

**BIG BUT BRITTLE:
ECONOMIC PERSPECTIVES ON THE FUTURE
OF THE LAW FIRM IN THE NEW ECONOMY**

Bernard A. Burk
Academic Fellow
Arthur and Toni Rembe Rock Center for Corporate Governance
Stanford University

David McGowan
Lyle L. Jones Professor of Competition and Innovation Law
University of San Diego School of Law

ABSTRACT

This Article addresses the deceptively simple questions why, up to the onset of the recent recession, law firms continued to grow at the rapid rate and in the unusual configuration that they have exhibited for over 40 years; and whether lawyers, clients, law students and law schools should expect familiar trends to reassert themselves as the economy improves. We show that the copious academic theorizing addressing these questions (focusing on such notions as diversification, asset specificity, “tournament” theory, and reputational and agency-cost concerns at the level of the firm as a whole) has proved ineffective at explaining or predicting actual events to date, and thus offers little guidance for the future.

We suggest two perspectives that appear more consistent with the available empirical evidence, and thus more likely to predict future trends. The first perspective shows that the core members of a professional service firm can mutually increase the value of one another’s connections and reputation in a manner that can increase the mutual gain with the size of the core group, and thus stimulate firm growth and help bind the firm together—though only somewhat loosely—as it grows. This perspective is new to the literature on law-firm economics, and helps explain why law firms have long continued to get larger despite ordinary diseconomies of scale, though with a certain brittleness reflected in the lateral mobility common in this day and age. The second perspective brings long-established economic principles concerning technological innovation and transaction costs to bear in the context of the elite law firm, where they have been largely overlooked in the commentary to date. We argue that reductions in particular transaction costs and in the cost of certain key inputs are helpful in explaining a number of the trends in the staffing and pricing of legal services documented in recent years.

We apply these perspectives to derive a range of predictions for law firms and law schools in the years to come. We conclude that, despite rumors of the “Death of Big Law,” the large firm is here to stay, but in an evolving configuration with profound implications for practicing and aspiring lawyers, as well as the law schools that prepare them for the increasingly competitive and increasingly global markets for their services.

TABLE OF CONTENTS

	PAGE
Introduction.....	1
I. The Arc of the Large Law Firm: Which Past Is Prologue?	3
A. Gradualism: The Late 19th Century Through The “Golden Age” Of The Early 1960s.....	3
B. Explosive Growth: 1970 To The Brink Of The Great Recession.	5
1. Accelerated Growth.	5
2. Geographic Expansion.	6
3. Growth In Revenues And Profitability.	7
4. The Advent And Expansion Of Lateral Mobility.	8
5. Erosion Of The Stability And Value Of Partnership.	9
6. Associate Recruiting And Compensation.	10
7. Promotion To Partnership And Firm Leverage.	12
8. Billing Rates.....	14
9. Work Allocation Between In-House And Outside Counsel.	14
10. Associate Training.	16
11. Nature Of Associate Work.....	17
12. Incipient Segmentation Of The Elite Sector Of The Bar.	19
C. The Great Recession	19
1. Reductions In Force.	20
2. Associate Hiring Curtailed.....	21
3. Associate Compensation Reduced And Restructured, With Seniority Raises Conditioned Or Curtailed.....	23
4. Increased Attention To Discounting And “Creative” Fee Arrangements.....	25
5. Proliferation Of Specialty “Boutiques.”	26
D. What Now?	27
II. Current Economic Models Of Law-Firm Growth, And Their Limited Explanatory Force.....	28
A. The Centrality of “Human Capital” (Gilson & Mnookin).....	29
B. The Role Of Human Capital In The Economic Relations Among Law-Firm Partners.	30
1. The Theoretical Primacy Of Diversification.....	30

TABLE OF CONTENTS

(continued)

	PAGE
2. The Diversification Theory's Failure To Withstand The Test Of Experience.	32
<i>Few actual instances of the lockstep compensation needed to achieve the benefits of financial diversification</i>	32
<i>No empirical evidence of any financial benefits from diversification</i>	34
3. Weaker Notions Of Diversification That May Be Relevant To Firm Growth Or Structure.	37
C. The Role Of Human Capital In The Economic Relations Between Partners And Associates.	39
1. Mutual Uncertainty And The "Up Or Out" Rule.....	39
2. The Promotion-To-Partner Tournament (Galanter & Palay).....	40
3. The Tournament Theory's Lack Of Engagement With The Basic Economic Forces Surrounding It, And Lack of Empirical Support As Anything More Than A Metaphor, Particularly After 1990.	41
<i>Lack of engagement with demand for or cost of high-end legal services</i>	41
<i>Lack of empirical support for tournament-style growth up to 1990</i>	42
<i>Broad inconsistency with events over the twenty years since the theory was published</i>	43
D. "Reputational Bonding" (Ribstein).....	44
1. Reputation's Function As A "Bond" In The Dual Sense Of "Guarantee" And "Tie That Binds."	45
2. Reputational Bonding's Failure To Fully Explain Historical Developments.	45
III. Firm-Brand And Personal Reputation, And Their Roles In Making A Partnership's Internal Referral Network A Binding And Growth-Stimulating Force.....	46
A. Brand And Personal Reputation.....	48
B. Firm-Brand And Personal Reputation's Role In Building An Internal Referral Network Within The Partnership.	49
C. The Internal Referral Network As A Binding And Growth-Stimulating Mechanism.	51

TABLE OF CONTENTS

(continued)

	PAGE
IV. Cost-Based Factors Affecting Growth.....	54
A. Coase And Schumpeter: Transaction Costs And The Effects Of Changing Times.....	54
1. Coase’s Theory of the Firm.....	54
2. Schumpeter’s Insights On Technological Change And Its Effects On Cost and Demand.....	57
B. Changing Technology And Practices Driving Changes In The Costs Of And Demand For Legal Services.....	58
1. The Digital Trend Toward Fixation In A Tangible Medium Of Expression.....	58
2. Changing Practices On The Supply Side: Downsourcing, Insourcing and Outsourcing.....	60
3. Technological Change And The High-Margin Boutique.....	62
C. Questions This Analysis Raises That It Cannot Fully Answer.....	64
1. Why Is Discussion Of These Forces Almost Absent From The Law-Firm Literature To Date?.....	64
2. Why Has This Issue, Which Has Been Developing For Many Years, Suddenly Come To The Fore During The Recession?.....	65
V. Implications And Predictions.....	67
A. Implications For Law Firms And Practitioners.....	67
<i>Disaggregation of legal services, and the price competition that causes and results from it, will accelerate.....</i>	<i>67</i>
<i>The number of highly compensated partnership-track associate positions at large firms will fall</i>	<i>68</i>
<i>The number of well-compensated, indefinite-term nonpartnership positions at large law firms will increase</i>	<i>68</i>
<i>The number of staff and spot-contract positions at large law firms, compensated at levels comparable to nonattorney staff and limited to legal process and other routine work, will increase</i>	<i>69</i>
<i>The fewer conventional associate positions that remain available at large firms will in some respects be more professionally rewarding than the greater number available before the recession</i>	<i>69</i>

TABLE OF CONTENTS
(continued)

	PAGE
<i>Equity partnerships will grow more slowly, and be more rigorously limited to those demonstrating success in business generation</i>	70
<i>After the recession-induced shakeout, overall growth in the number of well-compensated lawyer positions at larger firms will continue, but more slowly</i>	71
<i>Lateral mobility will remain a significant force, and BigLaw will remain brittle</i>	71
<i>Segmentation between a small cadre of “super-elite” firms and a larger group of “semi-elite” firms will become more pronounced</i>	71
<i>High-margin specialty boutiques will remain a significant part of the competitive landscape</i>	72
B. Implications For Legal Education.....	72
<i>Prestige will continue to predominate</i>	76
<i>Quantity and quality of entry-level placement will receive increasing weight for schools not among the super-elite</i>	77
<i>Cost considerations will become more important</i>	77
<i>A word about practical training</i>	78
Conclusion	80

INTRODUCTION

Why have so many American law firms grown so much and in the configuration they have over the last 40 years? Why have a number of venerable, brand-name firms recently failed or disappeared by acquisition? Is there an optimum, “just-right” size or structure for the large “elite” law firm, or a maximum size beyond which growth is generally unprofitable? Do law firms differ in any important ways from other professional service firms, or other business organizations generally? These questions have spurred a good deal of academic theorizing over the last 25 years, all of which has proved surprisingly ineffective at explaining actual events or predicting future trends.

The questions are not merely of academic interest. They have direct and vital application to the hundreds of thousands of lawyers and staff who already work in this sector of the service economy, the thousands of law graduates aiming to enter it every year, and the hundreds of law schools charged with preparing those graduates for the increasingly competitive and increasingly global markets for their services.

Current events raise these issues more pointedly than ever: In the Great Recession of 2008-2010, elite law firms laid off large numbers of their lawyers and staff, sharply curtailed new hires, and reduced associate pay. A growing number of elite-firm partners also began voluntarily leaving large, profitable firms to form or join smaller, lower-overhead specialty boutiques, a configuration that the *American Lawyer* calls the “Economy Model.” During the same period, market and cost trends that had been visible for some time became more pronounced, or at least more discussed. These trends include outsourcing routine tasks within a lawsuit or transaction to third parties specializing in such processes, what we call “downsourcing” of such work within large firms from full-cost associates to low-cost contract lawyers and non-lawyer specialists, and “insourcing” recurrent tasks that are commoditized or dependent on client-specific knowledge to in-house staff. All are practices that call into question the basic models of law-firm hiring, staffing and promotion that have been established for generations.

After similar (if more modest) retrenchments in hiring and compensation in previous recessions, large firms quickly resumed the rapid growth and pay escalation that has characterized their development for at least 40 years. Current circumstances raise the question whether these longstanding trends will reassert themselves. Opinions vary: A leading academic has proclaimed the “Death of BigLaw.”¹ The Bar’s reaction hovers uncomfortably between turmoil and denial: A 2009 survey of the 200 largest American firms by revenue found that 56% of their managing partners believed there had been a “fundamental shift” in the legal marketplace, yet 70% of the same group disclaimed any fundamental shift in their firms’ business models.²

We conclude that fundamental changes are indeed afoot. Although rumors of the death of “BigLaw” have been, in our view, greatly exaggerated, it is leading a much more interesting and challenging life. But the recent downturn has simply laid bare and compelled greater

¹See note 202, *infra*, and accompanying text.

²See notes 123-124, *infra*, and accompanying text.

responsiveness to circumstances and economic forces that have been building for some time. We believe that these phenomena will drive significant evolution in the structure and practices of the large, elite law firm, but that they do not threaten the viability of the basic form.

To explore these questions, we survey the most widely accepted economic models of the large law firm, specifically theories focused on diversification, asset specificity, “tournament” theory, and reputational and agency-cost concerns focused at the level of the firm as a whole. We conclude that each fails to explain observed events.

We then propose two new perspectives. The first suggests that each individual principal’s drive to develop and personally profit from his or her connections and reputation not only spurs quality and industry firmwide, but also fosters a mutual referral network within the firm that may, by mutually increasing the value of each principal’s connections and reputation, stimulate firm growth and help bind the partnership together—though only somewhat loosely—as it grows. This insight helps explain why firms have continued to get larger despite ordinary diseconomies of scale, though with a certain brittleness reflected in the lateral mobility common in this day and age.

