CASE STUDY

HELLER EHRMAN AND THELEN REID & PRIEST

Leslie A. Gordon

The fall of 2008 marked the demise not only of financial institutions like Lehman Brothers but also of two stalwarts in the San Francisco law firm community: Heller Ehrman and Thelen Reid & Priest.

By most accounts, Heller was the more surprising of the two collapses. The 118-year-old, 650-attorney firm was the victim of an unprecedented confluence of factors, what one industry watcher dubbed "a perfect storm." Amid Wall Street's collapse, Heller experienced the settlement of large litigation matters and term limits that ousted a popular leader. The firm inexplicably launched postlayoff expansion plans, which included shopping for a merger partner. By the summer of 2008, Heller's Hail Mary was Chicago-based Mayer Brown, which was dealing with the bankruptcy of its own large client, Lehman Brothers, and ultimately passed. Meanwhile, Thelen, which folded several weeks later, was plagued by its own poor merger choices and a politicized governance system.

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Though the details of each firm's collapse have already been widely reported, now that the dust has settled, zeroing in on the common denominators may be instructive to firms eager to avoid the same fate.

PARTNER OR PRACTICE GROUP DEPARTURES

Dozens of shareholders left Heller in 2007 and 2008. Mass departures not only shatter revenue but also the confidence of remaining lawyers. Lateral moves can also indicate a decline in firm loyalty in favor of profit motive. (See "Culture Crash," following).

UNSUCCESSFUL MERGERS AND FAILED MERGER NEGOTIATIONS

As articulately described in a *Recorder* editorial by consultant and past Thelen chair Rich Gary, looking outward will rarely solve a firm's problems. Law firm mergers should be strategic and a near-perfect cultural match—not a last-ditch grasp for survival.

Interestingly, while an Altman Weil survey, titled "MergerLine," tracked seventy new law firm mergers nationwide in 2008, making it the largest number of U.S. law firm combinations ever in a single year, mergers involving firms in the Western United States were down significantly from 2007.

DEBT

At Heller, partner departures in its core intellectual property practice triggered a fateful clause in the firm's loan agreement. It didn't help that, at the time, the banking industry was experiencing its own crisis.

Law firm debt should be reduced as much as possible and, if possible, spread among multiple institutions. According to Altman Weil's principal James Cotterman, law firms that keep banks as minor players in the capital structure will be in a far better position to weather the downturn. "Adding banking relationships mitigates against being held hostage to one bank's policies regarding rates, collateral, and the like," he says. "It is also good to have a backup plan in case a lead bank cuts off or severely limits access to credit."

CULTURE CRASH

Law firms must nurture the "glue" among their attorneys or at least a devotion to a common core value, especially at a time when, now more than ever, partners may be spread across the globe. Creating a culture and value system that includes associates—the next leaders of the firm—seems essential.

Furthermore, a reexamination of law firm governance may be necessary. Partnerships doing hundreds of millions of dollars in business need leaders with financial acumen, who can strategically manage a (let's face it) high-maintenance population. Yet many law firms have term limits or similar rotating leadership systems. Strangely, though, almost no other industry picks its leaders from among the workers.

Mozhgan Mizban, a consultant with the Zeughauser Group, recommends peer reviews to determine whether there is a best practice about how firms are governed. In addition to leadership, these reviews should examine compensation systems, practice group management, global operations, and structures centered on client teams as opposed to geography.

CASE STUDY

THE ECONOMY'S EFFECT ON LAW SCHOOLS AND STUDENTS

With Bay Area law firms tightening the purse strings on summer programs and students worried about being able to repay student loans, the recession has wormed its way into law schools. Traditionally, an economic downturn translates into a rise in graduate school applications, 1999 and the dot-com bust being Exhibit A. But traditional cycles may not play out in today's more complete economic collapse, combined with a credit freeze.


Dean Jeffrey Brand

"It is too early to tell what the impact will be," says Jeffrey Brand, dean of the University of San Francisco School of Law. "The next couple of months will be telling as the admissions cycle progresses and President Barack Obama has taken over."

According to Brand, law schools are affected by the condition of their parent universities, with results that include a hammering of the endowment, unpaid tuition by students who can no longer afford it, a rise in interest rates for borrowing, and some freezing of money impeding cash flow. Though Brand says USF School of Law is in good financial shape, "there is no institution in the country that is not reviewing budgets, cutting costs, considering how much hiring to do, seeking ways to minimize tuition increases, and trying to help students with additional financial aid. These are unprecedented times."

To combat law student paranoia, USF's administration has held forums about the economy. "We are candid, telling them that difficult economic times signal efforts by all schools to reconsider how money is being spent," Brand says. "We also have emphasized that our primary priority in these times is the quality of students' education and that we will do everything possible to minimize the effect on students." At USF, that translates into continuing financial aid, ensuring that opportunities for local and international internships continue, and helping students with career planning as the job market tightens.

Bryan Hinkle

Bryan Hinkle, director of USF School of Law's office of career planning, says his office hasn't yet fully felt the impact of the recession, but he does anticipate fewer firms participating in on-campus interviews next fall.

"We're forecasting a decrease in demand for legal services in general—even at midsized and smaller firms," Hinkle says. "It will be interesting to see what happens to summer associates this summer. Everybody is concerned and is worried." Already, he's seen unusual offer letters to students who had worked at Thelen last summer. "[They] contained language we don't normally see, such as 'This offer is contingent upon market conditions.'"

Aside from those students, Hinkle hasn't yet heard of offers being rescinded. "Firms have been fairly good about not getting themselves in the same position as they did in the early 2000s when their summer programs were too robust. Today, they've only taken on the number of summer associates they can support," he says.

Still, anticipating a decline in job availability, Hinkle tells his students, "'Network, network, network!' and get as many practical skills under their belt as they can." As a result, USF has seen "an uptick in [students participating in] clinics and externships."

USF's career planning office has also seen for the first time alumni from as far back as 1977 seeking the law school's assistance in job searching. Hinkle's advice to lawyers who have lost jobs: "Seek out opportunities to build skills in other areas, like BASF's Volunteer Legal Services Program. Get engaged in the legal community. You're more likely to get a job through personal connections so don't be afraid to let friends and family know if you lose a job."

According to Dean Brand, now more than ever, law schools have a responsibility to fan the flames of student passions and remind them that "the law can be a wonderful, rewarding profession capable of doing enormous good." No matter how tough times get, he adds, law school "spending priorities must focus on maximizing the student experience, knowing that we are training folks critical to the rule of law and the pursuit of justice."