LAW FIRMS

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Introduction

Lawyers create and apply knowledge and law firms are the paradigmatic vehicle for delivering that knowledge. The majority are formed by partnership where all the members agree to enjoy the profits or suffer the losses. Typically they are flat-profiled organizations composed of partners (owners) and associates (employees). Others may be run as franchises or as more hierarchical and autocratic structures. Some law firms can trace their histories for hundreds of years, e.g., Freshfields became solicitors to the Bank of England in 1743. But some countries, such as Greece, have only allowed the formation of law firms since the 1990s; and in other countries like England and Wales parts of the legal profession, e.g., barristers, prohibit the creation of law firm partnerships.

Law firms obviously come in many shapes and sizes from small upwards. But in the late 20th century the legal profession was marked by the growth of corporate mega-law firms. These are firms that measure their lawyers in the thousands and have scores of offices around the world. Although they are primarily an Anglo-American phenomenon, mega-law firms are taking root elsewhere in the world.

In the area of professional service firms there has been a move to providing portfolios of resources that engage many different types of skills. This has been particularly apparent in accounting and consultancy services. Law firms are beginning to move in this direction, but courts and some regulators are less than enthusiastic.

History

No definitive start date can be assigned to law firms, but historians have found records of partnerships existing, such as two or three-men partnerships, in England in 1780. The great majority of lawyers, however, were solo practitioners. Industrialization was one of the main incentives to the development of law practice in both the US and Europe. Landed gentry began to exploit their latent natural resources, which brought lawyers into the business of creating businesses and raising finance for them. Big enterprises, like the formation of the railroads, demanded an array of legal skills in finance, corporate structures, and bankruptcy, which lawyers were able to offer.

The spirit of enterprise was fostered by permissive and facilitative legislation such as the British Joint Stock Companies Act of 1856 and the Limited Liability Act of 1855. Regulation was limited and fraud rife. The City of London became a hive of inventive activity as investment trusts were born and foreign bonds issued. As railways extended their lines, law firms were involved in

forming companies, acquiring land, petitioning Parliament, and resolving contract disputes. For example, the London firm of Norton Rose maintained 23 railway company accounts between 1848 and 1878. These law firms had small numbers of partners, two or three were the norm. But they were buttressed by large numbers of clerks, unqualified men, at ratios of partners to clerks of between 1:20 to 1:100. The railway business gave lawyers considerable experience in risk management, investment strategy and trust administration, both domestically and abroad.

However, 19th century New York City is the true birthplace of the modern law firm. Both legal education and law firms transformed themselves to become meritocratic and rational, with law schools adopting the case method devised by Christopher Columbus Langdell at Harvard, and Paul D. Cravath evolving his law firm organically by selecting partners from the finest associates trained within the firm. The innovations in legal education allowed students to be ranked on intellectual grounds and this, coupled with the selection of student editors for law reviews, allowed law firms to choose the brightest applicants. For Cravath the training of lawyers was a continuation of the law school process in the real world. He believed that associates should observe their seniors breaking down complex problems into component parts then be assigned a part to analyze. At the same time the associate would be rotated through the different departments of the law firm before specializing. Cravath insisted the ideal tenure for a lawyer in the firm was six years, after which he could either stay on as a partner if selected or would move to another post in a client's legal department, perhaps. Associates who stayed longer would not have the correct motivation to ensure the firm's success, so "up or out" became the norm. The Cravath law firm still refers to the use of model in the firm on its website.

As law firms were changing from small, parochial partnerships into large, complex, diverse organizations, mirroring the growth of the economy, the expression "law factory" emerged and tensions within the profession opened up so that one Julius Henry Cohen, for example, published a small book in 1916 titled Law: Business or Profession? The expansion of the imperial world brought with it international development for law firms. John Foster Dulles, of the New York law firm Sullivan & Cromwell, played a key role in the negotiations of the Versailles Treaty at the end of the first world war and his firm subsequently helped capital flow from North America to Europe, especially to Germany aiding the National Socialist government. With the birth of the New Deal in the 1930s many lawyers were being drafted into government agencies. Eventually they left for private practice, but in so doing they established the pattern of the revolving door between government and practice, which worked to the benefit of law firms. Dulles became secretary of state in the Eisenhower administration. John J. McCloy of Milbank Tweed, for example, served as high commissioner of post-second world war Germany, president of the World Bank among many other offices, and acted as advisor to every president from Franklin Roosevelt to Ronald Reagan. Such lawyers comprised a modern aristocracy.