Our second contribution brings long-established economic principles concerning technological innovation and transaction costs to bear in the context of the elite law firm, where they have been largely overlooked in the commentary to date. We argue that reductions in transaction costs and in the cost of certain key inputs to legal services are helpful in explaining a number of the trends documented in recent years. Reductions in clients’ transaction costs—particularly in relation to finding suitable counsel and distributing pieces of a larger project among them—have increased competition among big-firm lawyers and are forcing firms to adjust their business models.

We also suggest that these processes have been accelerated by cost reductions resulting from technological advances in the creation, management and storage of information. These changes have no particular growth-valence on their own—they might allow large firms to get larger, for example—but they do help drive the outsourcing, downsourcing and insourcing trends discussed above. They also make it possible for small firms to enjoy significant economies of scale without bearing the high fixed costs commonly associated with such economies. Because of these technological changes, boutiques have become easier to set up and can operate at lower cost than larger firms. If clients increasingly are willing to pay only for core services from experienced lawyers, this model may prove more robust than conventional academic analysis has suggested in the past.

Part I of this Article reviews the history of the elite American law firm, and some of the principal developments in its structure and practices over the last 40 years. Part II reviews economic theories that have been advanced to explain large law-firm growth and structure, and shows their inadequate fit with available empirical data. Part III explores the role of firm-brand and individual-partner reputation in the functioning of a professional partnership’s internal referral network, and its possibilities in explaining law-firm growth and other observed developments. Part IV introduces the transaction cost and technological considerations just mentioned, and considers their explanatory power in light of current events. Finally, Part V

offers some implications and predictions based on our analysis, both for the elite sector of the bar we examine and for the future of legal education.

I. THE ARC OF THE LARGE LAW FIRM: WHICH PAST IS PROLOGUE?

There is a rich and increasingly substantial literature about the history and development of the large American law firm. In this section, we summarize some of these historical and empirical studies, and identify the salient elements of the stories they tell.

A. *Gradualism: The Late 19th Century Through The “Golden Age” Of The Early 1960s.*

Conventional scholarship traces the emergence of the large, elite American law firm to around the turn of the 20th century.³ As ably described by Marc Galanter and Thomas Palay, the institutions with which we are concerned share a number of features that, while often found singly or in some combination elsewhere, together define a recognizable species:⁴

- The firm’s client base included predominantly substantial business organizations and wealthy “captains of industry” with ongoing legal needs requiring the attention of numerous, highly skilled and experienced specialists.⁵
- The firm’s services were provided on matters with complexity and stakes requiring the highest levels of learning, skill and judgment, and accordingly commanded top rates.⁶
- A cadre of owners and managers, usually partners in a partnership, small in number relative to the total number of practitioners and others the firm employed, shared the profits of the enterprise.⁷

³MARC GALANTER & THOMAS PALAY, TOURNAMENT OF LAWYERS: THE TRANSFORMATION OF THE BIG LAW FIRM 4 (1991) [hereinafter Galanter & Palay, Tournament].

⁴*Id.* at 4-19.

⁵*Id.* at 5, 11, 16

⁶This characterization of the work for which elite firms are chosen may be unduly narrow. For many years, the deep, longstanding relationships with institutional clients described in the first bullet point and the lack of substantial numbers of in-house counsel resulted in elite firms’ providing routine day-to-day legal services for those institutions, such as lending documents for banks, rather than limiting the firms’ attention to the more unusual or doubtful matters that would benefit from their specialized experience and expertise. See Ronald J. Gilson and Robert H. Mnookin, *Sharing Among the Human Capitalists: An Economic Inquiry into the Corporate Law Firm and How Partners Split Profits*, 37 STAN L. REV. 313, 357-60 (1985) [hereinafter cited as Gilson & Mnookin, Profit Sharing]; Galanter & Palay, Tournament at 33-34. As we will see, the shift of more routine services to competent, and less expensive, in-house lawyers is a significant trend of the modern era. See notes 68-76, *infra*, and accompanying text.

⁷Galanter & Palay, Tournament at 4, 31. Although law firms adopt other forms, the predominant one has been some form of partnership, with the principals serving as its partners. With legislative recognition of limited-liability partnerships, the need for other forms has lessened further, and the partnership thus is likely to predominate in the future. The technical form of the enterprise is not material

- Highly qualified but inexperienced junior lawyers, selected for their potential for promotion to partnership, competed for a limited number of such positions at the end of a relatively lengthy apprenticeship.⁸
- Essentially only two classes of professionals were found at the firm: partners and partnership-track associates.⁹ Growth came almost entirely from within: Partners were selected from within the firm, and lateral hiring of partners, or of associates, other than

to our analysis, so for convenience and concision, we will generally refer in this Article to the lawyers participating in firm ownership and control as “partners” despite the many different titles and offices such principals may hold.

⁸Marc S. Galanter & William D. Henderson, *The Elastic Tournament: The Second Transformation of the Big Law Firm*, 60 STAN. L. REV. 102, 108, 117-18 (2008) [hereinafter Galanter & Henderson, *Elastic Tournament*]; Galanter & Palay, *Tournament* at 26-28. Although these candidates were regularly touted as the most able graduates of the finest institutions, the characteristics that recommended them for service in America’s elite law firms often strayed pointedly from the meritocratic. Hiring partners reportedly preferred “lawyers who are Nordic, have pleasing personalities and ‘clean-cut’ appearances, are graduates of the ‘right’ schools, [and] have the ‘right’ social background and experience in the affairs of the world” Galanter & Palay, *Tournament* at 24-25 (quoting ERWIN SMIGEL, *THE WALL STREET LAWYER: PROFESSIONAL ORGANIZATION MAN?* 37 (1969)). Women as well as racial, ethnic and religious minorities were almost completely excluded. *Id.* at 25-26. And Paul Cravath, to whom is attributed the “Cravath System” of recruiting, staffing and promotion that still grounds many practices of elite law firms today, even inveighed against too much raw intelligence:

Brilliant intellectual powers are not essential. Too much imagination, too much wit, too great cleverness, too facile fluency, if not leavened by a sound sense of proportion, are quite as likely to impede success as to promote it. The best clients are apt to be afraid of those qualities. They want as their counsel a man who is primarily honest, safe, sound, and steady.

2 ROBERT SWAINE, *THE CRAVATH FIRM AND ITS PREDECESSORS, 1819-1947* 266 (1946) (quoting a talk Cravath delivered at Harvard Law School in 1920).

Aside from the cautionary tale these reports provide, they show that, even at the height of its stability, success and professional independence, the elite American law firm was permeated to its core with a consciousness of the need to construct and show itself—even more than to do the best work—to attract, please and retain “the best clients.” This need has since been turned to better effect since a consortium of big-company general counsel signed onto guidelines demanding increased diversity in their outside counsels’ staffing as a condition of their custom. Leigh Jones, *A Decade of Thrills and Chills*, NAT. L. J., Dec. 23, 2009, <http://www.law.com/jsp/ca/PubArticleCA.jsp?id=1202437230869&src=EMC-Email&et=editorial&bu=Cal%20Recorder&pt=RECORDER%20Cal%20Law%20News%20Alert&cn=20091223&kw=A%20Decade%20of%20Thrills%20and%20Chills>) [hereinafter cited as Jones, *Thrills & Chills*].

⁹Galanter & Palay, *Tournament* at 28-29. This “two-class” view of the elite law firm, even in its golden age, may oversimplify. At least some such firms had established minorities of long-term salaried attorney-employees who were neither partners nor under consideration for promotion to partner, comprising as much as 10%-24% of the attorney census. *Id.* at 28-29, 64-65. Such arrangements apparently fell out of favor, and shrank in number by attrition, during the 1960s, but became more common again beginning in the mid-1970s and afterwards. *Id.* As discussed below (*see* notes 38-42 and accompanying text), long-term non-partner attorney-employees have become increasingly common in the 1990s and the first decade of the 21st century.

from government service was rare.¹⁰ Associates not successful in making partner were generally placed out.¹¹ Partner departures other than at the end of a career were uncommon.¹²

By about 1960, this structure was firmly established as the model for the elite law firm, and was accompanied by significant stability and success.¹³ As Galanter and Palay describe the state of this sector of the profession in 1960:

For big firms, circa 1960 was a time of prosperity, stable relations with clients, steady but manageable growth, and a comfortable assumption that this kind of law practice was a permanent fixture of American life and would go on forever. . . . Big law firms enjoyed an enviable autonomy. They were relatively independent vis-à-vis their clients; they exercised considerable control over how they did their work; and they were infused with a sense of being in control of their destiny.¹⁴

B. *Explosive Growth: 1970 To The Brink Of The Great Recession.*

By 1970, this familiar and comfortable arrangement was evolving. The forces influencing this change are numerous and their relative strength is subject to debate, but their overall effect by early 2008 has been well documented, principally in the outstanding empirical work of Marc Galanter and William Henderson. We discuss numerous related areas of interest in turn:

1. *Accelerated Growth.*

Perhaps the most striking and pervasive change—one to which we will return below—is that the number and size of the firms generally subscribing to the model just described began to increase at an accelerated rate. During the “golden age,” large firms grew at a steady rate of roughly 5% per year; after 1975 that growth rate jumps to 8% or more.¹⁵

¹⁰Galanter & Palay, *Tournament* at 23-24.

¹¹*Id.* at 28-29.

¹²MILTON C. REGAN, JR., *EAT WHAT YOU KILL: THE FALL OF A WALL STREET LAWYER* 25 (2005) [hereinafter cited as Regan, *Eat What You Kill*]; Galanter & Palay, *Tournament* at 23-24, 30; Smigel, *supra* note 8, at 259, 302.

¹³*Id.* at 20-22.

¹⁴*Id.* at 36.

¹⁵Robert L. Nelson, *Of Tournaments and Transformations: Explaining the Growth of Large Law Firms*, 1992 WIS. L. REV. 733, 736-37 (1992) [hereinafter cited as Nelson, *Explaining Growth*]; Galanter & Palay, *Tournament* at 24, 46. The number of lawyers practicing in the U.S. generally increased dramatically after 1970. See Richard H. Sander, *Elevating the Debate on Lawyers and Economic Growth*, 17 LAW & SOC. INQUIRY 659, 663 (1993) (the number of lawyers in the U.S. more than tripled between about 1970 and about 1990, from about 250,000 to about 800,000); Richard H. Sander & E. Douglass Williams, *Why Are There So Many Lawyers? Perspectives on a Turbulent Market*, 14 LAW & SOC. INQUIRY 431, 432-33 (1989) (between 1970 and 1988 the ratio of lawyers to the general population in the U.S. grew to more than twice its historic average, three times as fast as other professions and four times as

And the bigger the firms become, the greater the absolute numbers that those percentage increases yielded. In the late 1950s there were only 38 law firms in the United States with over fifty lawyers (over half of which were located in New York City).¹⁶ In the mid 1980s, there were 508 firms with 51 or more lawyers, and the number of firms larger than 100 had grown from a dozen to over 250.¹⁷ Similarly, in 1968 the largest firm in the United States had 169 lawyers.¹⁸ In 1988 the largest firm had 962 lawyers and there were 149 firms larger than the largest firm in 1968.¹⁹ By 2008, 23 firms employed over 1,000 attorneys, the *average* size of the 250 largest American law firms by headcount (the *NLJ* 250) was 535, and the 250th-largest firm was larger than the largest firm in the country in 1968.²⁰ Between 2004 and 2008, the *NLJ* 250 collectively increased in size by about 22,000, and by 2008 employed a total of roughly 132,000 attorneys.²¹

2. *Geographic Expansion.*

These firms expanded geographically as well as numerically. In 1960, most firms were associated with a single city.²² By 1980, 87% of the 100 largest law firms had a branch office somewhere else.²³ Growth was often wholesale, by merger or acquisition of a group. Branches

fast as the general workforce over the same period) [hereinafter cited as Sander & Williams, *So Many Lawyers*]. Whatever the forces animating the increases in large-firm size, and whether the increase is linear or exponential, the data show a marked “kink” upward in the steepness of the growth rate at larger firms beginning in about 1970. Galanter & Palay, *Tournament* at 87-88.

