The Law Firm Lifecycle: Why Some Firms Fail

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Summary

Law firms are just like any other organization, sometimes achieving great success, and other times going defunct. This article goes over the latter firms.

Dewey & LeBoeuf was once a thriving international law firm with 1,000 attorneys, offices in 26 locations, profits of one million dollars per partner, and clients that included Walt Disney and eBay. But the firm fell apart, declaring bankruptcy and dissolving in 2012 amidst scandal and bleak finances. The firm's top leaders are currently on trial in New York for grand larceny and other charges stemming from alleged efforts to "cook the books" and conceal financial troubles.

Click here for recent updates about the Dewey & LeBoeuf trial on JD Journal.

Dewey is not alone. Other large firms and countless small firms have also collapsed in recent decades, although most did not engage in bad dealings or alleged criminal activity. These firms include prestigious white-shoe firms like New York's Coudert Brothers and San Francisco's Heller Ehrman that managed to thrive for over a century before shuttering operations.

Why do some law firms fail?

- **See Making Sure Your Law Firm Will Not Fail for more information.**

The reasons vary, but financial difficulty is a common denominator, although that difficulty has different underlying causes. Some firms fail because of fraud, misfeasance or mismanagement. Others go under because they can't survive an economic downturn or adapt to changing business practices. Partner and client migration (especially when they become toxic) can also lead to dissolution, as can infighting among firm power players or a firm's inability to find the right firm or firms to merge with in order to compete in a legal market increasingly dominated by full-service "BigLaw" firms. Of course, most law firm dissolutions are complex and involve more than one cause.

Misfeasance and Scandal

Texas-based Jenkens & Gilchrist, Illinois-based Keck, Mahin & Cate, New York-based Steven J. Baum, P.C., and Beverly Hills-based Trevor Law Group are firms that can count misfeasance and scandal among the reasons for failure. The Dallas firm of Jenkins & Gilchrist first got into trouble during the 1980's Savings and Loan Crisis and had to pay $18 million in malpractice settlements. Ten years later, tax lawyers in the firm's Chicago office issued faulty opinion

letters to wealthy clients on tax shelter schemes, which prompted clients to sue and the Internal Revenue Service to investigate. The 600-person firm ultimately agreed to pay a $76 million penalty and cease practicing law. Four lawyers were found guilty of tax evasion and other crimes.

Legal improprieties also led to the demise of Keck, Mahin & Cate, which grew from a small firm to one with multiple offices and 350 attorneys. In 1994, the firm was found guilty of fraud in connection with a jail construction project and had to pay its share of a $36 million judgment. Creditors initiated a chapter 7 bankruptcy three years later.

The "mortgage mill" Steven J. Baum, P.C. closed shop after its unseemly involvement in the subprime mortgage crisis that wreaked havoc in the lives of homeowners in the late 2000's. The firm handled 40% of all foreclosures in New York state, including many involving robo-signing. Moreover, in 2011, someone leaked a photo taken at the firm's Halloween party depicting firm members mocking distressed and down-and-out consumers who had lost their homes due to foreclosure. The firm, which had 89 employees, closed in 2012 and paid damages to both federal and state authorities.

Trevor Law Group shut down in shame in 2002 after running a scam in which it misused a California consumer protection statute to shakedown at least 3,000 law-abiding small business owners. The firm filed baseless lawsuits against businesses alleging unfair business practices and then wrested nuisance settlements from those businesses to put an end to costly legal proceedings.

Economic Downturns

Some firms fail because they can't weather the storm of a failing economy. That's what happened to Brobeck, Phleger & Harrison on the West Coast and Testa, Hurwitz & Thibeault on the East Coast, among other firms.

San Francisco's Brobeck was a top-flight firm since its founding in 1926. The firm earned its stature by successfully representing Bay Area heavyweights from eras old and new like Wells Fargo, Cisco Systems and Sun Microsystems. But the firm got carried away by the "dot-com craze" and began taking equity from its high tech startup clients in lieu of traditional monetary payments. Brobeck's finances thus collapsed in the early 2000's along with the dot-com bubble. Much of the firm's compensation became worthless and on top of that there was a dearth of corporate work to do. The firm's last-ditch efforts to merge with Morgan Lewis & Bockius failed and the once strong and innovative firm dissolved in 2003.

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A similar story played out with Boston-based Testa, Hurwitz & Thibeault, which represented tech startups-turned-major-players such as Digital Equipment Corp. and Teradyne Inc. Testa was heavily reliant on IPO and corporate work and languished when venture capital dried up. The firm's partnership profits plummeted from $825,000 in 2000 to

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$500,000 in 2003. Many of Testa's partners decamped to other firms like Greenberg Traurig; Goodwin Procter; and Choate, Hall & Stewart. The firm dissolved in 2005, leaving 600 employees to find new jobs.

The death knell for other firms sounded a few years after the dot-com collapse, when global financial markets tanked in 2008. New York-based Thacher Proffitt & Wood was a leader in the mortgage-backed securities market and could not rebound from the financial meltdown and collapse of clients Bear Stearns and Lehman Brothers. With no more market for the structured finance transactions in which Thacher specialized (and which accounted for 70% of Thacher's revenue), there was simply no more work for the firm's 350 attorneys.

