

W E A T H E R I N G

T H E

S T O R M

Six attorneys
from Virtual Law Partners (VLP),
four of them
Stanford Law alumni,
are seated around a half-moon-shaped
conference table across from
three huge digital screens at Cisco
Systems' San Jose office.

On those screens, five attorneys from
the Beijing firm Broad & Bright,
including Changchun Yuan, JSM '94, JSD
'95, are gathered in an identically
outfitted room in China. The net effect is a
half-real, half-virtual meeting.

BY

JOAN O'C. HAMILTON (BA '83)

PHOTO ILLUSTRATION BY FREDRIK BRODEN

PORTRAITS BY LESLIE WILLIAMSON



THE ACOUSTICS OF THIS CISCO “TelePresence” system are so sensitive that when a Chinese attorney riffles through her papers, it’s as if she’s just a few feet away. Aside from all the fancy technology, what’s even more startling is the frank conversation the seasoned attorneys at these two newly affiliated firms are having about how they can sell legal services to major U.S. clients for, well, a bargain.

“What are you billing per hour?” VLP President RoseAnn M. Rotandaro ’95 asks her former Stanford Law classmate and friend Yuan.

“Starts at \$200 for associates, up to \$450 per hour for partners,” Yuan replies.

“And we’re billing at \$300 to \$500,” adds VLP CEO Craig Johnson ’74. Johnson, with Rotandaro and Andrea Chavez ’96 (MS ’98), founded VLP last year on the premise that it would use technology to create a firm of networked partners who could deliver the same quality of service as big law firms for a much lower cost. For example, U.S. clients who work with major firms in China routinely pay fees that start at \$600 and run to \$1,000 per hour. “By bypassing big global firms that legally must subcontract with local firms, we can cut out one layer of middlemen and curb about 50 percent of the hourly rate. What’s not to like?” adds VLP partner Wena Poon, a Harvard Law alum and veteran of London law firms Linklaters and Reed Smith LLP.

Top attorneys excitedly talking about low-balling the competition? Welcome to the legal profession, 2009.

The economic shock wave moving through the world economy is creating an upheaval in law firms not seen for almost two decades. Today, demand across broad categories of practice areas has plummeted. Especially hard hit: real estate, mergers and acquisitions (M&A), and corporate transactions. After growing by 12 percent in 2007, for example, M&A work contracted 2.5 percent in 2008, according to a survey by Hildebrandt International.

Layoffs in the first few months of the year have been widespread, with an estimated 800 attorneys losing their jobs on February 12 alone, a day law bloggers quickly dubbed “Black Thursday.” According to the legal newspaper *The Recorder*, prominent firms trimming both associates and staff that day in-

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(BS ’70, MS ’71)
Chairman and Partner,
Fenwick e3 West

cluded many in the Am Law top 100. That came just a couple of weeks after more than 1,000 lawyers and staff lost their jobs at many more firms. And news of more layoffs comes every week. According to a recent *National Journal* article, by the end of February another 4,200 jobs had been shed in the legal profession. And the news for March was equally bleak.

Students and recent graduates are starting to worry. Susan C. Robinson, associate dean for career services, says there were widespread cutbacks in summer internship programs for 2009, and many firms are considering shortening the programs to 8 to 10 weeks, down from the typical 12 or more weeks. Across the board, associate salaries have been frozen. Robinson says she sees no evidence of firms rescinding offers to Stanford Law students slated to arrive next fall, although some firms have offered incoming associates deferrals. More troubling are the calls from alumni who have been laid off. “The market out there is very tight right now,” she says.

And so are the key indicators. In its 2009 Client Advisory prepared with Citi Private Bank, the legal industry consulting group Hildebrandt projects that 2008 profits per equity partner in most firms will be flat to negative 10 percent and that in 2009 the drops are expected to be worse, particularly for firms with significant practices in the capital markets. Last year, venerable firms such as San Francisco’s Heller Ehrman and Thelen Reid & Priest were shuttered along with another 16 firms. There were 55 mergers of U.S. law firms, according to Hildebrandt, and more consolidation and shrinkage are likely ahead.