¹⁶Galanter & Palay, *Tournament* at 22, 46 (citing Erwin Smigel, *The Impact of Recruitment on the Organization of the Large Law Firm*, 25 AM. SOC. REV. 56, 58 (1960)).

¹⁷Barbara Curran, supplement to the lawyer statistical report: The U.S. Legal Profession in 1985 58 (1986); *The NLJ* 250, NAT. LAW J., Sept. 22, 1986 at S4 *et seq.*

¹⁸*Why Law is a Growth Industry*, BUS. WEEK, Jan. 13, 1968, at 78-79.

¹⁹*The NLJ* 250, NAT. LAW J., Sept. 26, 1988, at S1, S4.

²⁰*The 2009 NLJ 250: Complete List of Firms*, NAT. L.J., Nov. 9, 2009, <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202435254583> [hereinafter *2009 NLJ 250*]; Leigh Jones, *2009 Worst Year for Lawyer Headcount in 3 Decades*, NAT. L. J., NOV. 9, 2009, <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202435276422&slreturn=1&hbxlogin=1> [hereinafter Jones, *2009 Worst Year*]. For those uninitiated into the cult of money and personality known as the modern legal press, the *National Law Journal* began publishing statistics on the 250 largest firms, measured by lawyer headcount, in 1979. Galanter & Henderson, *Elastic Tournament* at 118-19. The *American Lawyer* began gathering and publishing statistics on the 50 largest law firms measured by revenues in 1985. It grew to the *Am Law* 75 in 1986, 100 in 1987, and 200 in 1999. *Id.* at 131 n.112. See generally Galanter & Palay, *Tournament* at 71-72 (modern legal press enabled by the United States Supreme Court’s decision in *Bates v. Arizona*; the press in turn disseminated information on law-firm economics that facilitated a more competitive market for legal services and among firms for personnel); Galanter & Henderson, *Elastic Tournament* at 130-32 (similar).

²¹Jones, *2009 Worst Year*.

²²Galanter & Henderson, *Elastic Tournament* at 117; Galanter & Palay, *Tournament* at 47.

²³Galanter & Palay, *Tournament* at 47.

proliferated, and their size increased, typically at a rate more rapid than the home office's.²⁴ By 2003, the average Am Law 200 law firm had nine branch offices.²⁵

3. *Growth In Revenues And Profitability.*

More and more money has been spent on legal services, both in absolute terms and relative to other sectors of the economy, with those increases disproportionately concentrated at the high end of the market. Between 1960 and 1985 the portion of the Gross National Product and the portion of national income attributable to legal services both doubled.²⁶ Businesses rather than individuals spent a greater and greater fraction of those sums and, significantly, the *share* of the market for legal services held by the largest firms doubled between 1972 and 1986.²⁷ From 1975-1995, real income for equity partners in firms of 101-299 lawyers increased 44%.²⁸

In short, though the legal profession as a whole grew rapidly during this period, the large firms grew faster than the Bar as a whole, and became relatively more affluent than their peers in smaller firms, in-house and in government.²⁹ That trend continued into the new century. By

²⁴Galanter & Henderson, *Elastic Tournament* at 123-24; Galanter & Palay, *Tournament* at 47-48.

²⁵William D. Henderson, *An Empirical Study of Single-Tier Versus Two-Tier Partnerships in the Am Law 200*, 84 N.C. L. REV.1691, 1714 (chart) (2006) [hereinafter Henderson, *Single vs. Two-Tier Partnerships*].

²⁶Galanter & Palay, *Tournament* at 40. *See also* Sander, *supra* note 15, at 665 (“The United States [in 1992] spen[t] about \$100 billion on legal services but spent only around \$30 billion (in 1992 dollars) in 1970”). Sander estimates that legal services consumed 2% of GNP in the early 1990s as opposed to about 0.6% a generation earlier. *Id.* The clientele of larger firms shifted more and more to businesses rather than individuals. Sander & Williams, *So Many Lawyers* at 440-41.

²⁷*Id.* at 40-41; Richard H. Sander and E. Douglass Williams, *A Little Theorizing About the Big Law Firm: Galanter, Palay and the Economics of Growth*, 17 LAW & SOC. INQUIRY 391, 392 n.4 (1992) (“the receipts of the nation’s 50 largest firms increased, in *real dollars*, an average of 10% per year from 1972 to 1987—more than double the rate of growth in the legal services field generally”) [hereinafter cited as Sander & Williams, *Theorizing*]. Between 1972 and 1986, total revenues for the 20 largest firms increased fourfold. Sander & Williams, *So Many Lawyers* at 437. A study conducted by the Corporate Executive Board found that, from 2000-2009, corporations’ legal costs rose close to four times faster than their average cost (up 75% vs. average cost increases of 20%). Jeff Jeffrey, *Alternate Billing Arrangements Putting Down Deep Roots, General Counsel Say*, Mar. 14, 2010, <http://legaltimes.typepad.com/blt/2010/05/alternate-billing-arrangements-putting-down-deep-roots-general-counsels-say.html>.

²⁸Galanter & Henderson, *Elastic Tournament* at 105 & n.11 (also noting that the real income of equity partners in firms of 2-100 lawyers fell during that period). Broader surveys of medium-sized and larger firms during the 1980s found partner earnings stagnant even as partners worked longer hours. Galanter & Palay, *Tournament* at 52 & n.103. This would suggest that income growth was concentrated disproportionately among the largest firms during this period.

²⁹Sander & Williams, *So Many Lawyers* at 435-40.

2007, profits per equity partner (“PPP”) at the 100 most profitable large firms *averaged* \$1.3 million, 68% more than in 2000.³⁰

4. *The Advent And Expansion Of Lateral Mobility.*

As discussed above, lateral movement into or out of elite firms (other than to or from government service) was rare before the 1960s.³¹ But lateral mobility of both partners and associates increased dramatically beginning in the 1970s. As Galanter and Henderson explain,

As U.S. corporations grew in size and geographic reach, and regulatory compliance and civil litigation became large and perennial expenses, company lawyers were given greater latitude to scrutinize the fees of outside counsel and, if cost-justified, hire additional lawyers to perform the work in-house. With the growing prominence of corporate general counsel, who had company mandates to control costs and the sophistication to assess and prioritize the company’s legal needs, hiring outside counsel was increasingly limited to matters requiring expertise. Moreover, when looking for this expertise, the search became more focused on the best lawyer rather than the best firm.³²

These developments created more informed and robust competition among law firms for the partners whose expertise and services were most in demand, resulting in a market by which a partner’s “human capital” could be valued. And this, in turn, encouraged lawyers to move to the firms where their human capital could be most profitably exploited.³³

By 1988, over a quarter of the 500 largest U.S. firms had acquired more than half their partners from outside the firm (excluding entry-level hires). A quarter also reported hiring more than half their associates laterally.³⁴ From 2000 through 2005, the *American Lawyer*

³⁰Jones, Thrills and Chills. Significantly, the increase in profitability has not been uniform across the market. From 1998 (the first year for which the *American Lawyer* published statistics for a second hundred largest firms) through 2007, average PPP for the top quartile most-profitable firms increased over 95%, while the bottom quartile most-profitable of the Am Law 200 increased 58%. The ratio of average profits per partner to starting associate salary (the latter of which is highly uniform across the Am Law 200) is nearly 14 at the 95th percentile of profitability, and only 4 at the 25th percentile. Galanter & Henderson, *Elastic Tournament* at 138-39.

³¹See notes 10-12, *supra*, and accompanying text; Galanter & Henderson, *Elastic Tournament* at 129 (“The age of lawyer mobility is the antithesis of the so-called ‘Golden Era’ of big law firms”).

³²Galanter & Henderson, *Elastic Tournament* at 129 (footnotes omitted); *see id.* at 50.

³³*Id.* at 131; *see* Lawrence J. Fox, *The End of Partnership*, 33 *FORD. URB. L. J.* 245, 248 (2005) [hereinafter cited as Fox, *End of Partnership*].

³⁴Galanter & Palay, *Tournament* at 54-55. *See also* Galanter & Henderson, *Elastic Tournament* at 111, 128-33.

accumulated information on over 14,000 lateral moves, most of them at the partner level, and 97% of which were into or out of Am Law 200 firms.³⁵

5. *Erosion Of The Stability And Value Of Partnership.*

As noted above, partnership during the “golden age,” once achieved, tended to be stable and last an entire career.³⁶ The development of competition among firms for the most profitable partners created a yardstick by which partners could measure their relative economic value. Competition between firms for profitable partners fueled increasing competition within firms for money and power (backed by the threat of departure for greener pastures), and more pronounced concentration of those rewards in smaller numbers of partners.³⁷ Partnership tenure and benefits became increasingly precarious, with compensation reductions, “de-equitizations” and outright dismissals of those partners viewed as inadequately “productive,” which often translated into the different notion of controlling inadequate amounts of “portable business”—that is, the ability to leave and have clients follow.³⁸

More and more firms introduced a lower class or “tier” of partners into their structure. Typically, these “nonequity” or “income” partners have no ownership stake in the firm, have minimal authority over firm management, and are compensated predominantly by a fixed salary with a limited bonus—in short, they are “partners” in name only.³⁹ For many firms, the

³⁵Galanter & Henderson, *Elastic Tournament* at 133-34. This article contains a detailed empirical study of the *American Lawyer’s* lateral movement data. *Id.* at 134-38.

³⁶See notes 9-12, *supra*, and accompanying text.

³⁷See Henderson, *Single vs. Two-Tier Partnerships* at 1697, 1741; Galanter & Henderson, *Elastic Tournament* at 102-03, 107, 141-42; Galanter & Palay, *Tournament* at 52-53, 58, 67-68. See generally ROBERT NELSON, *PARTNERS WITH POWER: THE SOCIAL TRANSFORMATION OF THE LARGE LAW FIRM* (1988); *id.* at 5 (the “organizational rationalization of the firm will be controlled by the partners with power,” and power is “inextricably tied to control of clients”).

