" law firm. In a situation where numerous plaintiffs and defendants are involved in a single cause of action, where multiple attorneys represent the parties, efforts to consolidate claims often result in the creation of entities representing particular classes of litigants. These *ad hoc* law firms are not traditional partnerships but rather groups of lawyers who come together for the sole purpose of managing specific cases. A variation of this approach involves a group of clients, usually defendants, establishing a center to manage claims, which might be described as an *ad hoc* legal department.

Many alternative dispute resolution systems represent innovative efforts to resolve problems outside the traditional court system. In a way, these new systems can be viewed as radical forms of restructuring. In these examples, the identity or significance of the traditional law firm is eclipsed by the alternative system as a method of making legal services available. Viewed in this light, it is apparent that much experimentation is

taking place in the legal profession today, and while for many firms it seems to be business as usual, new forms of organization are changing the practice of law.

Why the Changes?

What has happened to cause these changes in the legal profession and the practice of law? Although there has been much speculation about the roots of this upheaval, very little empirical data exist to explain it. Some of the causes are much more obvious than others. There is considerable conventional wisdom on the topic, but conventional wisdom is not always correct.

Increased competition is often cited as the underlying cause of law firm restructuring today. The statistics by now are old. The size of the legal profession has more than doubled in 20 years to some 800,000 lawyers; bar admissions have exceeded 40,000 per year for more than a decade and show no signs of abating; the number of law firms with more than 50 lawyers competing for the most lucrative corporate legal business has increased from a handful in the early 1960s to several hundred today; although the gross national product for legal services now exceeds \$70 billion annually, no single law firm accounts for more than one-half of one percent of these fees.

The legal profession has experienced rapid growth exceeding that of the national economy within an increasingly competitive environment. The recent economic downturn seems to have put the brakes on rampant growth in the demand for legal services, while the supply of new and existing lawyers available to provide legal services continues to grow. These pressures tend to reinforce the atmosphere of competitiveness as well as foster genuine competition.

The free market political atmosphere of the Reagan-Bush presidencies also has contributed to the competitive environment legal practitioners face. So has the legal setting, where *Bates v. State Bar of Arizona* and its progeny have effectively deregulated the marketing of legal services.

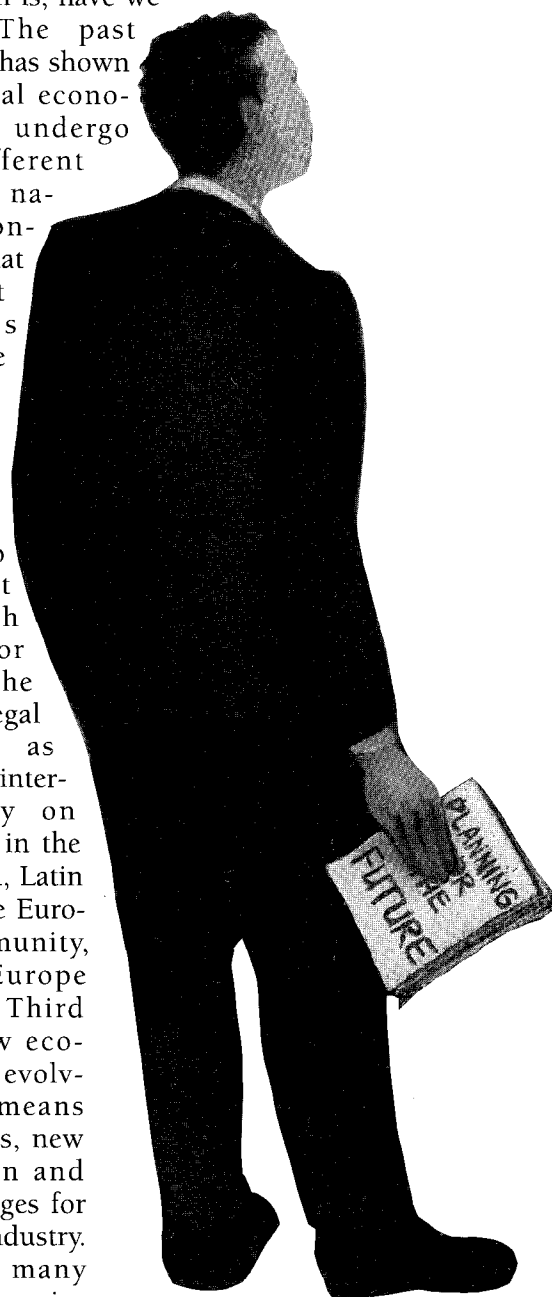
What happens when actual market competition is an active force in a business or industry? Power aggregates to those who have or can get clients. Clients themselves are less loyal and more willing to shop for bargains. There is a greater premium on efficiency, and organizations that cannot compete simply collapse. Experimentation is prevalent as practitioners strive to find some competitive edge. Market segmentation and specialization increase. Civility and coopera-