In the period since the second world war not only have the numbers of lawyers grown significantly but the numbers of large law firms have expanded along with the size of these firms. The most dynamic growth has taken place in the large law firm sector. In the aggregate small law firms, while containing the largest number of lawyers, are declining in strength as the changing economics of practice militate against them. In the US there has been the rise of the franchise law firm; and in the UK there has been the rise of the alternative legal services provider such as banks, insurance companies, trades unions, and building societies.

Small, Medium and Large Law Firms

In England and Wales in 2003, the Law Society estimated that there were around 9,200 law firms with 27 per cent of them based in London. Eighty-five per cent of all law firms have four or fewer partners. Within this 45 per cent of firms were solo practitioners. Firms with 26+ partners (1.6 per cent of the whole), however, are increasing in number and 60 per cent of these are located in London. And mega-law firms which accommodate 20 per cent of all practising lawyers are virtually all London-based. There were also 155 multi-national practices in England and Wales.

The American Bar Association data for 2000 tell us there are over 1 million lawyers of whom 75 per cent practice in 47,563 law firms in the United States. Firms with 1 to 5 lawyers comprise 76 per cent of all law firms, while firms with 20+ lawyers comprise 24 per cent (101+ lawyer firms are 14 per cent). While the number of law firms has increased—in 1980 there were 38,500 and in 1991 there were 42,500—the rise has been at the expense of the smaller firms, which in 1981 were 81 per cent of the population.

The UK and the US show similar trends in the year on year decline in the overall numbers of smaller law firms. Small firms are shrinking in number while larger firms are growing in size if not so much in quantity. When these movements are linked with the trend of increasing numbers of applicants to the legal profession each year, this suggest that there is consolidation of law firms occurring. The biggest growth has been in large law firms: there are a substantial number of law firms with over 1,000 lawyers. But even the largest law firms are tiny compared to the large accounting firms such PricewaterhouseCoopers (PwC) which has over 120,000 professionals on staff worldwide.

The statistics for lawyers across Europe show wildly divergent numbers. For example, Germany has about 116,000 lawyers; France over 40,000; Italy 140,000; and Belgium 12,600 lawyers, which seems to indicate that population size is not a reliable indicator of the numbers of lawyers. Moreover, in these countries the typical law firm is small as, for example, France shows with the average number of lawyers in a law firm being 2.73. There are occasional large law firms like NautaDutilh of Amsterdam with 500 lawyers. Beyond Europe statistics are scant but in a country such as China there are 110,000 lawyers with more than 10,000 domestic law firms and around 160 international law firms with offices in China.

Work in Law Firms

Most legal practice occurs in urban areas. For rural areas and middle-sized cities the demand for legal services appears to correlate with the level of retail trade and local government activity. Lawyers' work in law firms varies tremendously depending on the kind of firm and the type of client. Early work by John Heinz and Edward Laumann offered an analytical framework for distinguishing firms' work by client type. Practice effectively fell into two hemispheres—personal and corporate. Personal plight lawyers are involved in the least prestigious areas of law such as plaintiffs' personal injury, criminal defense, and divorce. In the corporate hemisphere most practice areas are of considerably greater prestige and a considerable segment of the work is undertaken for institutions such as finance houses and governments. These include business litigation, antitrust defense, securities, and intellectual property work. In the UK much of the work of the personal plight sector is based on property transactions and state-funded areas like criminal defense, children's cases, and immigration and asylum matters. According to Heinz and Laumann the types of work with the most stable sets of clients are probate, labor (both union and management), commercial, and municipal. Later research has suggested these distinctions are no longer so sharp.

Large law firms are also significantly involved in international legal work. This can have three characteristics: it may involve the export of the "home" legal order; the practice of "local" law; or the creation of non-state law such as lex mercatoria as found in large-scale international arbitrations. These characteristics reflect the way law firms seek to position themselves in the global market for professional services. For example, McKinsey hypothesized that for law firms to become dominant players in this market only two strategies were available to them. The first was to establish the firm as a leader within its own market without establishing overseas offices, e.g., Cravath Swaine & Moore in New York (about 400 lawyers) and Slaughter and May in London (about 600). Their domestic professional reputations thus endow them with the capabilities of forming a series of "best friend" alliances with similar elite firms elsewhere in the world and circumventing the costs associated with globalization. The second strategy is to attain global reach with offices in as many countries as possible, e.g., Baker & McKenzie (US) (69 offices in 38 countries) and Clifford Chance (UK) (29 offices in 19 countries), both with over 3,000 lawyers. The global firms provide all legal services in-house. The remaining firms straddle a middle ground that includes a mixture of domestic and international laws. Nevertheless, there is intense competition among law firms for international or transnational work. Law firms actively promote their country's law as the best vehicle for business transactions. The area of capital markets work displays this clearly. The main sources of finance in the international arena are the US (New York) and the UK (London). Thus most transactions would be undertaken either in New York State law or English law or a hybrid of both. Increasingly global transactions involve a number of different jurisdictions and each has to be incorporated into a form that allows either New York or English law to coordinate the range.