³⁸*Id.*; Galanter & Henderson, *Elastic Tournament* at 111-13, 127 & n.88; Henderson, *Single vs. Two-Tier Partnerships* 107; Fox, *End of Partnership* at 247 (“elevation to partnership no longer comes with any sense of tenure”). See also Kimberly Kirkland, *Ethics in Large Law Firms: The Principle of Pragmatism*, 35 U. MEM. L. REV. 631, 675, 694 & n.227 (2005) (showing that similar concerns can drive partnership promotion decisions). A 2010 Altman Weil survey found that over a quarter of the respondent law firms had de-equitized partners in 2009 and 37% will or might in 2010. Firms over 250 lawyers were twice as likely to de-equitize partners as smaller ones. Thomas S. Clay & Eric A. Seeger, *2010 Law Firms in Transition* 5, 11, http://www.altmanweil.com/dir_images/upload/docs/2010LFIT_Survey.pdf [hereinafter Clay & Seeger, 2010 Law Firms in Transition]

³⁹Henderson, *Single vs. Two-Tier Partnerships* at 1722-23, 1730 & n.146; Galanter & Palay, *Tournament* at 58-59; Fox, *End of Partnership* at 247 (“fewer and fewer of those now called partners really occupy that status”); Gilson & Mnookin, *Profit Sharing* at 379 n.113 (if the title of partner has any value independent of a right to share profits, “it would be foolish not to call them partners and simply continue to pay them less”). This is not to suggest that the extended longevity and “partner” title are not potentially valuable to all concerned. The firm gets improved client service by retaining experienced practitioners with knowledge of and relationships with existing clients, an extended period to evaluate candidates for promotion to equity partner, concentration of voting power in “rainmakers” (which reduces the risk of their defection), and higher reportable profits per equity partner (by the simple expedient of

nonequity tier has become a potentially permanent position; for others, it is a way station to true equity partnership from which employees are encouraged to depart if they have not advanced after a period of time.⁴⁰ In 1988, half of the firms with more than 75 lawyers had two tiers of partners.⁴¹ By 2004, 79% of the 200 largest firms in America had two partnership tiers, and the number of nonequity partners at those firms was increasing far more rapidly than the number of equity partners.⁴²

6. *Associate Recruiting And Compensation.*

To support this sprawling structure, recruitment of entry-level associates accelerated and broadened as well. The elite firms had always prided themselves on recruiting only the “top” graduates from the “top” schools to ensure personnel equal to their “top” work.⁴³ But as the sheer number of new recruits necessary to support the pyramid increased, firms interviewed at more and more law schools, and reached further and further down into their graduating classes, to fill their needs.⁴⁴

Increasing demand pushed associate pay higher and higher. Beginning in the 1920s and continuing for over 40 years, the managing partners of the leading New York firms had met annually to set a common salary for the next class of new associates.⁴⁵ During the Vietnam era,

reducing the denominator of the fraction). The nonequity partners get the “title and institutional support to focus on business development” and an extended period to prove themselves, or conversely a relatively stable and valued position from which to practice their skills and serve clients with reduced pressure to become rainmakers themselves. Henderson, *Single vs. Two-Tier Partnerships* at 1709-12.

⁴⁰Henderson, *Single vs. Two-Tier Partnerships* at 1745-48; Galanter & Palay, *Tournament* at 58-59.

⁴¹Galanter & Palay, *Tournament* at 58.

⁴²Henderson, *Single vs. Two-Tier Partnerships* at 1695, 1725. *See also* Galanter & Henderson, *Elastic Tournament* at 126-27 (for fiscal year 2005, number of equity partners in the Am Law 200 up 148 vs. 1,455 for nonequity partners); Alison Frankel, *Am Law 100: Veil of Tiers*, AM. LAW., July 2004, at 92 (77 of 100 top firms have two-tier partnerships, up from 55 in 1994). From 1993 to 2003, the ratio of nonequity to equity partners at Am Law 200 law firms increased close to 25%, and increased over 40% at the 75th percentile. Henderson, *Single vs. Two-Tier Partnerships* at 1714 (chart).

⁴³Galanter & Henderson, *Elastic Tournament* at 104-05; Galanter & Palay, *Tournament* at 24. *See* Nick Brown, *Firms’ ‘Ego-Driven’ Salary Structure Can’t Last: Experts*, Oct. 2, 2009, <http://ip.law360.com/articles/125954> (Law-firm consultant: “Some firms, their egos are really tied up in saying ‘We’ve got to be at the top.’ . . . [T]hey’re willing to take a hit on profits per partner to maintain that ‘first-among-equals’ look when it comes to attracting top associates at top salaries”).

⁴⁴*Id.* at 55-57; Gilson & Mnookin, *Associate Careers* at 589-92; Sander & Williams, *So Many Lawyers* at 476-77. The degree to which this affected the overall quality (however measured) of the firms’ associate corps is debatable. Increasing numbers of industrious and talented law-school applicants, and increasing levels of law-school admissions selectivity, have likely increased the number of highly qualified graduates substantially since the 1960s. *See, e.g., id.*; RICHARD ABEL, *AMERICAN LAWYERS* tbl. 4 (1989); Sander & Williams, *So Many Lawyers* at 462-63, 476-77. However, some commentators believe that the variability of the quality within the associate corps has increased as large firms grew larger. *See, e.g., Galanter & Palay, Tournament* at 110-11.

⁴⁵Galanter & Palay, *Tournament* at 24, 55-56 (citing historical sources).

as the draft and the youthful idealism of the time reduced the number of qualified applicants willing or able to pursue careers in such firms, Cravath broke with the longstanding cartel in 1968 by raising the “going rate” from \$10,500 to \$15,000, nearly 50% in a single stroke.⁴⁶

The pattern repeated over the succeeding years: Smooth and uniform (if increasingly generous) pay increases across this sector of the bar were punctuated by sudden upward leaps prompted by a self-styled market leader when demand seemed to be especially straining supply.⁴⁷ Cravath again shocked the market in 1986, raising entry-level salaries from \$53,000 to \$65,000. Scores of firms nationwide that considered themselves Cravath’s competitors followed suit, matching that salary in major urban markets.⁴⁸

In 2000, amidst the unprecedented demand for associates created by the “tech bubble,” starting salaries leaped again, from \$95,000 to \$125,000 (plus bonuses).⁴⁹ Although the bursting of the “tech bubble” the following year, intensified by the economic reaction to the terrorist attacks of September 11, 2001, kept base salary stable for the next five years, caused bonuses to retreat for a year or two and even produced some scattered layoffs in 2001 and 2002, the upward trend in pay resumed as the economy recovered.⁵⁰ The volume of all kinds of staple work again increased. At the same time, a rash of corporate scandals and investigations such as the Enron and Worldcom failures and innumerable stock-option backdating issues created many high-

⁴⁶*Id.* The “going rate” had risen \$3,000 over the previous five years. *Id.* at 24.

⁴⁷*See generally* Sander & Williams, *So Many Lawyers* at 466, table 14.

⁴⁸*Id.* at 56-57.

⁴⁹Jones, Thrills & Chills. This sudden jump plus the increasing size of entering large-firm classes, established a “bimodal” pay distribution among law graduates, with a spike around \$50,000 per year for non-BigLaw jobs, and another spike at \$125,000 for large firm hires in 2006. William Henderson, *How the Cravath System Created the Bi-Modal Distribution*, *Empirical Legal Studies*, July 18, 2008, http://www.elsblog.org/the_empirical_legal_studi/2008/07/how-the-cravath.html [hereinafter Henderson, *Bi-Modal Distribution*] (noting how unusual and typically unstable such a distribution is in a labor market).

The market dynamics of the jump in 2000 are particularly interesting. The first mover was a modest-sized firm (about 70 lawyers) spun off from Brobeck, Phleger & Harrison a few years earlier, called Gunderson Dettmer Stough Villeneuve Franklin & Hachigian LLP. Gunderson then had a single office in Silicon Valley (the technology-centered region south of San Francisco), no litigation practice, and a hard focus on business and transactions involving the many emerging technology companies germinating in its backyard. The “tech bubble” produced substantial amounts of work for practices like Gunderson’s, but made it increasingly difficult to find and retain younger lawyers with appropriate skills as, palpably aware of the many options-rich employees at the companies they served awash with venture capital and later public money, they thronged in-house themselves to seek their fortunes. At the height of the tech bubble in early 2000, Robert V. Gunderson, Jr. shocked the legal community by announcing that his firm would increase entry-level associates’ pay from \$95,000 to \$145,000 per year, nearly 50% more than the going top rate, to ensure his firm attracted the best candidates. Jones, Thrills & Chills. What happened next surprised many observers even more. In what the legal press has called a “bicoastal frenzy” (*id.*), the largest and most elite firms in every major market promptly followed this single small firm, offering combinations of salary and bonus increases meant to match Gunderson’s. *Id.*

⁵⁰*Id.*

stakes endeavors for elite firms, while structured finance and capital markets work exploded. Base associate salaries jumped in 2006 to \$145,000 and once more in 2007 to \$160,000.⁵¹

During the same period, the shortage of suitable associates and the proliferation of multi-office firms resulted in salary “nationalization”—a tendency for “national” firms to pay associates at most or all of their offices as much as they paid in New York, though previously other leading markets had set compensation a notch or two lower, and smaller markets proportionately less.⁵² The need for local and regional firms to keep up with what the national firms offered in their branch offices created a more nationally uniform market for entry-level associates at larger firms, generally decreasing pay-scale disparities among urban markets and increasing associate pay everywhere at regional and national firms.⁵³

Burgeoning numbers of associates required to continue the cycle of expansion thronged to collect the bounty. By 2004, an astounding 28% of all recent law graduates worked at private firms of more than 100 lawyers, compared with 8% of all practicing lawyers.⁵⁴

7. Promotion To Partnership And Firm Leverage.

These numbers, and the fixed-cost expansions they entailed, put tremendous pressure on the gateway to partnership. Associates’ time to partnership, which had contracted during the 1960s and 1970s, expanded again during the 1980s and beyond.⁵⁵ Similarly, rates of promotion to partnership, which had increased during the 1960s and 1970s, receded to lower levels more typical of the 1950s during the 1980s.⁵⁶

Although some complement of long-term non-partnership track attorneys was not uncommon before 1960, during the 1960s the arrangement fell out of favor, and the “up or out” promotion rule was generally enforced more vigorously.⁵⁷ This trend had also reversed by the

⁵¹*Id.* Many firms sought to distinguish themselves to potential associates during this period by vaunting their unique “culture” (almost always stressing collegiality, teamwork and hands-on training and experience) and offering special perks, such as rebates on the purchase of hybrid cars, 401k matches and onsite childcare facilities. *Id.*

⁵²*Id.*; Bradford Hildebrandt, *Unprecedented Decade in the Legal Profession*, NAT. L.J., Dec. 28, 2009, <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202437225077>.

⁵³*Id.*

⁵⁴RONIT DINOVITZER ET AL., AFTER THE JD: FIRST RESULTS OF A NATIONAL STUDY OF LEGAL CAREERS 25-27 & tbl. 3.1 (2004).

⁵⁵Galanter & Palay, *Tournament* at 62-63 (noting that the evidence is somewhat equivocal, but that shorter partnership tracks of 5 1/2 to 7 1/2 years typical of the 1960s and 1970s lengthened to 8 to 9 years, with longer periods more typical in New York throughout).

⁵⁶Galanter & Palay, *Tournament* at 63-64, 75-76 (citing studies, which are not entirely consistent). Probably some of the difficulty reconciling the studies relates to classification concerns, such as whether one counts a nonequity partner as one promoted to partner, and which non-partner attorneys are counted in the denominator of the ratio as within the class eligible for partner.

⁵⁷Galanter & Palay, *Tournament* at 28-29, 63-64. Galanter & Palay cite studies documenting as many as 10%-24% of the attorneys at elite firms in this category during this time. *Id.* The reduction in

1980s. In addition to rapidly increasing numbers of nonequity partners, firms retained greater numbers of non-partnership track attorneys, variously denominated staff attorneys, senior associates, counsel or the like.⁵⁸ This period also saw the beginning of a trend to delegate portions of some more routine tasks, such as cite-checking and document review, to nonattorney employees.⁵⁹ As we will see in Part IV, this trend is animating significant changes in the cost and structure of legal services that are becoming increasingly influential.