tion decline; call it the "Gold Rush" mentality. All these statements may be made about the practice of law today.

Competition is not the only causal factor in the restructuring process. Economic cycles have a profound effect on legal services. Many areas of practice are directly related to the larger economy, and national economic indicators can be used to project trends in legal business. Some types of legal work, such as bankruptcy, foreclosure and business reorganization, grow inversely to the economy. Many lawyers, buoyed by decades of unbridled growth in the legal profession, appear hopelessly ignorant of the basic economic truth that their well-being is tied to something larger than themselves. With the recent recession, we should know it isn't necessarily so.

The question is, have we learned? The past decade also has shown that regional economies can undergo cycles different from the national economy, and that different industries can deviate from national conditions.

For the 1990s, probably no development has as much potential for reshaping the American legal profession as does global interdependency on every front: in the Pacific Basin, Latin America, the European Community, Eastern Europe and the Third World, new economies are evolving. This means new markets, new competition and new challenges for American industry. Although many lawyers are in-





clined to dismiss these international events as the concern of a relatively small number of law firms that engage in international corporate practice, the reality is that the changes such global restructuring produces will filter down to every village and hamlet in America, and the fallout will touch every lawyer. This will have a continuing effect on law firm restructuring into the 21st century.

Technology represents another cause of restructuring. Despite the fact that lawyers have been slow to acknowledge the advent of the technology revolution, most have begrudgingly accepted the fact that computers are here to stay. Many are even embracing new technology. The revolution, however, means more than power computing, and many lawyers have not contemplated technological change in this larger milieu. Without doubt, technology is changing and will continue to change the way lawyers practice law, and this can only catalyze law firm restructuring in response to these advances.

There remain wide variations in sophistication among lawyers and law firms using computers. The result of this disparity, as suggested in the LPM Section's new publication *Winning with Computers* (edited by John Tredennick and James Eidelman), is that those lawyers who effectively use computers have a significant advantage over those who do not in the highly competitive adversarial process of practicing law.

Technology is a great equalizer. With computers, the little guy can more easily take on an adversary with far greater numbers and resources. Just as guns evened the odds in a fight between two combatants of different strength in a way that swords never could, computers even the odds between small firms or solo practitioners doing battle against megafirms and corporate giants.

Paralleling the rise of small, powerful, inexpensive personal computers has been the advent of advanced communication technologies. Modems, fiber optics, satellite transmission and fax have all contributed to a world where access to information, contact with others and management of data are as close as the nearest phone jack.

Fundamentally, this means the essence of the law firm is no longer its physical presence in the form of a law office, but rather the people in the firm, wherever and whenever they are doing the firm's work. Lawyers can take their computers home and work there; they can take their computers to court; they can travel to Eastern Europe and remain tied to the larger organization by way of an electronic umbilical cord. This is restructuring at the basic level of what it means to be a law firm.