A significant area for growth in law firms has occurred among “franchise” law firms. These are firms which have capitalized on the range of legal needs manifested by the middle class. The work is highly routinized and and standardized; nothing complex is taken on. Franchise law firms are corporately owned, with no partnership prospects for their attorneys, with many satellite offices that generate work for secretaries, e.g., wills, licenses, leases. Their offices are typically found in retail areas such as shopping malls.

Law Firm Growth: Tournaments, Mergers and Clients

It is clear that law firms have grown in size and appear to possess a dynamic for growth. A number of causes have been adduced to explain this growth. Galanter and Palay argue that there is a tournament at the heart of law firms which provides the reason. Law firm partners are endowed with capital. The best way to exploit their capital is to hire associates who will share in it and expand the work base. This is known as leveraging and creates profit for the partners. However, only a proportion of those associates can be promoted to partner, in order to maintain the partner-associate ratios, so they engage in a tournament to discover which ones will succeed. Those who become partners will have invested heavily in the firm and hence will be committed to staying. This is close to the Cravath model outlined above. The law firm therefore contains its own engine of growth and soon becomes identified with exponential growth.

The model has attracted critics. Some say growth rates among law firms are too varied to be explained by a single model. Moreover, many law firms are introducing more layers between associate and partner, such as “salaried partner” or “nonequity partner”, thereby extending the tenure track. Other suggestions propose that firms have incentives to become “one-stop shops” for their clients, cross-selling services across a number of areas so clients rely on single firms for all legal work. Another is law firms grow by offering a large array of services to a large range of clients to avoid becoming dependent on a single client or a particular type of work.

Many law firms have grown through mergers. In some cases these are marriages of equals and in others they are effectively takeovers. One of the key mergers that sparked a rush to merge among law firms was that between Clifford-Turner and Coward Chance in the late 1980s: the corporate and banking firms were galvanized by the deregulation of financial services, the “Big Bang”, in London in the mid-1980s. The result grew into the UK’s largest law firm, Clifford Chance. In the 1990s Clifford Chance then undertook a three-way merger with Pűnder Volhard of Frankfurt and Rogers & Wells of New York producing one of the world’s biggest law firms. The other big global law firm, Baker & McKenzie, took a different route. It started in the late 1940s in Chicago with the intention of becoming a firm with global reach. The process was to acquire lawyers in each target country to form a firm that was a partnership within the local jurisdiction but also a part of an international partnership. Over a period of 50 years Baker & McKenzie achieved what Clifford Chance attained in fifteen by aggressive mergers and acquisitions. One other law firm should be considered in this context, namely, Skadden

Arps of New York. In its early years the firm was largely Jewish and because of the discrimination against Jews in the US, Skadden was consigned to mainly marginal legal work. During the 1960s and 70s Skadden earned a reputation for aggressive lawyering in hostile mergers and acquisitions (M&A), such work being shunned by the mainstream law firms. From this basis Skadden was able to evolve from being merely an M&A law firm to a full-service one. The firm became renowned for engaging in high-profile transactions such as the $25 billion leveraged buyout of RJR Nabisco by the private equity firm KKR.

Perhaps the significant feature of the emergence of law firms like Skadden Arps and Wachtell Lipton, another Jewish M&A firm, was the manner in which they altered the structure of lawyer-client relationships. Until the 1980s corporate client relationships with their legal counsellors were of longstanding duration. Some of the relationships between law firms and investment banks go back more than a hundred years, based on social as well as economic links. Because of the highly-sought after skills that a firm like Skadden possessed in proxy fights, any corporation enmeshed in a hostile takeover would not be able to rely on the abilities of their normal law firm. It simply would not possess that experience. The corporation would attempt to retain Joe Flom of Skadden or Marty Lipton of Wachtell, the key players in the field. Thus notice was served on longstanding lawyer-client relationships in favor of transactional relationships. Two other changes reinforced this alteration in style. Corporations took more of their legal work in house and corporate legal counsel became more selective about which law firm they chose, tightly monitoring budgets and bills. Law firms ceased to be the stable structures they traditionally had hitherto been. Instead of partners remaining with the same firm throughout their careers, they began to move from firm to firm seeking greater advantages, taking their clients with them.

Work Practices and Gender

Law firms are nominally partnerships and also flat-profiled. They also appear at face value to be collegial organizations. These concepts are being modified as law firms cope with the demands of increased competition in the legal and professional marketplace. Law firms are no longer the only organization that delivers legal services. At the personal plight end service providers already include banks, insurance companies, and even supermarkets. In the corporate sector accounting firms have established their own law firms, e.g., Landwell (PwC).