While the number of partners in large firms overall increased smoothly and steadily (though with significant variability at individual firms), associates and nonpartnership-track attorneys proliferated.⁶⁰ With time to partner increasing, promotion rates decreasing, and greater and greater numbers of long-term nonpartner attorney employees, firms' leverage ramped up substantially.⁶¹ From 1960 to the mid 1980s, leverage appears to have increased about 30%, to what has been variously calculated at between 1.47 and 2.25⁶² From there, it skyrocketed. By

permanent associates corresponded with the falling cachet of elite-firm service among law graduates during the 1960s and early 1970s, and was accompanied by shortening partnership tracks and increased promotion rates. *Id.*

⁵⁸Galanter & Henderson, *Elastic Tournament* at 110; Galanter & Palay, *Tournament* at 64-65.

⁵⁹*Id.*

⁶⁰Galanter & Henderson., *Elastic Tournament* at 118-19. In the aggregate, growth in both the average and total number of partners in this sector of firms has increased “at a remarkably steady pace” since 1978. *Id.* However, “partners” for this purpose may include both equity and nonequity partners. If this is true, it suggests that the growth rate for equity partners has slowed substantially. *See* note 42, *supra*, and accompanying text (showing that number of nonequity partners is increasing much more rapidly than the number of equity partners). And this partner growth rate differs dramatically from firm to firm. *See* Galanter & Henderson, *Elastic Tournament* at 119 (noting change in the average number of partners at the 129 firms that remained in the NLJ 250 from 1979 to 2007 ranged from +57% to +1782%), and varies widely year-to-year at many firms (*id.* at 126 (showing that 25%-30% of NLJ 250 firms in any given year between 1984 and 2007 had *fewer* partners year-over-year, and observing that an increasing number of partners in recent years are nonequity rather than true equity partners). *See also id.* at 112-13 (attributing year-to-year intra-firm instability to large scale defections, demotions or firings of partners, which have become “commonplace”). By contrast, the growth rate of associates appears to have varied more according to the business cycle. *Id.* at 118-19.

⁶¹Leverage is a malleable term in need of a consistent definition, but loosely refers to the ratio of nonpartner attorneys to partners. Differences in counting regimes, most particularly regarding whether nonequity partners are added to the numerator or the denominator of the leverage fraction, lead to disparate statistics. *See* Leigh Jones, *Legal heavyweights lean on NALP to track nonequity partners*, Apr. 7, 2010, NAT'L L.J., http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202447654877&Legal_heavyweights_lean_on_NALP_to_track_nonequity_partners=&src=EMC-Email&et=editorial&bu=The%20American%20Lawyer&pt=Am%20Law%20Daily&cn=Am_Law_Daily20100408&kw=From%20The%20National%20Law%20Journal%3A%20Legal%20Bigshots%20Ask%20NALP%20to%20Track%20Non-Equity%20Partners&hblogin=1; Elie Mystal, *Vault Explains Why It's Better Than NALP*, Feb. 25, 2010, http://abovethelaw.com/2010/02/vault_explains_why_its_better_than_nalp.php (describing difficulties in getting firms to disclose equity vs. nonequity partner demographics); Henderson, *Single vs. Two-Tier Partnerships* at 1722-23; Galanter & Palay, *Tournament* at 61 n.152.

⁶²Galanter & Palay, *Tournament* at 59-62. New York-based firms show consistently greater leverage than firms based elsewhere, possibly in part because of the increased number of nonequity

2003, mean leverage among the Am Law 200 firms was over 3.5, with the 75th percentile boasting over 4 nonpartner attorneys per equity partner.⁶³

8. *Billing Rates.*

To support the expense of rapidly increasing associate salaries in a heavily leveraged structure, law firms raised their rates, including partners' rates, as precipitously as they raised associates' salaries.⁶⁴ A limited number of "marquee" partners breached the \$1,000-per-hour threshold in 2007.⁶⁵ By then, many large firms were charging \$250 to \$300 per hour for first-year associates with no skills or experience beyond the odd clinical class in law school.⁶⁶ Clients began voicing with increasing volume and poignance their growing misgivings about financing this practice structure, and being charged these rates to "pay for associates' training."⁶⁷

9. *Work Allocation Between In-House And Outside Counsel.*

During the "golden age," elite law firms had stable, longstanding relationships with client companies, typically large financial or industrial firms.⁶⁸ The client companies often had few lawyers in-house, and some depended on their outside firms to accomplish some or all of their

partners that reporting firms outside New York added into their leverage denominator as if they were equity partners. *Id.* at 61 n.152.

⁶³Henderson, *Single vs. Two-Tier Partnerships* at 1714, 1728 tbl. 6 (charts).

⁶⁴Bradford Hildebrandt, *Unprecedented Decade in the Legal Profession*, NAT. L.J., Dec. 28, 2009, <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202437225077>.

⁶⁵Leigh Jones, *Billing Goes Up*, NAT. L.J., Dec. 13, 2007, <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=900005498302>; Kellie Schmitt, *Yes, They Charge More: They're Experts*, THE RECORDER, Aug. 29, 2007, <http://www.law.com/jsp/ca/PubArticleCA.jsp?id=900005489816&slreturn=1&hbxlogin=1>.

⁶⁶*See A Nationwide Sample of Firm Billing Rates*, NAT. L.J., Dec. 7, 2009, <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202436055916> (2009 rates); *Firms Report Their Billing Rates*, NAT. L.J., Dec. 7, 2009, <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202436056039> (2009 associate rates by class); *A Nationwide Sampling of Law Firm Billing Rates*, NAT. L.J., Dec. 10, 2007, <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=900005497835> (2007 rates); *2007 NLJ Associate Billing Rates Survey: Billing Rates by Associate Class*, NAT. L.J., Dec. 10, 2007, <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=900005497944> (2007 associate billing rates by class).

⁶⁷Nate Raymond, *Clients Grow Cool To The Support Of Dwindling Summer Classes*, June 8, 2010, N.Y.L.J., http://www.law.com/jsp/nylj/PubArticleNY.jsp?id=1202461074366&Clients_Grow_Cool_to_the_Support_of_Dwindling_Summer_Classes&hbxlogin=1&loginloop=o (noting clients' refusal to pay for summer associate time); Zach Lowe, *This Isn't The End of Big-Law-Firm Associates*, Mar. 10, 2010, <http://amlawdaily.typepad.com/amlawdaily/2010/03/clobiglawassociates.html> (referring to clients' refusal to pay for first-year, and in some cases second-year, associate time); Jones, Thrills & Chills; Debra Cassens Weiss, *Nixon Peabody Hiring Partner: Student Recruiting Model is 'Antiquated,'* ABA J., Oct. 5, 2009, http://www.abajournal.com/news/article/nixon_peabody_hiring_partner_student_recruitment_model_is_antiquated/ ("If a young lawyer can't work on a matter because their rates are too high—how do we get them the training they need?"); Sharon Driscoll, *Law Firm Hiring: Time for a Change?* STAN. LAW., Fall 2009, at 9, 11. *See also* note 93, *infra*.

⁶⁸Galanter & Palay, *Tournament* at 33-34, 48-52; Gilson & Mnookin, *Profit Sharing* at 357-60.

more routine legal work (such as everyday contract drafting and ordinary commercial disputes) as well as more highly specialized or unusual projects (such as securities offerings or substantial mergers and acquisitions).⁶⁹ The more routine matters were delegated, with appropriate supervision, to the firms' associates, and served as a valuable training ground in which they acquired not only skills and experience relevant to their professional interests, but familiarity with clients' businesses, practices and procedures, records and personnel that allowed the services to be provided more efficiently.⁷⁰

As related above, this arrangement too began to evolve beginning in the 1970s.⁷¹ General counsel and other senior in-house legal staff became steadily more knowledgeable and sophisticated about acquiring legal services, and were increasingly charged by their management with reducing legal costs.⁷² They exploited the economies of concentrating recurring tasks and issues and their associated knowhow efficiencies in-house with permanent employees who did not have to be paid high hourly rates to be trained. In-house law departments began handling more of their companies' day-to-day contractual and regulatory issues, as well as many kinds of litigation, and became significantly larger in the last third of the twentieth century.⁷³ Correspondingly, outside counsel's domain centered more and more on work for which highly specialized expertise (and/or large teams of people) were required.⁷⁴ As specific expertise became the touchstone for selection of counsel, companies relied less in their selection decisions on the general reliability of a "name-brand" firm, and more on the unique skill or experience of a particular lead lawyer.⁷⁵ This change in focus in turn inexorably reduced large companies' recourse to a single firm as "outside general counsel."⁷⁶

⁶⁹*Id.* A 1959 survey of 286 manufacturing companies found more than half had no in-house legal department at all. Organization of Legal Work, 16 CONF. BD. BUS. REC. 463-68 (1959). However, the extent of client companies' reliance on elite outside law firms for routine legal work during this period is not documented with much quantitative, or even qualitative, precision. See, e.g., Galanter & Palay, Tournament at 33-34, 48-52 and authorities cited. Quite a lot of routine transactional work in the periods before and after World War II at companies without legal departments may well have been accomplished (and accomplished quite adequately) by lay personnel using form documents such as printed short-form mortgages and purchase orders.

⁷⁰*Id.*; see PAUL HOFFMAN, LIONS IN THE STREET: THE INSIDE STORY OF THE GREAT WALL STREET LAW FIRMS 76 (1973) (noting that outside counsel's accumulated knowledge of client preferences and practices makes it difficult for a bank to switch).

⁷¹See notes 33-35, supra, and accompanying text.

⁷²Galanter & Henderson, Elastic Tournament at 129; Galanter & Palay, Tournament at 50; Gilson & Mnookin, Profit Sharing at 366 n.93, 381-83.

⁷³See Rees Morrison, *How Many In-House Counsel Are in the World's 500 Largest Corporations?* http://www.lawdepartmentmanagementblog.com/law_department_management/2010/02/how-many-in-house-counsel-are-in-the-worlds-500-largest-corporations-102324-well-some-other-bench-marks.html (estimating "high tens of thousands"); Galanter & Palay, Tournament at 49-50 and authorities cited (tracking growth of in-house law departments in the 1970s and 80s).

⁷⁴Galanter & Henderson, Elastic Tournament at 129; Galanter & Palay, Tournament at 51-52.

⁷⁵Galanter & Henderson, Elastic Tournament at 129; Regan, Eat What You Kill at 33; Mark C. Suchman, *Working Without a Net: The Sociology of Legal Ethics in Corporate Litigation*, 67 FORD. L.

10. Associate Training.

Despite these changes, the demand for outside counsel's services continued to increase rapidly. The expansion of the regulatory state, of the evolving art of the "Big Deal," of litigation as a commercial or competitive tool, and of the general litigiousness of American culture all assured outside counsel numerous and expanding arenas in which to purvey their expertise.⁷⁷

What the swelling ranks of associates in the increasingly leveraged firms were asked to do as these changes took hold evolved as well. The original conception of the "Cravath System," which had been adopted in significant measure by nearly every firm with elite ambitions, centrally depended on rigorous long-term training and "graduated increase in responsibilities" for associates.⁷⁸ The firm's long-term survival was impossible without it: Because partners were until the 1970s chosen almost exclusively from the ranks of current senior associates,⁷⁹ there would have been no competent and skilled successors, steeped in the firm's style and the knowledge of its clients, to take the place of partners as they retired.