Ripe for Change?

IT’S NO WONDER SUCH A CLIMATE HAS MANY PEOPLE ACROSS THE LEGAL PROFESSION questioning the role lawyers play today in general and also grappling with just how much of the traditional firm structure and its billing and management practices is sustainable. “There isn’t a large corporate general counsel in the United States right now that isn’t working hard to figure out better alignment with outside counsel,” says Mark Chandler ’81, senior vice president, general counsel, and secretary of Cisco. Chandler has been aggressively working with Cisco’s legal partners for several years to implement better technology and process to rein in soaring legal



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costs. "There are a thousand flowers blooming right now. It's conceptually a general relook at every facet of law practice and the appropriate way to define the relationship," says Chandler, who also sits on the VLP advisory board.

To those attuned to both the business and practice of law, this day of reckoning comes as no surprise. "The need for the profession to change pre-dates this current crisis; it's a model of practice that's teetering on collapse," says Larry Kramer, Richard E. Lang Professor of Law and Dean of Stanford Law School. Kramer believes that, for a profession steeped in tradition and stubbornly organized around management practices many consider out of date, the widespread shocks can be an opportunity to step up and reinvent itself. Such practices as the traditional billable-hour structure, which seems to many clients to reward inefficiency; associate starting salaries that have climbed to the stratosphere; and the expensive wooing and entertaining of top law students, in summer programs that create a fantasy of what a young lawyer's life is really like, should all get a once-over, says Kramer. But when he looks around he says he is disappointed that he sees few signs that real change is imminent. "I worry that everyone will hunker down and hope to wait until things pick up."

CARL A. LEONARD, FORMER chairman at Morrison & Foerster and now chairman and director of The Hildebrandt Institute, the educational arm of Hildebrandt International, agrees with Dean Kramer. Leonard consults extensively with law firms about their business models and despite the enormous bottom-line hits, he says, "We're still in the mentality that we're a guild and business forces don't apply to us. Well, we're wrong." Among the most fundamental problems, according to Leonard: "We still have a separation in most firms between the management committee and the compensation committee. We have lockstep advancement by year regardless of performance. And I've been writing and speaking for so many years about the stupidity of time-based hours."

The fall 2007 *Stanford Lawyer* feature, "The Changing Business of Law," looked at gather-

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ing pressures that now, with this economic crisis, have converged into a "perfect storm" for the legal profession. These include soaring salaries for associates, which in turn fueled the steadily escalating hourly rates that have prompted clients to revolt, as well as many firms' slow adoption of more technologically efficient business practices. But a big issue in 2007, work-life balance, is barely whispered today. As we noted then, despite starting salaries at an eye-popping \$160,000 per year, associate attrition at many large law firms was nearing 30 percent and had even inspired some Stanford Law School students to launch an organization called Law Students Building a Better Legal Profession.

The turnover and unhappiness of large-firm associates was a factor in driving talented lawyers to sign on with new outfits like Axiom, a legal service company that provides attorneys to corporations for a fraction of what firms charge for project-based help. In exchange, the lawyers get to practice without putting such brutal pressure on their personal lives. In the current economic climate, many expect this trend to continue. "The development of the independent contractor market for lawyers is an important trend," believes Dan Cooperman '76 (MBA '75), general counsel at Apple Inc. "The capabilities and qualifications of lawyers who are willing to make themselves available on this basis are now very high."

In conversations with Stanford Law alumni and others working in a wide variety of firms and as general counsel today, there is no doubt these sobering and difficult issues remain, although concern about associates' work-life balance mostly has dropped off the radar. "In 2000, people came out of law school looking to be masters of the universe; now they are happy to be employed by the universe," observes a Stanford alum who recruits for a major Silicon Valley firm.