Another way of dividing up law firms is by category of worker. The tripartite division of “finders, minders and grinders” is an expressive depiction of basic functions within law firms. The finders are the “rainmakers”, or the business-getters, who bring in the clients. They often play significant roles in the governance of the firm. Minders are those lawyers who execute and distribute the work among the firm’s associates. Often they are junior partners. Grinders are the ones upon whom the bulk of the work falls, the associates who write the memoranda and briefs. Crude as this distinction is, it provides a guide to law firm hierarchy, power, and remuneration. Rainmaking creates work for the

firm as a whole and is often remunerated separately and profitably. This is sometimes referred to the “eat what you kill”, or merit, approach in contrast to the “lockstep”, or seniority, method whereby partners form separate cohorts depending on date of promotion with each cohort’s members receiving the same amount. Lockstep has traditionally been the English law firm mode of remuneration, although some American firms have also adopted it. “Eat what you kill” is now becoming the predominant mode, especially as law firms globalize and encounter cultures where equality and collegiality have been absent. The rewards of “eat what you kill” usually include a position on management and partner remuneration committees and a strong say in which associates should be promoted to the partnership.

Maintaining the durability of law firm partnerships involves subtle negotiations among peers, forming alliances, and building niches. Whereas bureaucracies endow hierarchies with authority to manage organizational relationships and resolve conflicts, collegial structures are more interdependent and in need of lateral controls that depend on moral suasion. Although collegiality may be a dominant motif in law firms, gender equality is not. Law firms are primarily male institutions even though greater proportions of women are entering the legal profession. In part the difficulties for women lie in law firm cultures. Two aspects are significant. The first is the long hours culture which is endemic in law firms; yearly billable targets of between 2,000 and 3,000 hours are habitually the norm. The second is the culture that creates sets of resource interdependencies not always available to women because they are unable to join established networks, e.g., “old boy networks”, or easily start new ones. These barriers to combining family and law practice and to creating social capital spur women on to leave private practice in favor of in-house or government legal positions where the situation is perceived as less fraught and more family-friendly. There are also similarities with ethnic minority members of law firms.

Ethics, Regulation, and New Forms of Practice

As Lazega points out the greater a law firm’s ethical commitment, the more business it will turn away. Yet ethics and regulation are of considerable concern to law firms. The consolidation of law firms has created an ever-increasing capacity for conflicts of interest. Joe Flom of Skadden Arps was notorious for having a retainer agreement with clients that expressly forbade them to claim conflict of interest in hostile takeovers if he was unable to act for them. The move from stable lawyer-client relationships to more transactional relationships has also heightened the potential for conflicts, especially where cross-selling of services occurs. It is clear that a division between large law firms and medium-sized and smaller law firms is emerging over ethical conflicts. The latter two groups are generally able to accommodate the rules, but the large firms would like to redefine them. Flom even went so far as to suggest conflicts rules ought to be abandoned to prevent shortages of available skills. The situation has intensified with various corporate crises, such as the collapse of Enron, where a number of large law firms were implicated in unethical activity. Some law firms have created “Chinese walls”, artificial intrafirm barriers between teams to avoid conflicts. While in many

cases clients sanction the adoption of Chinese walls, the courts have cast doubt on their efficacy.

Ethical codes are generally the task of the local jurisdictions, yet globalization is raising new ethical and regulatory issues. States no longer have the power to control the movements of capital nor the autonomy of multinational enterprises (MNE). And some nation states' GDPs are dwarfed by the capital values of MNEs. Moreover states are increasingly bound by the adoption of supranational rules, e.g., GATS, NAFTA, Basel II, which may run counter to domestic policies. Generally if self-governance is difficult or impossible, regulation steps in although lawyers have generally avoided regulation. Some bodies—e.g., the US Securities and Exchange Commission—are making moves towards becoming global regulators through legislation like the Sarbanes-Oxley Act of 2002. Lawyers are tentatively taking the first steps to global ethical regimes through the International Bar Association International Code of Ethics and the Council of the Bars and Law Societies of the European Community Code of Conduct for Lawyers in the European Union. But all these developments depend on the law firm remaining an entity *sui generis*, which is not necessarily the case. The emergence of the multidisciplinary practice—and its little sister, the legal disciplinary practice—combining different professionals in a single organization, is already straining the limits of organizational identity and self-governance. And where the state is stepping in, it is in the guise of antitrust authorities, e.g., the UK and Eire, advocating the removal of restrictive professional boundaries, especially those between professions. Law firms live in interesting times.

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