With the advent of widespread lateral recruitment and hiring of both associates and partners, however, "home-schooling" of younger lawyers became less central to the prevailing model's self-perpetuation and success.⁸⁰ This created a classic group action problem. Greater numbers of lawyers arrived at a firm already partly or fully formed, their hiring itself bearing witness that somebody else had done a good enough job with their training before they had arrived, at least up to that point.⁸¹ Meanwhile, partners were under pressure from every direction: greater numbers of associates per partner;⁸² greater pressure to bill more, but bill only

REV. 837, 856 (1998); Galanter & Palay, *Tournament* at 50; Emily Couric, *New Relationships, New Rules*, NAT. L. J., Aug. 1, 1988, Pull-Out Supp. at 2; Rita Jensen, *Banking Clients More Willing to Shop for Firms*, NAT. L. J., Jan. 18, 1988 at 1; Gilson & Mnookin, *Profit Sharing* at 385; Francis Flaherty, *Comparison Shopping Hits the Law: Companies Cut Costs*, NAT. L. J., Oct. 31, 1983, at 1.

⁷⁶See note 75, *supra*, and authorities cited. By 1980, a quarter of the companies surveyed by the *National Law Journal* reported that they no longer used a general outside counsel. *Ma Bell: Top Lawyer Employer*, NAT. L. J., Feb. 4, 1980 at 25.

⁷⁷Galanter & Palay, *Tournament* at 50-52. See notes 26-27, *supra*, and accompanying text.

⁷⁸Galanter & Palay, *Tournament* at 9, 14-15; 2 Swaine, *supra* note 8, at 2-12.

⁷⁹See notes 10-11, *supra*, and accompanying text.

⁸⁰See David B. Wilkins and G. Mitu Gulati, *Reconceiving the Tournament of Lawyers: Tracking, Seeding and Information Control in the Internal Labor Markets of Elite Law Firms*, 84 VA. L. REV. 1581, 1610-11 (1998) [hereinafter Wilkins & Gulati, *Reconceiving the Tournament*] (limited economic incentives for partners to train younger lawyers); *id.* at 1635 (suggesting the training is a "scarce commodity" for which firm management does not want all associates to compete); S. Elizabeth Wilborn & Ronald J. Krotoszynski, Jr., *Views from the Front: A Dialog About the Corporate Law Firm*, 1996 UTAH L. REV. 1293, 1299-1300 (similar).

⁸¹See note 34, *supra*, and accompanying text (a quarter of all large firms have acquired at least half their practitioners, both associates and partners, through lateral hiring).

⁸²See notes 60-63, *supra*, and accompanying text.

time and tasks that would survive in-house counsel's or a fee auditor's scrutiny;⁸³ greater misgivings from clients as associate rates soared to pay for anything resembling on-the-job training.⁸⁴ As a result, associates saw less and less of the experienced practitioners and firm leaders who in past generations had taught at least by observable example, and in many cases by personal tutelage as well. With smaller and more routine transactions and cases more frequently reserved for the client's own in-house legal staff, junior associates at elite firms were more and more often forced to find their training (if they found it at all) as deeply subordinated members of crowded "teams" in large, complex transactions and litigation.⁸⁵

11. *Nature Of Associate Work.*

During the same period, a growing complement of junior associates' work both required less practical training and provided less professional opportunity. Those projects requiring significant commitments of person-power increasingly called upon large teams composed principally of more subordinate lawyers to gather and organize large quantities of information and documents. Examples include document review in complex litigation and due diligence or compliance work related to large transactions.⁸⁶

At around the same time as this less desirable and rewarding work began to fill more associates' time, their salaries began to rise more sharply.⁸⁷ As discussed, the publicly articulated justification for these salary increases was competitive—that the "best" firms could remain on top, retaining the "best" clients and the "best" work, only by successfully competing for the "best" young talent.⁸⁸ But it is not clear that this justification reflected the firms' actual practices. Ironically, as salaries and billing rates rose, the last 25 years saw elite firms hiring more law graduates with fewer of the traditional qualifications the firms claimed to value. And those graduates received increasingly higher salaries to spend increasingly long hours at

⁸³See note 32, *supra*, and accompanying text; Alix Stuart, *Legally Blind*, CFO, Aug. 20, 2009, http://www.cfo.com/article.cfm/14257550/c_14276506?f=home_todayinfinance (reporting on clients' use of fee audits). Between 1985 and 2003, associates' average billable hours across the Am Law 200 firms remained about the same, but the hours of 25-29 year partners increased substantially, from 1538 to 1703 per year. This may be attributable to a greater number of nonequity partners, whose role is to bill more hours; or to the increased competition among partners to accrue rewards or simply preserve their status. See Henderson, *Single vs. Two-Tier Partnerships* at 1710-11.

⁸⁴See notes 67, 93, *supra*, and accompanying text.

⁸⁵It is no coincidence that the elite bar and the academy's mutual recriminations regarding the adequacy of the preparation of young lawyers, now a commonplace and often strident refrain for each, arose and grew as these trends gathered momentum. See, e.g., Elie Mystal, *Corporate General Counsel Puts Fear of God into Legal Educators (And You Should Be Worried Too)*, Apr. 9, 2010, <http://abovethelaw.com/2010/04/corporate-general-counsel-puts-fear-of-god-into-legal-educators-and-you-should-be-worried-too/>. This issue appears to be coming to a head as law schools and law firms both experiment more aggressively with methods of imparting practical skill and experience to law students and recent graduates. See Parts I.C.3, V.C, *infra*.

⁸⁶See Part IV.B, *infra* for a more detailed discussion of the source and nature of this class of work.

⁸⁷See notes 47-51, 64-66, *supra*, and accompanying text.

⁸⁸See note 43, *supra*, and accompanying text.

monotonous and menial tasks. Those tasks neither called for the special talents for which their employers said they had recruited them, nor particularly developed their professional skills to prepare them for more challenging and responsible work—or for partnership, which became increasingly unavailable as track length rose and promotion rates fell.⁸⁹

Although information and document gathering and processing do require a real measure of intelligence, legal literacy and learning, they require appreciably less of it than the more skilled and responsible work that still exists in large firms. And more recently, it appears that this more desirable and rewarding work has been parceled out to the relatively few chosen out of the throngs of recent hires who have been informally judged best able to perform and profit by it.⁹⁰ By contrast, the back-office work provides few opportunities for acquiring professional skills or judgment, preparing to assume greater practical responsibility or, for that matter, distinguishing oneself from one's classmates. It is tedious and repetitive; offers little or no contact with representatives of the client, its adversary, or senior lawyers at the firm; and often leads only to more of the same.⁹¹

Yet these back-office projects have often been the most leveraged, and thus the most profitable, that large outside firms can obtain—indeed, William Henderson has recently shown that greater amounts of work a firm's mid-level associates consider more interesting and of higher quality is *negatively* correlated with firm profitability!⁹² The disconnect of being charged

⁸⁹See notes 43-44, 55-60, *supra*, and accompanying text; Dan Slater, *At Law Firms, Reconsidering the Model for Associates' Pay*, N.Y. TIMES, Mar. 31, 2010, <http://www.nytimes.com/2010/04/01/business/01LEGAL.html?pagewanted=all> (managing partner of Howrey expresses the view that current associate recruiting and compensation model is based on the “fallacy” that firms hire “a labor force of associates to come in and work toward becoming partner over a period of eight years”: “they weren’t really selected for that purpose They came in and did rudimentary work for two or three years. Clients were overpaying enormous amounts for that work”).

⁹⁰David Wilkins and Mitu Gulati go so far as to suggest that associates are from the day of their arrival “tracked” and “seeded” onto either a “training” track, with opportunities for mentoring and risk-taking that allow them to develop professionally, and a “paperwork” track, with few such opportunities and a surfeit of eye-straining, mind-numbing monotony. Those on the former track, say the authors, advance toward a shot at partnership; those on the latter collect generous paychecks and benefits for a few years and then depart prepared for little else. Wilkins & Gulati, *Reconceiving the Tournament at 1609-11, 1643-50, 1651-57*.

⁹¹See William D. Henderson & David Zaring, *Young Associates in Trouble*, 105 MICH. L. REV. 1087, 1096-1104 (2007) [hereinafter cited as Henderson & Zaring, *Young Associates*]; Patrick J. Schiltz, *Legal Ethics in Decline: The Elite Law Firm, the Elite Law School, and the Moral Formation of the Novice Attorney*, 82 MINN. L. REV. 705-725 (1998) (describing junior lawyers’ work as “numbingly dull”); William H. Rehnquist, *The Legal Profession Today*, 62 IND. L. J. 151, 151-54 (1987) (“drudgery”).

⁹²Henderson & Zaring, *Young Associates* at 1100-01 & tbl. 4; *see also* Galanter & Henderson, *Elastic Tournament* at 128. Henderson’s attrition study also found that large-firm associates were more likely to remain longer at firms that had more interesting or higher “quality” work; salary and benefits were *not* correlated with a desire to stay on (and in fact higher profitability was correlated with a likelihood of associates’ intending to leave the firm in the near future). Henderson & Zaring, *supra*, at 1102 & tbl. 5; *see also* Galanter & Henderson, *Elastic Tournament* at 128. This appears to differ from what associates report induced them to hire on in the first place: “[M]any students state that the high

top dollar for “top” graduates to perform these less intellectually demanding tasks has not been lost on the client community, which has stepped up its protests as associate salaries and rates continued to rise.⁹³

12. *Incipient Segmentation Of The Elite Sector Of The Bar.*

As the eve of the Great Recession approached, commentators remarked on a trend toward a practical segmentation of elite law firms into two subgroups: One is a small cadre of super-elite firms principally distinguished by exceptionally high prestige. These firms are generally characterized by very high profits per partner; a single-tier partnership (true equity partners only); somewhat harder-working associates; and the most price-insensitive work concentrated in traditionally supra-profitable areas: large-scale capital markets transactions (securities offerings, mergers and acquisitions, private equity) and litigation; high-end white-collar criminal defense; antitrust and intellectual property.⁹⁴ The other, a broader realm of “semi-elite” firms, is less (but still very) profitable, and reaches out to a broader practice base, including traditionally less leveraged and more price-elastic specialties such as labor and employment, real estate, and trusts and estates as well as the prestige practices where the super-elite tend to focus. These firms often have two-tier partnerships, with a smaller equity tier in which most profit and power are concentrated.⁹⁵

C. *The Great Recession.*

In the summer of 2007, the *American Lawyer*, extrapolating from business as usual, estimated that the Am Law 200 law firms *alone* would hire ten thousand entry-level associates to begin in the fall of 2008.⁹⁶

salaries paid by corporate firms are the primary reason why they choose jobs in this sector over what they consider to be the more rewarding work in government or in public interest practice.” Wilkins & Gulati, *Reconceiving the Tournament at 1637 & n.186.*

⁹³Jones, Thrills & Chills; Shannon Henson, *Change May Be Coming To Law Firm Staffing Models*, LAW360, Dec. 8, 2009, <http://ip.law360.com/articles/135593>; Nick Brown, *Firms’ ‘Ego-Driven’ Salary Structure Can’t Last: Experts*, LAW360, Oct. 2, 2009, available at <http://ip.law360.com/articles/125954> (“As the economy suffered, clients woke up and said, ‘Are we out of our minds, paying hourly rates to first-, second- or third-year associates who can barely find their way to the bathroom?’”)