Profound Effects

Most firms, locked into traditional structures, have not begun to appreciate the implications of these developments. Is the office a place where work is done or is it just a central information storage and meeting point? In the future, will lawyers who control access to information wield the same kind of power as lawyers who control access to clients do today? Will highly administered, hierarchical organizations prove to be economic dinosaurs in an era where the main function of hierarchy is to maintain the status quo? In the most extreme scenario, will law firms as we know them cease to exist, replaced by information centers linked to independent practitioners practicing alone or in teams as necessary to meet client needs? Even less radical forms of restructuring to accommodate new technologies and communication could have a profound effect on all lawyers.

The topic of demographics may seem as pedestrian as the subject of technology seems esoteric when discussed in the context of restructuring. Demographics is simply counting heads. As populations change in composition and distribution, their legal needs change, and the legal organizations that serve them will have to change. The basic demographic shift in America for most of the 20th century has been from rural to urban and ultimately suburban environments, and from the Northeast to the West and South. For much of this period the median age was declining, although presently, advances in health care resulting in longer life expectancy are changing this trend. Women have become an increasingly

significant component in the work force, with a concomitant decline in the "single breadwinner, mother at home" traditional family. Minorities are securing greater economic and political clout, although not at a rate as fast as the increase in their actual numbers, producing an actual decline in the standard of living for many nonwhites. The point here is that demographic conditions are always changing, and law firms must go where the clients are. In today's environment, this means law firms will have to restructure their services and organization in order to accommodate these demographic developments.

Today's Changing Lawyer

In addition to demographic changes in the client population, the demographics of the legal profession have changed as well. Two particular shifts are noteworthy. The first is the significant rise in the number of women in the legal profession. With women graduating from law school at a rate of approximately 50 percent, some time in the early part of the 21st century half of all lawyers will be women. Second, as the number of law school graduates rose between 1960 and 1980, the median age for all lawyers dropped noticeably. Although it is likely this trend will be reversed over the next several decades as the American population ages, for the time being the legal profession is uncharacteristically young.

These two changes have introduced lawyers into the work force who possess some very different attitudes than their predecessors. Their work values are different; they are much more concerned about lifestyle quality outside the office and less willing to sacrifice personal happiness for loyalty to the institution or the prospect of future advancement. They are much more willing to refuse weekend assignments, to opt for nonpartnership tracks and to change jobs if they cannot find satisfaction in their present situations. Those who opt for a fast track are less willing to wait decades before inheriting the mantle of power and revenue in their law firms. Although a higher percentage of new lawyers are single, most of those who are married or marry later dwell in a two-career family and postpone having children until later in life. Such families present special problems of mobility, parenting and the coordination of complex lives. A clear dichotomy appears to be arising between those lawyers who see themselves as employees and those who are entrepreneurial by nature.

The typical law school graduate today is in his or her mid to late 20s, grew up and attended school in a metropolitan environment, was supported by parents or loans throughout much of the educational process, and grew to maturity long after the last American troops left Vietnam. Most are computer-literate and almost all are more electronically tuned in than their parents. They are more conservative, materialistic and health-conscious than their parents; they are also much more sensitive to such issues as environment, racism and sexism. Fewer of them are married or are strongly affiliated with any church or political party.

If legal talents are the basic building blocks of every law firm, and if law firms must work with the basic raw materials on hand, then they must find ways to meet the needs of today's graduates. In an era when increasing numbers of lawyers will be permanent employees of legal organizations, there will be increased pressure on employers to provide a satisfying work environment. This, in turn, suggests that many law firms will be required to undergo substantial restructuring in order to accommodate and assimilate this work force.

Restructuring may be precipitated by some very basic considerations within law firms. Fundamental economics may point to a profitability squeeze in many law firms as income generated by fees fails to keep pace with increases in overhead expenses. For many firms the practice mix is changing, in some cases because of changes in the client base itself, and in others as a result of intentional efforts to alter the mix. Since 1977, marketing has become much more important to law firm development. Not only have law firms been forced to compete for clients in the marketplace, but they also have had to learn how to assess and exploit their own market niche. Decisions about these matters frequently trigger hard choices about firm organization, staffing and policy.