Business Outlook: Uncertain

BUT IN THE LAST 18 MONTHS, SIMMERING CONCERNS HAVE BEEN MAGNIFIED by the global recession and a few developments even experts didn't see coming. For example, "Nobody knows what's really going on with litigation," says Hildebrandt's Leonard. More and more companies seem to be settling rather than



RoseAnn Rotandaro '95 and Craig Johnson '74

prosecuting big cases, he notes, and demand for litigation fell into negative digits from 2007 to 2008. Litigation tends to be a counter-cyclical practice that often cushions economic downturns for firms. “That litigation is down is unprecedented, and it’s not picking up,” says Leonard. “We can’t figure out if it’s just the cost of litigation that companies are rejecting or the economy or both. That would be a tectonic shift if litigation really changed on a long-term trend line. But we just don’t know.”

The conventional wisdom is that during this recession the very large firms will prosper as will highly specialized boutique firms, but the mid-size firms are vulnerable. At least one SLS alumnus who helps manage a 2,000-plus attorney firm, however, says he does not believe the impact will be so black and white. “Everybody in the middle thinks the sky is falling and economic activity will never return. Economic activity will return to the country and the world. It’s a mistake to develop the mind-set that the work won’t return. There are investment banks that no longer exist—but the ones that do will be subject to more regulation. My instinct is that this will be like the early 1990s, but more pronounced. We need to retool and readjust.”

Those terms seem to mean different things to different firms. “There is definitely a reset going on in the profession. We are looking at ways to control rising costs, associates’ salaries, and other pressures on billing,” says John Roos ’80 (BA ’77), CEO of Wilson Sonsini Goodrich & Rosati. Also on many firms’ list for review: real estate. An imposing, even luxurious office once was considered, along with the ampersand, as one of the premier signs of stability and strength for law firms. Today, Roos and others are looking at real estate costs, for example, and questioning to what degree it makes sense, in a highly networked, work-anywhere world, for every attorney to have a private office in a high-rent location.

However, reforming one of the most hotly debated foundations of legal work—billable hours—seems to remain more talk than action. Many academics, companies, and business consultants predict that the days are numbered for the billable hour way of doing business. They say that the field must move to more transaction-based billing and fees for service that don’t incentivize firms to do more than is required to keep associates busy. The presiding

partner at Cravath, Swaine & Moore in New York even told *The New York Times* in January, “This is the time to get rid of the billable hour.” But many law firm partners aren’t so sure. “I don’t believe the legal profession is going to move away from the hourly rate anytime soon,” says Roos. “What we know is that it has to be a certain kind of client and mind-set. Neither lawyers nor clients are in love with the hourly system, but if the clients really wanted to transition to transaction-based fees or other billing schemes, we’d have them.”

GORDON K. DAVIDSON ’74 (BS ’70, MS ’71), chairman and partner of Fenwick & West, seconds Roos’s observations that clients are not demanding negotiated fees in large numbers—though Davidson entered into just such a relationship with Cisco a while back. However, despite an agreement with Cisco that both Davidson and Chandler say works very well, it isn’t a one-size-fits-all remedy.

“The tradition has been to charge by the amount of effort expended. Clients are happy to pay for value, less happy to pay for effort,” says Davidson. “A fixed-fee relationship depends on predictability. We can predict the business we will do with Cisco in a year—perhaps 6 to 10 acquisitions, 20 to 30 investments. We can predict when a startup will need to go public. But if a client says they want a fixed fee for one acquisition or for litigation, well, for companies without a regular pattern, it’s hard to estimate a fair price. In fact, even internally it’s easier for the general counsel to say to the CFO, ‘I got our law firm to give us a 10 to 15 percent discount.’ The fixed fee is harder to calibrate and explain,” says Davidson.

