

COMMON SENSE

Dewey's Fall Underscores Law Firms' New Reality

By JAMES B. STEWART Published: May 4, 2012

When I graduated from law school in the 1970s, Dewey, Ballantine, Bushby, Palmer & Wood rolled off the tongue in the same company as Sullivan & Cromwell, Davis Polk & Wardwell, and Cravath, Swaine & Moore, venerable New York firms whose place at the pinnacle of the law profession seemed unassailable. For a young lawyer, a job at any of them was the first step to the golden ring of partnership and, with it, lifetime tenure, prestige and affluence.

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Patrick A. Burns/The New York Times Former New York Gov. Thomas E. Dewey outside the offices of Dewey, Ballantine, Bushby, Palmer & Wood, on Jan. 3, 1955.

Maybe that's why the seemingly inevitable collapse of a firm like Dewey, since renamed Dewey & LeBoeuf as a result of a 2007 merger, has so rocked the legal profession. Dewey is hardly the first major law firm to fail. Recent years have seen the demise of once-respected names like Howrey & Simon; Coudert Brothers; Brobeck, Phleger & Harrison; and Heller Ehrman. But none had the pedigree of Dewey, named for the former New York governor and presidential candidate Thomas E. Dewey.

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As the dire plight of Dewey & LeBoeuf worsened this week, a partner, Stuart Saft, the head of the firm's global real estate practice, decamped to Holland & Knight. "Apart from the last six weeks," he told me, his time at Dewey

represents "the best five years of my professional career. We worked on the largest and most complicated and interesting deals in the world. That's what practicing law is all about, not the size of your paycheck. Maybe the business model wasn't the best. But as lawyers we did fabulous work." Dewey's collapse "is as crazy as Arthur Andersen going under," he added. "It's a loss. We became a media sensation, and now a great firm is disappearing."

The circumstances at Dewey may turn out to be extreme. But the firm's messy decline lays bare the harsh realities of today's law practice, and shatters the perception, still held by many members of the bar, that however transformed in recent decades by the realities of the market, law is at heart still a guild, a brotherhood (and

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increasingly a sisterhood) — in short, a profession more than a business.

As dispatches from my Times colleague [Peter Lattman](#) have made abundantly clear, Dewey collapsed under the weight of a toxic combination of high leverage, lavish financial guarantees to many partners and faltering revenue. This makes it, in many ways, the Lehman Brothers of the legal profession, although perhaps that's unfair to Lehman Brothers. Though highly leveraged, Lehman Brothers had enormous assets on its balance sheet — while Dewey, like law firms generally, had scant tangible assets. Nonetheless, that didn't stop the firm from heavy borrowing of about \$225 million, both by issuing bonds and by drawing on a large line of credit.

“This absolutely falls into the category: What were they thinking?” Bruce MacEwen, a lawyer and president of Adam Smith Esq. and an expert on law firm economics, told me this week, as Dewey suffered a new wave of partner defections and the firm's accelerating collapse appeared unstoppable. “This was Mismanagement 101 across the board. They had a ringside seat for the collapse of Lehman and Bear Stearns. But they had the same mismatch of assets and liabilities. They took on a massive amount of long-term debt, but their assets are short term: they walk out of the firm every day and may not come back, which is what more and more of them did.”

It's not yet clear how the firm used the debt proceeds. Partners say most of the debt predated the merger with LeBoeuf, and was a rational and cost-effective way to try to manage existing debt. Still, it seems likely at least some of it went to meet the extensive guarantees the firm made to individual partners, some reaching millions of dollars and apparently extending over many years.

Other lawyers and management consultants have been shocked by the size and duration of the guarantees that appear to have prevailed at Dewey. “The guarantees were extremely corrosive culturally because they were divorced from individual or firm performance, which shatters the whole notion of a partnership,” Mr. MacEwen said. “And they were promiscuously awarded.” Although such guarantees have been spreading throughout the profession, the magnitude of those at Dewey “is unheard-of,” said Thomas S. Clay, a principal at Altman Weil law firm consultants. “We recommend only one to two years for a guarantee. And those usually also have some performance component.”

