BANKRUPTCY COURT DECISIONS

Weekly News & Comment

VOLUME 40, ISSUE 22 March 11, 2003

# Economy taking its toll on firms; How is your footing?

Although it may be inaccurate to say that law firms are dropping like flies, there's no denying that once-successful firms are dissolving, filing for bankruptcy, or merging to stay afloat at a concerning rate — usually to the surprise of the associates and even partners that staff them.

In the recent collapse of **Brobeck, Phleger & Harrison**; **Lyon & Lyon**; **Limbach & Limbach**; **Majestic, Parsons, Siebert & Hsue**; and **Skjerven Morrill** the finger of blame was largely pointed at the dot-com industry. So, that would mean that firms that did not buy into the dot-com explosion are safe, right?

Not necessarily, say attorneys. The dot-bomb is just the latest bump in the road that's exposed attorneys' competence to manage their firms as a business. These bumps have exposed firms that have grown too quickly, turned the other cheek to shrinking markets, and gone deeper and deeper into debt. Bankruptcy attorneys may be better equipped with business knowledge, but they are not immune.

"I'd like to think that attorneys in bankruptcy would have the foresight to see problems coming. But the Texas debtor firm of **Sheinfeld,**

**Maley & Kay** certainly wasn't immune — it dissolved in 2001. No attorney out there wants to believe that this is going to happen to their firm, especially when you're working as hard as most bankruptcy attorneys are working these days," said **R. Michael Farquhar**, member of Dallas-based **Winstead Sechrest & Minick PC**'s bankruptcy and business reorganization section.

Having the foresight to avoid problems on the horizon requires that you gain a familiarity with the factors that have brought decline in the past, and never lose sight that your firm is a business that must be managed just as carefully as you advise your clients to manage their businesses.

### History repeats itself

Be it the dot-com market today, or the gas or financial firms of the 80s and 90s, both the underlying causes and the results are the same. **Matthew J. Shier**, a partner at the **Pinnacle Law Group LLP** in San Francisco, described the spiral of the dot-coms this way: "To meet the needs of their clients, law firms contracted for more space at ever-escalating rents. In addition, firms hired more attorneys and staff and frequently financed expanded operations with larger and larger bank debt. When the technology market crashed, firms were left with large blocks of vacant space at rent levels way above market, attorneys and staff they no longer needed, and, potentially, back-breaking bank debt. Brobeck is a good example of this."

Attorneys agree that the silly assumption that law firms are immune to the rise and fall of the economy is just that — a silly assumption — and one that has likely been at the heart of many law firms' demise. **Alan G. Tippie**, a member of Los Angeles-based **Sulmeyer, Kupetz, Baumann & Rothman, A Professional Corporation**, said law firms need to do a better job of staying in touch with the economy and their markets. "Law firms are no different than other businesses that must respond to changing times and the impact of market trends, industry downturns, and the like. Smart firms take note of trends and respond to them, by reducing in size, laying off personnel, shifting focus to another practice area or areas, and expanding work in hot areas already practiced by the firm."

Taking on debt is a relatively new exercise in law firm management, and one that contributes heavily in the downfall of firms. **Dan Glosband**, a bankruptcy partner with **Goodwin Procter** in Boston who represented the partners in *Gaston & Snow* in the early '90s, said that firm bankruptcies are no different than any other bankruptcy. "Gaston borrowed against their accounts receivable and could no longer service their debt. The underlying reason behind any firm going bankrupt is that there is some disruption to revenue and the firm can no longer service their debt."

### Attorney disloyalty

Lawyers are no longer as loyal to their firms as in the past. This can leave firms with too much glitzy office space and too few attorneys working off the tab. **Stephen J. Lubben**, law professor at **Seton Hall University** School of Law said, "Partners seem more willing to move around than they may have been in the first 80 years of the 20th century. And it seems that once flight from a firm begins, its difficult to put a stop to it. The best partners are the ones that have the easiest time jumping ship, and the firm is increasingly left with partners who are less productive, for whatever reason."

The departures of the firm's best and brightest creates a domino effect, said **Allan H. Ickowitz**, member of **Nossaman Guthner Knox & Elliott LLP** in Los Angeles, and creditors attorney in *Lyon & Lyon*. Brobeck's dissolution typifies a pattern he's seen with a number of other law firms that have gone under. It starts with a significant departure of attorneys, and the firm is left to deal with the increased overhead of half the number of attorneys in the same amount of expensive space. "The firm's only chance is to skinny down with a relatively cohesive group," he said, but that isn't likely to happen, because "no one likes to be the one to turn the lights off at night." ■

### How could a debtors firm fail?

Every failing firm has it own story to tell, said **Alan G. Tippie**, member of **Sulmeyer, Kupetz, Baumann & Rothman**. "While you may see problems common to all or many, the demise of a law firm is not the product of a cookie-cutter analysis."

Case in point: In 2001, the Houston debtors firm of **Sheinfeld, Maley & Kay** dissolved after 33 successful years. The firm gained recognition working on the **Dow-Corning** class-action case and by serving as bankruptcy counsel for **Continental Airlines**.

Core members of the firm left, not because they suspected financial problems within the firm, as was the case in Brobeck, but because bankruptcy attorneys were in such high demand that they were charmed away to national firms.

When the economy faltered, large national firms began seeking out bankruptcy attorneys to support the industry demand, and key attorneys at the firm were eager to show off their skills on the big cases that the national firms had the resources to attract. ■