On the other hand, he is very happy to explore such arrangements and sees potential for clients to save money and take valuable legal counsel with fixed fees. “With the hourly rate, in-house counsel may say ‘I have a small question; I’ll just make a best guess.’ It could be that a 10-minute call could have prevented an expensive mistake,” says Davidson. “With a fixed fee there is no inhibition to make that call, and you avoid a \$10,000 legal bill later. All this really needs more research. I

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think it works at the low end and the high end, but in the middle it's hard to tell."

Deborah L. Rhode, Ernest W. McFarland Professor of Law and director of the newly launched Stanford Center on the Legal Profession, agrees that these tumultuous times demand more targeted research from the academy—and that the start of the center couldn't have come at a more opportune time. "We've just put in a grant to look at the alternative structures for law firms. We'll look at billing, fee structures, quality of life. This kind of research should inform decisions moving forward," she says. "For example, in the last recession firms reacted with layoffs but then they didn't have the manpower at the mid-associate level when business picked up again." Indeed, a number of partners at major firms say they are forecasting internally that the huge drops in corporate valuations probably make a burst of mergers and acquisitions inevitable; the question is how do you balance staff in the interim. Rhode says the answer may lie in projects such as "strategic pro bono work" designed to retain and train particular associates with particular skills.

As part of the wider rethinking, the profession also must recommit to its most fundamental responsibility to serve clients by telling them "what they ought to hear, not what they want to hear," says William H. Neukom '67, former general counsel of Microsoft, former president of the American Bar Association, and now the CEO of the San Francisco Giants. Whether in situations like the imploding of Enron, the dot-com bust, or the current misconducts and mistakes in the financial industry, he says, "Part of what we're seeing is that the classic role of the wise, trusted lawyer wasn't being played. We had companies going public without a business plan, reporting their activities in confusing or even misleading ways, managing for the short term to impress the street, and reaching for questionable ways to generate profit well outside their core competence."

Part and parcel of looking at fee structures and efficiencies are these more fundamental notions about the proper role and value of a lawyer. "We have to ask, 'Are lawyers asserting themselves in the way that they should?'" says Neukom.

Some lawyers certainly are asserting themselves in new and different ways. For example,

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the famously entrepreneurial Craig Johnson, who created Venture Law Group (a new model for a branded, high-tech-oriented firm) in the 1990s and sold it to Heller in 2003, recently started VLP, which is a radical new idea. While a temporary service company such as Axiom maintains offices, VLP's model—no physical offices, all lawyers as partners who keep 85 percent of what they bill—is a big departure from the associate-dependent, high-overhead structure of most firms. "The large law firm business model is broken; nobody even disputes that it's broken," claims Johnson. While some attorneys do try to strike out on their own, the difficulty in doing so hinges on generating enough business and keeping it. The idea behind VLP is to develop a brand and a reputation for being able to assemble an experienced, sophisticated team quickly, but without a traditional firm's overhead.

Some partners in mid- and large-size firms say that while the growth of contract lawyers and more independent staff attorneys is a trend that's here to stay, they aren't so sure such a virtual arrangement can replace the stability and relationship-based business of traditional law firms. "The economy could lead to a prolonged reduction in lawyers in major firms," says Stephen C. Neal '73, chairman of Cooley Godward Kronish. "But I don't think it's time to change the concept of a private law firm. I think a lot of what we're dealing with is not even as much the economy as that we weren't as disciplined as we should have been in our hiring and we have to recalibrate."

However, David Jargiello, former general counsel to Heller who has since joined VLP, believes virtually all law firms today are vulnerable to a sudden turn of fortune. "The traditional law firm model is overly dependent on a small number of individuals with some to little to no loyalty to the organization—an exquisitely fragile structure. Because of this free agency factor, any law firm is within a matter of months of imploding." And that reality is making for tense, uncertain days across the profession. **SL**

JOAN O'C. HAMILTON (BA '83) is a former bureau chief for *BusinessWeek* magazine: this fall *Smart on Crime: A Career Prosecutor's Plan to Make Us Safer*, by San Francisco District Attorney Kamala D. Harris, written with Joan, will be published by Chronicle Books.