

How It Really Works . . .

Public Service Stipends for First-Year Associates

Among the interesting developments during this current crisis in BigLaw economics, some law firms have rethought their approach to the 2009 first-year associate classes. Instead of rescinding offers, leaving even the best qualified graduates of fine law schools unemployed and exposed to the full brunt of a major employment downturn, they're requiring the new attorneys to defer their start dates from September or October 2009 to January or even March 2010.

Some firms are pursuing an even more aggressive option. They are offering/requiring a one-year hiatus during which the graduating student may pursue a public service stint, with a \$60,000 stipend and a typical support package that allows the graduates to study for the bar exam. That add-on is usually worth in the range of \$12,000 to \$14,000. The strategy is being expanded and refined as firms more closely study the purported benefits.

Why would a major law firm pursue either program amidst a major economic downturn pressuring profits lower, and why would a graduating law student from the top of his or her class at a prestigious law school consider accepting it?

Dual Necessities

While there could be a number of ostensibly high-minded motives, it really boils down to a lack of options for both sides. For law firms in 2009, double-digit declines in net distributable income to equity partners, notwithstanding major cost cutting, define a stark reality. As the budgeting process for 2010 begins in October, and forecasts of the predictable range of 2009 partner incomes crystallize—combined at many firms with the resetting of income shares for 2010—the big question is not whether there will be net income disappointment.

The real question is whether the numeric decline will begin with a 1, a 2, or even a 3! Any proposed business course of action, however legitimate, that does not triage the profit erosion will be rejected by the stakeholders.

For the first-year wannabes, the situation is pretty straightforward. It is virtually impossible as a graduating law student to land a job with a major firm if you do not already have one. The terminations have affected every corner of the legal profession, and the numbers of firms simply rescinding offers to graduating law students have increased apace. There is no room in the profession for graduating law students. None.

If not a single new hire is made this year, there are still too many lawyers for the work available (the layoffs now are not in anticipation of making room for large numbers of new additions in the fall!), and there is no present expectation that this situation will change any time soon. Even if demand were to pick up, the natural reaction of the firms will be to strain every single timekeeper to their limits before bringing on new talent.

When actual hiring does re-commence, there will be large numbers of eager applicants all having a wide range of prior experience and training at top firms and with excellent educations. At that point, who will you hire first: the experienced professional or the novice?

Clients have made their position loud and clear: They do not want to underwrite the education of inexperienced young attorneys. As a result, charging their time as billable has become increasingly problematic. Relative to their actual contributions, and even in the good years, it is not until sometime in their third or even fourth year of practice that graduates typically reach

a “break-even” point where collections on their time exceed their salaries, benefits, and per capita allocation of fixed overhead and costs.

As such, the actual loss incurred by the firm as it invests in the future of the new additions is likely to be greater in the next year or two (if not much longer), absent changes to the way in which associates are compensated, or the way that firms deliver legal services, or both.

For the firm, the financial benefit of deferring start dates adds up, in salary, benefits, and perks, to about \$60,000 per capita for 2009. Add continuing legal education classes, training time on systems, and a variety of other start-up costs, and the number rounds out much closer to \$85,000-\$100,000 for every nose kept out of the tent until next year. So we’re talking in the range of \$1 million to \$3 million savings per firm depending on the size of the entering class. (We’re not considering allocations of fixed overhead, but that component is certain there as well.)

The math is easy, and the burden shift is likewise easy, as the new law grads bear the economic burden of profession-wide retrenchment. There are no real alternatives in the marketplace, so the new graduate lives with mom and dad and waits nervously for the other shoe to drop, specifically, the possibility that in January or March there will be a full withdrawal of the offer of employment.

In fact, let it be said that the altruistic motives here are not quite as heartfelt as they might at first blush appear.

Alas, however, in the context of all the challenges now facing big law firms, even these rescissions will not save enough money to make a major difference in the outcome for annual profits and losses. The savings help, but they do not help a lot. So, to the deferral strategy, some law firms have added a fresh new idea.

Additional Step

The public service stipend option is indeed an aggressive extra step that a broader range of law firms are likely to take in the next few months.