Thelen LLP also dissolved and filed for bankruptcy in 2008. The firm went from 600 attorneys in 2006 to 400 at the time of dissolution. Observers link Thelen's demise to toxic partner defections along with toxic securities and their effect on capital markets.

Partner and Client Migration

Partner and client migration, especially in conjunction with other problems, can destabilize a firm to the breaking point. San Francisco-based Heller Ehrman dissolved after 50 partners left for Covington & Burling and other firms. The firm was also weakened by the loss of collapsed clients Washington Mutual and Lehman Brothers. Heller was founded in 1890, and by the time of its breakup in 2008 it had over 700 attorneys and 15 offices. The venerable firm helped in the construction of the Golden Gate Bridge and in the overturning of California's same sex marriage ban. Heller received recognition for pro bono work and community service in addition to excellent work product.

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Attorney migration also contributed to the downfall of Washington, D.C.'s Howrey LLP and Boston's Hill & Barlow. Howrey was known for its antitrust and intellectual property practices and at one time had 700 attorneys. The firm dissolved in 2011 in part due to the departure of partners to Winston & Strawn and Sidley Austin. Hill & Barlow, one of Boston's most elite firms known for litigation, lasted from 1895 until 2003, when most of the real estate group and almost one-third of the firm left to join Piper Rudnick (now DLA Piper).

For Mudge Rose Guthrie Alexander & Ferdon, a prominent New York City firm that launched the career of Richard M. Nixon, the problem was client migration in addition to ego contests and other problems. The firm specialized in municipal finance and effectively ceased to operate after a major client, Cigna Corporation, pulled its $15 million annual business from the firm. The firm's chairman left for Latham & Watkins and brought 12 partners and 20 associates with him.

Changing Business Models

In the past decades, law firms have become more global, expansion-oriented and profit-driven – and not all firms thrive in that climate.

Coudert Brothers, one of Wall Street's oldest firms, found it could not compete in this "new school" of law firm practice. The firm opened numerous foreign offices, including the first foreign law office in Moscow in 1988, but eventually lost business in overseas markets to other international firms that were more aggressive, hungrier and better able to capitalize on opportunities. Some observers attribute Coudert Brothers' decline to unprofitable foreign operations and reticence on the part of management to do anything about it. Others cite the firm's tradition of placing intellectual acumen and gentility above profit. In any event, the firm dissolved in 2006 after partners in the firm's London and Moscow offices left for Orrick, Herrington & Sutcliffe.

Donovan Leisure was another old school firm of "gentlemen lawyers" (which reportedly served tea and cookies in the afternoon) that faltered in the new dog-eat-dog world of law. Donavan Leisure was founded in 1929 and dissolved in 1998. Many of Donavan Leisure's lawyers ended up at Orrick.

Even as some firms fail because they don't expand quickly enough or because they value service over profit, other firms fail for the opposite reason; they implode under pressure caused by rapid growth and the leverage and greed that often accompany it. Finley, Kumble, Wagner, Underberg, Manley, Myerson & Casey was founded in 1968. The firm expanded fast, took on debt, poached prominent lawyers from other firms at exorbitant rates and replaced the traditional law firm payment model based on seniority with one based on rainmaking and business development. In Finley's case, this led to infighting and unsustainable leverage. The firm surged to the fourth largest firm in the United States, but dissolved in bankruptcy just 20 years after it began with $60 million in debt.

After Finley disbanded, Harvey D. Myerson, one of Finley's former partners, helped establish the short-lived Myerson & Kuhn. The firm had an aggressive business model and favored leverage as well as edgy legal work involving hostile takeovers and bankruptcy. The firm lasted just two years, from 1988 to 1990. Myerson went to federal prison for tax fraud and defrauding clients.

Firm Specialization in a Big Law World

Certain boutique firms wind up affairs when they find themselves unable to compete with massive firms that offer clients the benefits of a "full service" firm with different departments to handle all the clients' needs. New York-based Pennie & Edmonds, a boutique IP firm, dissolved in 2003 when many of its lawyers joined Morgan, Lewis & Bockius and Jones Day. Pennie & Edmunds' demise may also have resulted from pending litigation against the firm involving conflict of interest issues. Another IP firm, Los Angeles-based Lyon & Lyon, also dissolved in 2002. Lyon & Lyon was founded in 1919 and had a client list that included Disney, Honda, Gucci, K-Mart, Taco Bell and Mitsubishi.

Moving On

For some firms, the end comes when a major player simply moves on to other endeavors. The San Francisco firm Halleck, Peachy & Billings lasted from 1849 until 1861. The firm specialized in land cases and handled more than half of the state's land claim cases

after the Land Act of 1851 was enacted. The firm dissolved after one of the partners left California to fight in the American Civil War.

Other large law firms that have dissolved and are now defunct are Altheimer & Gray; Arter & Hadden; Isham Lincoln & Beale; Lord Day & Lord; Rider Bennett; Shea & Gould; Tillinghast Licht; Waesche, Sheinbaum & O'Regan; Washington, Perito & Dubuc; and WolfBlock.

Conclusions

Law firms have lifecycles just like other organizations. That cycle can end for any number of reasons. Greed, fraud and criminality can play roles in the dissolution of law firms. Other factors include the inability of a firm to adapt to changing conditions and the loss of significant partners and clients. To stand the best chance of surviving, firms need to maintain high ethical standards, be resilient to economic shifts and adaptable to new associations and ways of doing business.