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Giant no more

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The impending end of bankruptcy proceedings for Lehman Brothers Holdings Inc. seemed sure to affect future editions of The Deal Pipeline's bankruptcy league tables the last time around. The inescapable story this quarter is the collapse of law firm Dewey & LeBoeuf LLP, once one of the largest in the U.S.

Although the firm was not a big player in the table by number (29 cases, good enough for a tie for 64th), its $849.6 billion in volume on 24 cases placed it 17th, ahead of large firms such as Jones Day ($763.7 billion, 38 cases) and Kirkland & Ellis LLP ($731.7 billion, 61 cases), among others.

The firm's troubles, however, have led most of its partners to depart over the past couple of months, including bankruptcy heavy hitters Martin Bienenstock and Bruce Bennett, for Proskauer Rose LLP and Jones Day, respectively. (See Deal Doctors, page 26.) Dewey's caseload looks likely to follow them.

"Often the clients move with partners with whom they have worked in the past when they were satisfied with the services provided, their cost, and the ability of the partner's new firm to meet their needs," says Michael Trotter, a partner at Atlanta law firm Taylor English Duma LLP. "As a practical matter, continuing matters and cases cannot 'wrap up' with a bankruptcy. They must be managed to completion by lawyers who have left the bankrupt firm or new lawyers."

At stake are assignments on some of the largest high-volume cases filed over the past few years, such as AMR Corp. ($24.7 billion in assets), Lehman Brothers ($639 billion) and MF Global Holdings Ltd. ($41 billion), to name a few. Most recently, the firm was retained to represent the official equity committee of Sunnyvale, Calif., electronics manufacturer Trident Microsystems Inc. ($310 million).

Several broader factors in the legal marketplace have contributed to Dewey's downfall.

"The legal profession in the U.S. has experienced a fundamental change in its competitive environment," Trotter says. "Firms have become larger, more highly leveraged and more profitable to their equity partners. Many of the firms have become more unstable as a result of their inability to bind their partners to their firms. Corporate law departments have grown in size and capability, and corporate general counsel are able to negotiate for lower fee arrangements because of the surplus of capable lawyers and law firms."

David Skeel, professor of corporate law at the University of Pennsylvania Law School, adds: "Even before the Great Recession, the legal industry was in the midst of major changes. Firms were beginning to outsource their 'cookie-cutter tasks,' [so] they could no longer bill a full lawyers' rates, and the firms that were most successful tended either to have a specialized, highly lucrative core business or to be expanding internationally."

Dewey specifically ran into trouble after its creation — through the 2007 merger of Dewey Ballantine LLP and LeBoeuf, Lamb, Greene & MacRae LLP — when it could not fulfill its guarantees to lateral hires from other firms because of insufficient revenue generated to cover costs. Peter Zeughauser, a legal strategist and founder of Newport Beach, Calif., consulting firm Zeughauser Group LLC, says the firm encountered the problem in the past few years during the economic downturn.

Payment "guarantees to equity partners on the scale that Dewey did were extraordinarily uncommon, because they disproportionately shift the risk of a diminution in net operating income to the nonguaranteed equity partners," he says. "At Dewey, [nonguaranteed] partners who were budgeted at $1 million a year, for instance, actually received $300,000 or less for three years. They were better off leaving for another firm at which they could be paid $1 million."

More and more partners apparently did so, with guaranteed partners ultimately making moves as well.

"The number of partner defections had grown so high that the firm was no longer sustainable, as evidenced by ordinary creditors like FedEx [Corp.] and the back-room operators and the copy machine leasing companies cutting off the firm's credit," Zeughauser says. "The firm released its lawyers to look for other jobs. It gave the [Worker Adjustment and Retraining Notification Act] notice. All of those added together indicated the firm could not stay in business for anything but the shortest amount of time."

While the firm's partners and many associates had many places to land, the summer associates who were promised positions aren't so lucky. They now must seek other opportunities in an extremely competitive market for a limited number of high-paying jobs.

"This is increasingly difficult, as law schools are graduating almost twice as many lawyers each year as there are legal jobs for them," Trotter says. "Unfortunately, because many law students have to borrow a large portion of the cost of their legal education, most of them cannot afford to take the lower-paying jobs that are available in government such as becoming public defenders or with not-for-profit organizations, because their income would be insufficient to retire their student loans while supporting their families."

The biggest lingering questions are the endgame for Dewey and whether other firms will find themselves in a similar situation, making an unplanned exit from the league tables.

In recent years, a series of law firms have filed for bankruptcy, such as Heller Ehrman LLP, Howrey LLP, Thelen LLP and Dreier LLP, to name a few, but none on the scale of Dewey & LeBoeuf, which at its peak had more than 1,300 attorneys in 12 different countries. Nearly all of the firms that filed continued to pursue wind-down processes begun out of court, and Dewey may follow before long.

(An exception was Ruden McClosky PA, purchased out of Chapter 11 in December by fellow Florida law firm Greenspoon Marder PA for about $7.78 million, according to The Deal Pipeline.)

Skeel, though, isn't positive Dewey will become the latest filing. "Although this is a difficult time for many law firms, I think [the situation of] Dewey & LeBoeuf is isolated, and it's still not clear that Dewey will file for bankruptcy," he says.

Regardless of Dewey's ultimate fate, Zeughauser says it is possible troubled firms will surface once every 12 to 18 months. "The industry has been weakened by the downturn and its increasing competitive environment, and we will continue to see the effects."

Trotter agrees. "Because of significantly increased competition in the legal profession resulting in part from a growing excess supply of capable lawyers and law firms, increased commoditization of many legal services, the impact of technology and the growth of thoroughly competent in-house law departments, I think many of the larger firms will face difficulties in the years ahead," he says. — *Kimberly Ghorm*