Overseeing the End:

What should a leader do when his firm enters a death spiral?

(first published in *The American Lawyer*, February 2009)

The role of every law firm chairman changes as his firm grows and evolves, but his focus is always on building a sustainable enterprise—except when the firm's future clearly becomes unsustainable. The notion of a firm's failure can be so disturbing that it escapes planning until the eleventh hour. As is the case with all unanticipated events, though, the conflicting interests that arise in a law firm's failure are best managed with careful forethought.

In every firm failure there is a window—sometimes referred to as the "death spiral"—between the moment when the chairman realizes that the firm likely cannot survive and the moment the firm votes to dissolve. During this window, the chairman's role is fraught with conflicting interests. Commonly without a book of business, the chairman has his own future to worry about. Unlike the chief executive of a failing company who can often find work as a CEO elsewhere, chairmen who preside over the demise of their firms seldom find work as a chairman of another law firm. And while the chairman is often the confidante and friend of the firm's most successful partners, he is faced with the reality that their practices are typically worth more on the market when unencumbered by weaker partners, making it difficult for the chairman to find a home for the whole firm. Finally, while the chairman has a duty to disclose the firm's underlying weaknesses to his partners, he is also responsible for maintaining the luster of the firm's brand, which can make a big difference in the employment prospects of attorneys and staffers far into the future. How the chair manages the firm during this window greatly affects the likelihood of a smooth transition. Here are four critical responsibilities.

1. **Develop a plan.** The chairman must lead the development decision-making process during the death spiral. Topics to be addressed include:

- Assembly of a team of internal and external advisors to guide the firm through the period preceding the formation of a dissolution committee.

- Management of communications, both inside and outside the firm, and
- Development of a timeline with "fish or cut bait" dates for making key decisions, including whether to combine with another firm and whether to cut special deals with key partners. The timeline should be based on a sober short-term financial plan that optimizes the likelihood of an orderly dissolution, including managing creditor relationships. Most importantly, the plan should set a realistic outside date by which a dissolution decision must be made. This will ensure that the firm's liabilities are appropriately addressed, that key partners and staff understand that management has a realistic view of the firm's future, and crucially, that client work can be smoothly transitioned.

Executive committees of many firms pride themselves on operating by consensus and rarely taking formal votes. But as a dissolution vote nears, conflicts between protecting and advancing one's personal interests and acting for the greater good intensify. If ever there is a time for a formal vote, it is on the important decisions that management makes to stabilize a firm in its final months.

Mergers (and even more so, dissolutions) make clients nervous. When firms combine, clients worry about distraction, and when they dissolve, clients worry about whether the teams that serve them will stay together. In either case a well-crafted client transition plan that addresses the timing and content of client communications, file transfers and staffing is essential.

Creditors are another crucial group to consider. Dissolutions empower creditors. They can drive merger discussions and influence staff and partner compensation. Open and candid working relationships between the chairman and creditors build trust and lead to greater cooperation. By proactively engaging the firm's creditors in a dissolution, a chairman can gain greater flexibility in a merger talk.

2. **Get help.** As a custodian of bad news about the firm's future, it is often tempting for a chairman to shield his partners from an unpleasant reality. Indeed, if holding the firm together while either seeking a combination with another firm or analyzing the best path to an orderly dissolution is a priority, keeping it to one's self might seem like a good idea. That's a mistake. Partners who have invested their careers in building a firm respond with anger when they are surprised with the news that the firm's practice isn't sustainable. The anger clouds good judgment and results in self-centered decision making instead of decision making for the greater good.

Who needs to know what, and when they need to know it, requires careful thought and the balancing of self-interest with the interests of others. The chairman should call together the formal and informal leaders of the firm to develop and get buy-in for management's course of action, to keep them abreast of alternatives, and to seek their advice in evaluating the options. Every firm has a grapevine; it is essential that the firm's leaders be in a position to manage it as constructively as possible while the firm considers and pursues its alternatives. Open lines of communication with accurate information about management's thinking is the most effective way to bring everyone to the conclusion that their personal interests are best served by acting for the common good.

In all likelihood, neither the chairman nor members of his kitchen cabinet will have previously dissolved a professional services partnership. Strong, independent, outside advice is critical during this time. At a minimum the team of advisors should include a strong bankruptcy attorney experienced with dissolutions or professional service firms, a financial advisor experienced in dissolutions and combinations, and a consultant to help identify, prioritize, and shepherd talks with other firms.

3. **Make the big decision.** Before the dissolution vote, the firm typically has two options: combining with another firm (this may be called something else, but it is basically an asset sale) or dissolving and letting the market set the price of the individual practices. Selling is typically the best alternative, and to make it as attractive as possible, it is generally cast as a merger. Holding a failing firm together for a merger, though, is something of a Hail Mary.

Rather than having a short list of realistic candidates, chairmen can make the mistake of entering into a prolonged period of talking to numerous suitors. Often, many of these potential suitors are more interested in looking for star performers who might ultimately come onto the market in a dissolution than in genuinely pursuing a combination. A chairman has to be disciplined about how long to stay in the market before deciding to opt for an orderly dissolution. Star performers can hardly be asked to turn down offers elsewhere as they watch the firm's assets, and their capital, dissipate.

Firms fail because too many partners underperform. When the underperformers become too numerous, the firm can't survive without the marginal contributions they make to overhead. When high-performing partners recognize this reality, the temptation for them to seek the highest price the market will pay for their practice is great. They can get their capital back and take their business with them. Once they leave, there is little left to sell, and dissolution is inevitable.

Even in good time, a chairman must manage a firm around the performers, not the underperformers. But at a failing firm, this becomes even more crucial. Encouraging underperforming partners to leave (through appropriate pay packages), while demonstrating to the performers that staying together for a sale will enhance the likelihood of them preserving the firm's capital, should be one of the chairman's top priorities. This may involve making special arrangements with top performing partners to encourage them to stay at the firm.

If performing partners lack faith in the firm's ability to hold on to them and to eliminate underperformers, the chairmen's goal must be to seek an orderly dissolution—one that takes the best advantage of the firm's assets so that the liability of individual partners is minimized.

4. **Manage the media.** There is likely no time in a firm's life when managing the media is more important than when a firm is moving towards a dissolution vote. Giving media inquiries a low priority or ignoring them often results in highly inaccurate press coverage. On-the-record candor can be equally problematical.

Credibility with the journalists is essential. It's the rare chairman who can meet the firms' need to be discreet while communicating messages that satisfy a journalist's desire to promptly and accurately report the story of the firm's dissolution. It requires a mastery and trust of journalistic relationships and ground rules—something that doesn't come naturally to most firm leaders. Chairmen must recognize that when a firm is down, inaccurate press can be fatal. And there will be no dearth of sources for bad press, including headhunters, competitors, and former partners. Opening up to the press, even when it's on an off-the-record, for background, or not-for-attribution basis, can help ensure accurate coverage and stave off an uncontrolled, media-fueled scrum.

Speaking with one voice is as important as mastering the rules and relationships of interactions with journalists. Partners who talk with friends at other firms or headhunters wind up hurting themselves as much as anyone else. When these conversations find their way to the press, which they often do, they can derail merger talks, upset creditor relationships, diminish the confidence of important partners in firm management, and otherwise harm efforts to pursue an orderly dissolution.

No firm wants to enter a death spiral. But carefully planning how to work through it to the best conclusion results in a far better end than the alternative.