Another law firm consultant, Peter Zeughauser, said that much of the onus fell on incumbent Dewey partners who insisted on their own guarantees. “It's common to give guarantees to lateral hires,” he said. “But you need the existing partners to buy into the strategy. At Dewey, some of the most important partners didn't buy in. They said, ‘If they're getting a guarantee, I should, too.’ They weren't willing to invest in new partners. That's very unusual.”

In what appears to have been an increasingly desperate effort to hang onto its prestige and profits, Dewey violated some unwritten but still sacred rules of the profession. As the exodus of partners began last year, the firm's managers publicly disparaged their departing colleagues. In the once-collegial profession, when partners left — no matter what the circumstances, short of embezzlement or fraud — the firm wished them well and said



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nothing to disparage them.

By contrast, Dewey issued a statement saying that the firm was moving in a “new direction” and that departing partners “didn’t like the change” and were part of “firm-initiated reductions,” implying they were asked to leave. “Trashing your partners: How classy is that?” Mr. MacEwen said. It was also almost surely untrue. “It should be obvious that the partners who leave are the most mobile,” he said.

And the firm seems to have violated another unwritten law: it inflated its revenue in the annual American Lawyer survey of law firm rankings, the AmLaw 100, the equivalent of the Fortune 500 for law firms. The annual survey, which relies on self-reporting, is indispensable to clients, other lawyers and law school graduates choosing firms. After Dewey partners provided Bloomberg News with profit numbers that differed sharply from what the firm had reported to American Lawyer, [AmLaw restated Dewey's 2010 and 2011 results](#), which dropped Dewey’s revenue per lawyer in 2011 to \$750,000 from \$900,000 and lowered the firm’s rank based on revenue to 28th from 22nd in 2010. Dewey has defended its reporting and said the discrepancies resulted from differing methodologies.

The practices of Dewey’s ousted chairman are now under investigation both by the firm itself and the Manhattan district attorney.

Of course, Dewey’s managing partners may have been confronting the realities of a vastly more competitive market for professional services. When I was a young associate at Cravath, one of my tasks was to compile the detailed billing records, organize them and submit them to the senior partner. What emerged for the client was a one-sentence bill in calligraphy on beautiful stationery: “For professional services rendered,” followed by the time period covered and a large number with a dollar sign. So far as I know no client ever objected or asked for a more detailed explanation, and had they done so, I suspect the senior partner would have deemed it a grave breach of trust.

Today, firms bargain over rates and compete fiercely for both their own talent and for clients. Clients have figured out that much of what lawyers do is a commodity that can easily be outsourced far more cheaply. Law firms always had a few dynamic partners who wielded disproportionate influence both within and outside the firm, and another group who may have been highly skilled and specialized, but were rarely seen by clients. They were supported by a broad base of lower-paid associates who developed their skills at client expense and performed, in many instances, relatively menial and repetitive tasks. “There’s a dawning recognition that many partners don’t add much value other than their legal work,” Mr. Clay said. “Many are being asked to leave, or to accept a nonequity, salaried partner status.”

Mr. Saft, the former Dewey partner, contended: “The partner guarantees are symptomatic of the underlying change in the practice of law over the last several decades. Before that, law firms were partnerships. It was an institutional practice, not individuals with portable books of business. Now, everyone has become a free agent. It has changed and destabilized the nature of the legal

profession. And once it takes hold, it accelerates. Other firms say they don't do it, but I wonder if that's really true."

Mr. MacEwen was inclined to agree. "I've been struggling with the degree to which Dewey is a lesson for other firms," he said. "Everything they did was so extreme and so ill advised. But part of me has to admit that the dynamics of the practice, the eat-what-you-kill remuneration model, makes a law firm inherently fragile. And part of the lesson of Dewey is that if you put practices in place, like the guarantees, that corrode culture, then you're playing with fire."

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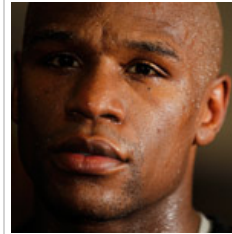


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