With this program, the firm avoids more than \$200,000 in direct costs per attorney. They pay a stipend, which is dribbled out over the ensuing year, so as a cash flow element it is relatively minimal in its effect.

But the firm gets much more than that. There is the client service issue as these beginners can now be presented as relatively experienced practitioners if and when they do become full members of the firm. There is also the morale issue as firms can appease attorneys already at the firm who’d be utterly consternated to see new people brought in right after a so-called “right sizing” with its painful reductions to match staff size to work volume.

And, of course, there is the public relations issue, and the positive impact on on-campus perceptions when, instead of rescinding offers, firms make *pro bono* investments where they are needed most.

Meanwhile, that \$60,000 is not a real cost. In fact, let it be said that the altruistic motives here are not quite as heartfelt as they might at first blush appear.

Sleight of Hand

All large law firms have targeted billable hour allocations for *pro bono* services. In fact, for associates, the first 100 hours are often given full equivalent credit as a billed and collected hour. A typical, perhaps even generous, target for a firm would be 3 percent of billable hours devoted to *pro bono* service. With a 2,000-hour billing quota, that means 60 hours per year per attorney.

Some attorneys bill more, some bill less. Associates typically do more *pro bono* on average than partners, as these cases can provide greater responsibility and deeper experience than paying clients are willing to entrust. At \$250 to \$300 per hour, those 60 hours translate to about \$18,000 of otherwise collectible time that is “lost” to the firm coffers, yet paid for with overhead and salary and benefits.

Here, though, we’re only talking about the lowest avoided cost of new associates. Senior associate and junior partner time is charged from \$400-\$600 per hour, so those same hours are actually worth \$24,000 to \$36,000. For senior

partners, the numbers are, of course, much higher. Under the new stipend program, firms can now *totally* re-direct those *pro bono* hours to the lowest-cost providers, who have no other work to do anyway.

Indeed, our altruistic law firms can gently pull back on the *pro bono* hours of the attorneys in the firm for just this one year (and with consciences self-reassured) so that the “right sizing” focuses the higher billers almost completely on billable work. The firm then generates 1,800 to 2,000 hours of *pro bono* contribution from each start-deferred associate even as those deferred associates now consume the *pro bono* hours expected of 30 attorneys next year.

The billable hour value of those more senior attorneys, at an average weight of \$400 per hour for those 1,800 hours (which is conservatively low), is \$720,000. Every one of those marginal hours is potentially pure income to the firm. So, at an out of pocket cost of \$60,000 for each deferred associate, the firm can still meet its *pro bono* commitments for hours while hoping to recover a margin of \$660,000.

It’s a pretty sweet return to the firm for *every* associate who takes this option. It means that the program is returning net revenue in the range of an additional \$7 to \$20 million to the firm, not including the \$1.4 to \$4.2 million (assuming 10 to 30 new associates) of direct cost savings. Now this is serious money!

It’s as slick as we’ve seen law firms operate in years. The stipend is paid to the *pro bono* organization, which then pays it to the associate. As a result, the firm ledgers show that total as direct charitable/community service contributions, not as salaries. After all, the law grads are not technically employees of the firm.

As cost savings initiatives grind over time at law firms throughout the country, look for this ploy to increase in popularity and interest. The remaining challenge is that there may not turn out to be as many spots to fill as there are candidates to fill them because the recipients of this newfound law firm largesse may not be able to afford it!

Indeed, “free” lawyer support from the perspective of the law firm may not be “free” to the charity. Office space, desks, supplies, support, insurance, etc., those have to be paid for. In a constricted revenue environment exacerbated by recession, many charities may be compelled to say, “Thanks, but no thanks.”

Without a placement at a qualifying organization, the stipend to the deferred associate goes to zero. For the sake of the grads and the *pro bono* clients, we certainly wish them all well, but it remains to be seen how many full placements will occur.

If things do not get better soon, reductions in associate salaries, cancelled or sharply curtailed on-campus interviewing, and suspended summer clerk programs, among other losses, are still on the horizon. There may be no job for the deferred associate at the end of the service period after all.

There are no guarantees of a tomorrow. In life or the law. ■

—Ed Reeser

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