⁹⁴Henderson, *Single vs. Two-Tier Partnerships at 1696-97, 1742-43*; Galanter & Henderson, *Elastic Tournament at 135-38* (analysis of lateral partner movement shows that partners in these specialties tend to move “up” to more profitable firms, or receive a premium for switching firms). Ironically, these firms tend to have leverage that, while significant, is generally lower than that of many firms in the other subgroup, owing principally to having no nonequity partners. Henderson, *Single vs. Two-Tier Partnerships at 1727.*

⁹⁵See Galanter & Henderson, *Elastic Tournament at 102, 107, 111-12, 120-23, 135-3d8*; Henderson, *Single vs. Two-Tier Partnerships at 1691-92, 1697-98, 1742-43.*

⁹⁶Aric Press, *The New Reality*, AM. LAW., Aug. 2007, at 91. The article noted that this comprised about a quarter of all the law students who would graduate in 2008, and that the schools conventionally considered among the top twenty in nation would graduate a total of only about 6,500. *Id.*

We all know what happened next: The housing bubble popped. Capital markets froze; numerous investment and commercial banks failed, collapsed into a more solvent acquirer, or sought government-funded life-support. Demand for high-end legal services plummeted as transactional activity slowed to a crawl; falling corporate revenues and budgets forced client companies to avoid or curtail all but the most essential legal work, and reassess the cost and staffing of any work they concluded was unavoidable.⁹⁷ Naturally these events had profound effects on the law firms that served these clients:

1. *Reductions In Force.*

Large law firms shed personnel in unprecedented numbers. From January 1, 2008 through January 31, 2010, the *Law Shucks* website documented 14,347 people laid off by “major” law firms. These layoffs included 5,632 lawyers and 8,715 staff (a category comprising staff attorneys and contract attorneys as well as nonlawyer staff), numbers that the site itself was quick to point out its counting methodology significantly understated.⁹⁸ The number of attorneys

⁹⁷See Elie Mystal, *In-House Counsel Don't Intend to Give You Hours*, June 1, 2010, <http://above.thelaw.com/2010/06/in-house-counsel-dont-intend-to-give-you-hours/#more-19685>. Not only capital markets work and lending-dependent transactions dropped steeply. Venture capital investments dropped 27% from the prior year to a 12-year low. *VC Investing Hit 12-Year Low in 2009*, SAN JOSE BUS. J., Jan. 22, 2010, http://sanjose.bizjournals.com/sanjose/stories/2010/01/18/daily81.html?ed=2010-01-22&ana=e_du_pub. Litigation, traditionally viewed as “countercyclical,” did not fill the yawning gaps created by the seizing of the credit markets. See Karen Sloan, *For litigators, a different kind of recession*, NAT. L.J., Aug. 17, 2009, <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202433056970>. See also Erin Marie Daly, *Weak Economy Slows Litigation Growth*, Jan. 4, 2010, <http://ip.law360.com/articles/141372> (litigation filings in 2009 rose only 5%, compared with 9% the year before). Antitrust filings fell 39% in 2009, though this also reflected an upward spike in 2008 (Jacqueline Bell, *Antitrust Filings Recede from Peak in 2009*, Jan. 4, 2010, <http://ip.law360.com/articles/141345>); intellectual property filings fell 11%, with copyright filings down and patent and trademark filings essentially flat (Erin Coe, *Depressed by Copyright Plunge, IP Litigation Drops*, Jan. 4, 2010, <http://ip.law360.com/articles/141363>); environmental litigation filings fell (Jesse Greenspan, *Environmental Litigation Drops in 2009*, <http://ip.law360.com/articles/141496>); insurance-law filings in federal court dropped 9% (Christie Smythe, *Bucking Expectations, Insurance Suits Drop 9% in '09*, Jan. 4, 2010, <http://ip.law360.com/articles/141369>); and securities filings rose more slowly than anticipated, including a drop in class-action filings (see Evan Weinberger, *Securities Litigation Grows More Slowly Than Expected*, Jan. 4, 2010, <http://ip.law360.com/articles/141366>).

⁹⁸See <http://lawshucks.com/layoff-tracker/>. These numbers cover only the website staff's informal sense of which are “major” law firms (likely omitting many private firms with more than 50 lawyers). See the discussion of *Law Shucks*'s methodology at <http://lawshucks.com/layoff-tracker/#methodology>. They do not count the fallout from the dissolution of large firms such as Heller Ehrman (over 700 lawyers and over 1,000 staff); Thelen (over 400 lawyers); Wolf Block Schorr & Solis-Cohen (about 300 lawyers) and Thacher Proffitt & Wood (about 200 lawyers). *Id.* They cannot account for “stealth” layoffs of associates and staff in the guise of performance reviews. *Id.* And they cannot account for the undoubtedly large number of partner “de-equitizations” and dismissals that are by mutual agreement accomplished quietly. *Id.*; see also Jocelyn Allison, *Firms Roll Out 5 Cost-Cutting Strategies for 2010*, Jan. 1, 2010, <http://ip.law360.com/articles/139219> [hereinafter cited as Allison, *Cost-Cutting Strategies*]; Christine Caulfield, *Firms Quietly Show Partners the Door*, Sept. 1, 2009, <http://www.law360.com/articles/117009>.

in the *NLJ* 250 decreased 4.3% compared with 2008, only the second time since the *National Law Journal* started compiling these statistics in 1979 that the total decreased.⁹⁹

The total number of associates and non-partnership-track attorneys each fell nearly 9%, while partners increased slightly less than 1%.¹⁰⁰ At least 25 firms decreased 12% or more in overall attorney census. Fifteen firms shed more than 100 lawyers, and seven more than 200. Latham & Watkins alone jettisoned 444 lawyers, or 19%; Fried Frank dropped 168, over 26%.¹⁰¹

2. Associate Hiring Curtailed.

In addition to laying off existing employees, firms also drastically cut new associate hiring.¹⁰² In 2009 and 2010, numerous firms rescinded existing employment offers¹⁰³ and

⁹⁹Jones, 2009 Worst Year. The last time (which the *NLJ* characterizes as two times because it spanned two calendar years) was in the recession of the early 1990s, when the total fell about 1% in each of 1992 and 1993. *Id.* The current 4% drop does not illustrate the full year-over-year effect, as 13 firms fell out of the biggest 250 firms by shrinking or by disappearing altogether through dissolution or merger. Smaller large firms previously off the list took these firms' places. NAT. L.J., charts of "Firms New to the List" and "Firms that Fell Off the List," <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202435287840>. William Henderson's analysis of the *NLJ* figures shows losses disproportionately concentrated in firms headquartered in New York City, and percentage losses inversely proportional to firm size (that is, bigger big firms tended to lose a greater *percentage* of their personnel than smaller big firms). William Henderson, *New Data on BigLaw Contraction: Patterns of Winners and Losers*, Empirical Legal Studies Blog, Nov. 13, 2009, http://www.elsblog.org/the_empirical_legal_studi/2009/11/new-data-on-biglaw-contraction-patterns-of-winners-losers.html.

¹⁰⁰*Id.* Again, these numbers do not reflect the year-to-year change in the firms constituting the *NLJ* 250, and may not differentiate in some cases between equity and nonequity partners. Needless to say, partnership promotion rates have fallen as well. Clay & Seeger, 2010 Law Firms in Transition at 5 (40% of firms with over 50 lawyers surveyed made fewer partnership offers in 2009, and 50% will or might do so in 2010); Carlyn Kolker, *Making Partner Less Likely As Big Law Firms Face Cash Crunch*, BUS. WEEK, Feb. 17, 2010, <http://www.businessweek.com/news/2010-02-17/making-partner-less-likely-as-big-law-firms-face-cash-crunch.html>; Shannon Henson, *Fewer Associates Promoted to Partner in Downturn*, Nov. 11, 2009, <http://ip.law360.com/articles/131439>. The American Bar Association has released a report expressing concern that the reductions in force have disproportionately affected minorities. AMERICAN BAR ASS'N, *DIVERSITY IN THE LEGAL PROFESSION: THE NEXT STEPS* (2010); see also Emily Barker, *Diversity Scorecard 2010: One Step Back*, AM. LAW., Mar. 1, 2010, http://www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202444097605&pDiversity_Scorecard_p_One_Step_Back&slreturn=1&hbxlogin=1 (Am Law 200 diversity statistics have fallen for the first time in the ten years they have been surveyed, with African-Americans most substantially affected); Elie Mystal, *The Recession's Impact on Diversity Initiatives*, Feb. 8, 2010, http://abovethelaw.com/2010/02/the_recessions_impact_on_diver.php#more.

¹⁰¹Jones, 2009 Worst Year.

¹⁰²See generally Natl. Assn. Law Placement, *Perspectives on 2009 Law Student Recruiting*, <http://www.nalp.org/uploads/PerspectivesonFallRec09.pdf> (2010) (gathering figures on drastically reduced hiring); Natl. Assn. Law Placement, *Entry Level Recruiting Volumes Plunge, Some Start Dates Deferred*, Mar. 2, 2010, <http://www.nalp.org/2009perspectivesonfallrecruiting> (press release summarizing NALP report). See also Karen Sloan, *Summer Associate Offers Hit 17-Year Low, Says NALP*, NAT. L.J., Mar. 3, 2010, <http://www.law.com/jsp/article.jsp?id=1202445366576> (only 10 of 300 firms surveyed made any

“deferred” new hires’ start dates 3-12 months or more. Over 100 *NLJ* 250 firms reported deferring a total of nearly 2,800 new associates, some 42% of their entering classes.¹⁰⁴ Sixty percent of the Am Law 200’s responding managing partners reported deferring associates in 2009, and 43% expected to defer associates *again* in 2010, apparently including some already deferred once.¹⁰⁵ Firms also reduced or cancelled on-campus interviews, slashed or eliminated summer programs, and dramatically cut hiring goals.¹⁰⁶ 72% of responding Am Law 200 firms

job offers to third-year law students); Elie Mystal, *Statistics About the Lost Generation*, Mar. 3, 2010, http://abovethelaw.com/2010/03/nalp_statistics_summers_2009.php (“the class of 2009 got rogered, but good”).

¹⁰³See, e.g., Hillary Russ, *Wildman Harrold Rescinds Incoming Associate Offers*, Oct. 2, 2009, <http://ip.law360.com/articles/126046>; Tina Peng, *Arent Fox Revokes Some Associate Offers*, Sept. 24, 2009, <http://ip.law360.com/articles/124431>.