Perhaps the oldest cause for law firm restructuring is partner incompatibility. Why do law firms break up? The simple answer is that the partners do not get along. It is unlikely that any of the changes the legal profession has undergone will alter the fact that personality conflicts are a fact of life in every office. It may be the case that other pressures invoked by the changes enumerated in this article exacerbate personality conflicts that would otherwise remain manageable. But in all probability, lawyers who do not get along when they start to practice together will not get along better after the passage of time.

In all probability, lawyers who do not get along when they start to practice together will not get along better after the passage of time.

The Effect of Institutionalization

A final cause of restructuring that has not been fully explored in discussions of the subject is the effect of institutionalization on the practice of law. In 1950, the vast majority of all practicing lawyers were solo practitioners. Even law firms in many cases were collections of individual practices operating under the banner of a joint letterhead. Over the years, an increasing percentage of private practitioners have joined law firms. Law firms themselves have grown larger and become increasingly leveraged, resulting in fewer owners compared to employees. Outside of private practice, increasing numbers of lawyers have entered the profession as employees of corporations, government agencies, private associations and other entities.

On one level, this institutionalization means that most lawyers graduating from law school today can expect to spend a significant portion if not all of their careers as employees of organizations rather than as partners or independent practitioners. Professor Murray Schwartz of the UCLA Law School, as far back as 1979, raised the question of how the fundamental lawyer-client relationship might be affected by the fact that an employee's first loyalty is to the organization that employs rather than to the client. Can an individual lawyer-employee exercise the same kind of independent professional judgment on behalf of a client that a truly independent practitioner can provide? Do the economic objectives of institutional law firms conflict with loyalties to clients? If the dominant factor in determining ownership and power in the organization is the ability to bring in clients, what happens to incentives to provide quality services at a reasonable price?

This is restructuring at the most basic level. While many of the reasons for law firm restructuring are statistically or analytically demonstrable, this last cause is much more speculative, but intriguing just the same.

The mere fact that institutionalization, technology or any other factor may drive change in the legal profession both now and in the future suggests the folly of characterizing restructuring as a short-term problem—typically downsizing in response to adverse economic conditions or expanding in response to economic boom. Certainly, both of these approaches are valid responses to short-term economic situations, but if lawyers continue to demonstrate such

myopia, they will continue to suffer from the instability of short-term economic fluctuations.

The Big Picture

This article has attempted to look at a contemporary problem for many law firms in a slightly different light. It has suggested that restructuring is something organic to every law firm responding to the winds of change, that it involves a complex set of factors and responses, and that in order to cope, law firms must adopt a long-range point of view.

The current economic environment has heightened the significance of a number of considerations. What is the proper relationship between rainmakers and producers in a law firm? What role does control of and access to information play in this equation? How should the administrative side of the legal business be managed to maximize the effectiveness of the service delivery side? Are the owners and employees operating from different agendas concerning their own careers and their expectations of the organization? What services do clients need from organizations that provide legal advice? What structures will most efficiently and profitably meet those needs?

The answers to these questions are anything but clear, but any law firm that does not ask them is courting disaster. One thing is apparent: Nothing is typical anymore. The decade of the '90s is likely to produce a formidable array of new delivery systems and organizations. Some of these may be extremely controversial while others will slip into the mainstream of law practice without notice. Those who understand the events that are changing their professional lives and respond wisely will survive; those who stick their heads in the sand with a business-as-usual attitude will wither and die (professionally, at least). ■

Gary A. Munneke is an associate professor of law at Pace University School of Law, 78 North Broadway, White Plains, New York 10603, where he teaches Torts, Professional Responsibility and Law Practice Management. He is the author of numerous articles and seven books on the legal profession, including a casebook, Materials and Cases on Law Practice Management (West, 1991). He is also a member of the LPM Section Council and chair of the LPM Publishing Board.