¹⁰⁴Jones, 2009 Worst Year. Larger firms have tended to offer deferred associates a stipend of some kind equal to about one-third to one-half of what their starting salaries would have been, and sometimes some benefits as well, and encouraged them to seek temporary public interest positions. See, e.g., Russ Ferguson, *After the Crash*, AM. SPECTATOR, Feb. 15, 2010, <http://spectator.org/archives/2010/02/15/after-the-crash> (usually \$60,000-\$80,000); David Lat & Elie Mystal, *Cravath Offers Voluntary Deferral to the Class of 2009—And Delays the Class of 2010 a Full Year*, June 12, 2009, http://abovethelaw.com/2009/06/cravath_voluntary_deferral.php#more (\$80,000); Michael D. Goldhaber, *THE AM LAW 100: Profits Up, Revenue Down at Shearman & Sterling*, AMLAW DAILY, Feb. 16, 2010, <http://amlawdaily.typepad.com/amlawdaily/2010/02/al100shearman.html> (\$65,000 plus medical benefits). About a third of the deferred associates responding to a survey reported that they had decided not to report when their large firms eventually offered them the opportunity to do so, raising questions whether some firms might request that the stipends be repaid. Kashmir Hill, *If You Bail on Biglaw, Do You Have To Repay Your Deferral Stipend?*, Feb. 26, 2010, http://abovethelaw.com/2010/02/the_deferral_stipend_follow-up.php; see also Lisa Faye Petak, *Young Lawyers Turn to Public Service*, N.Y. TIMES, Aug. 19, 2010, <http://www.nytimes.com/2010/08/20/us/20defer.html?th=&emc=th&pagewanted=print>.

¹⁰⁵*Law Firm Leaders Survey 2009: Associates*, AM. LAW., <http://www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202435769845> [hereinafter cited as Am Law 2009 Survey: Associates]. See also Elie Mystal, *Mintz Levin 2012 Deferral Follow-Up*, May 18, 2010, <http://abovethelaw.com/2010/05/mintz-levin-2012-deferral-follow-up/#more-18174>; Liz McKenzie, *Contract Attorneys Sitting Pretty as Associates Deferred*, Feb. 9, 2010, <http://www.law360.com/articles/148068>. And as the cost of law-school tuition has climbed, one-third of current law graduates are facing this bleak job market with effectively nondischargeable six-figure student loans. See Alex Williams, *No Longer Their Golden Ticket*, NEW YORK TIMES, Jan. 15, 2010, <http://www.nytimes.com/2010/01/17/fashion/17lawyer.html?pagewanted=1&ref=fashion>; *Almost 1/3 of Law Students Expect to Graduate with \$120K Debt*, http://www.abajournal.com/weekly/article/almost_1_3_of_law_students_expect_to_graduate_with_120k_in_debt; Lat & Mystal, *supra* note 104.

¹⁰⁶See note 102, *supra*; Clay & Seeger, 2010 Law Firms in Transition at 5 (64% of surveyed firms larger than 50 reduced their summer programs in 2009, and 54% will do so again in 2010); Elie Mystal, *NALP 2010: NALP Executive Director James Leipold Talks to the ‘Lost Generation,’* <http://abovethelaw.com/2010/05/nalp-2010-nalp-executive-director-james-leipold-talks-to-the-lost-generation/#more-15253>; Debra Cassens Weiss, *New OCI Reality: Students Less Cocky, 40 Fewer Firms Recruit at Illinois*, ABA J., Sept. 1, 2009, http://www.abajournal.com/weekly/new_oci_reality_law_students_less_cocky_40_fewer_firms_recruit_at_illinois; Debra Cassens Weiss, *A ‘Lost Year’ for 2Ls: About Half of BigLaw Jobs Are Gone*, ABA J., Aug. 26, 2009, http://www.abajournal.com/weekly/a_lost_year_for_2ls_about_half_of_biglaw_jobs_are_gone; Gerry Shih, *Downturn Dims Prospects Even at Top Law Schools*, N.Y. TIMES,

expected to have an even smaller entering class in 2010 than they did in 2009 (which had already shrunk from 2008 levels), and 22% no larger than the currently reduced size; only 6% expected a larger one.¹⁰⁷

Even if nothing about the markets for lawyers and their services has changed (an assumption we question in the balance of this Article), law graduates in 2010 and coming years thus face an extraordinary reduction in demand for large firms' services, recovery from which may well take years. Their prospects are further dimmed by cancelled summer programs, reduced hiring goals, and the pent-up supply of all those deferred hires. Those deferrals alone amount to roughly half of the entering classes at half of the biggest firms, which collectively have been hiring about a quarter of all the law graduates in the country in recent years.¹⁰⁸

3. Associate Compensation Reduced And Restructured, With Seniority Raises Conditioned Or Curtailed.

Many large firms froze associate salaries, or reduced entering associates' salaries 10%-20% with similar reductions up the line in the more senior classes.¹⁰⁹ Firms also eliminated or reduced associate bonuses, which can be a substantial part of more senior associates'

Aug. 25, 2009, http://www.nytimes.com/2009/08/26/business/26lawyers.html?_r=2. Questions have been raised in the legal press about the viability of the high-leverage staffing model. See, e.g., Shannon Henson, *Change May Be Coming to Firm Staffing Models*, Dec. 8, 2009, <http://ip.law360.com/articles/135593>

¹⁰⁷Am Law 2009 Survey: Associates. See also Clay & Seeger, 2010 Law Firms in Transition at 5 (2010 Altman Weil survey of firms larger than 50 found that more than half discontinued or reduced first-year hiring in 2009, and 38% will do so again in 2010). Early reports from the curtailed 2010 summer season indicate that (unlike summer 2009, when offer rates hit historic lows) healthy percentages of the summer associates who participated received employment offers, at least at the more prestigious firms. Elie Mystal, *Summer Offer Rates: Vault Top 25 Are Hot*, Apr. 6, 2010, <http://abovethelaw.com/2010/04/summer-offer-rates-vault-top-25-are-hot/>. But those programs were significantly smaller than in prior years, and it remains to be seen how long firms may defer the offerees' start dates. See notes 102-103, *supra*. Summer classes for 2011 should be larger than 2010, though still well below the record sizes in 2007 and 2008. Zach Lowe, *Weil, Cleary Also Projecting Larger Summer Classes*, Aug. 2, 2010, <http://amlawdaily.typepad.com/amlawdaily/2010/08/2011summersupdate.html>.

¹⁰⁸See notes 96, 102-103, *supra*, and accompanying text.

¹⁰⁹The *American Lawyer* 2009 survey of Am Law 200 managing partners found that 40% of responding firms had cut associate pay in 2009, and 44% were considering doing so in 2010. Am Law 2009 Survey: Associates. See also, e.g., Julie Zeveloff, *Mayer Brown, Pillsbury Disclose 2010 Pay Scales*, Feb 3, 2010, <http://www.law360.com/articles/147454>; Julie Triedman, *Associate Pay Cuts Here to Stay, Say Firms, Analysts*, AM. LAW. DAILY, Dec. 14, 2009, http://www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202436313459&Associate_Pay_Cuts_Here_to_Stay_Say_Firms_Analysts [hereinafter cited as Triedman, Associate Pay Cuts]. In an intriguing alternative effort, at least two large firms have required their nonequity partners to purchase equity stakes in the firm, effectively by reducing their salaries and devoting it to the "investment." Debra Cassens Weiss, *Reed Smith Will Ask Nonequity Partners to Pony Up Possibly 15% of Pay*, ABA J., Nov. 16, 2009, http://www.abajournal.com/weekly/reed_smith_will_ask_nonequity_partners_to_pony_up_possibly_15_of_pay; Steven R. Stahler, *DLA Piper makes seismic shift in structure*, Nov. 19, 2008, <http://www.chicagobusiness.com/cgi-bin/news.pl?id=31887> (275 nonequity partners asked to contribute capital of \$150,000 each).

compensation. Many firms cut associate bonuses in half for 2008 and in half again for 2009, reducing senior associates' total compensation at some firms by as much a third compared with 2007.¹¹⁰

A number of firms are also adjusting their rules for advancement. Until recently the vast majority of large firms paid associates' salaries, and often their bonuses as well, in a strictly seniority-based "lockstep" system.¹¹¹ A number of firms are experimenting with abandoning lockstep in favor of a "tiered" system that ties advancement to demonstrated professional experience, achievement or (more inchoately) "merit."¹¹² These changes allow firms to respond economically to the lack of practical experience that may have resulted from low demand, or concentration on less professionally fortifying tasks such as document and information processing. They also allow firms to concentrate resources, and retention efforts, on associates who appear to be advancing in skill and value, while paying (and possibly charging) less for

¹¹⁰*Id.* As 2010 proceeds, some firms are beginning to "unfreeze" salary and relaxing strictures on associate bonuses. See, e.g., Julie Zeveloff, *MoFo to Pay 1st-Years \$160K Across the Board*, Feb. 17, 2010, <http://ip.law360.com/articles/150371>; Amanda Royal, *Latham: We're Gonna Pay You Like 2009 Never Happened*, Jan. 4, 2010, http://legalpad.typepad.com/my_weblog/2010/01/latham-were-going-pay-you-like-2009-never-happened.html#more; Elie Mystal, *Nationwide Salary Thaw: Arnold & Porter*, Jan. 4, 2010, http://abovethelaw.com/2010/01/arnold_porter_salary_thaw.php#more. Others are not. See, e.g., Elie Mystal, *Morgan Lewis: Not Enough Pie for Everybody*, Feb. 11, 2010, http://abovethelaw.com/2010/02/did_you_go_to_law_school_to_ma.php#more (quoting an anonymous associate: "Something is nauseatingly wrong . . . [w]hen third years billing over 2200 hours [per year] are being paid \$5,000 more than first years").

¹¹¹*Id.*; Allison, *Cost-Cutting Strategies*.

¹¹²A 2009 survey of Am Law 200 managing partners found that more than half of the responding firms had implemented a "competency model" of associate compensation in or before 2009, and that 74% were considering it. (Presumably this means that some of the firms that had some form of this model were considering modifying it.) Am Law 2009 Survey: Associates. See also Dan Slater, *At Law Firms, Reconsidering the Model for Associates' Pay*, N.Y. TIMES, Mar. 31, 2010, <http://www.nytimes.com/2010/04/01/business/01LEGAL.html?pagewanted=all>; Amanda Becker, *Howrey firm shifts pay, development of entry-level associates*, WASH. POST, Apr. 26, 2010, <http://www.washingtonpost.com/wp-dyn/content/article/2010/04/23/AR2010042303429.html>; Triedman, *Associate Pay Cuts*; Allison, *Cost-Cutting Strategies*; Jones, *Thrills & Chills*; Debra Cassens Weiss, *Five Questions for Law Firms Abandoning Lockstep Compensation*, ABA J., Nov. 17, 2009, http://www.abajournal.com/weekly/five_questions_for_law_firms_abandoning_lockstep_compensation; Rachel M. Zahorsky, *Law School Rank and Class Take Back Seat to Practical Skills in 2010*, ABA J., Jan. 7, 2010, http://www.abajournal.com/news/article/law_school_rank_and_class_year_take_back_seat_to_practical_skills_in_2010/; Elie Mystal, *Associate Bonus Watch: Orrick, A Case Study in Merit-Based Bonus Payments*, Feb. 10, 2010, http://abovethelaw.com/2010/02/associate_bonus_watch_orrick_a.php#more (including a copy of Orrick management's memorandum to associates with detailed charts on the amount and distribution of bonus awards); Julie Zeveloff, *Morgan Lewis Reveals Details on New Pay System*, Jan. 20, 2010, <http://ip.law360.com/articles/144550>; Elie Mystal, *Orrick's New Compensation Structure*, Dec. 3, 2009, http://abovethelaw.com/2009/12/orricks_new_compensation_struc.php; Erin Fuchs, *Life Post-Lockstep: Moving to Merit Pay Without a Map*, Jan. 25, 2010, <http://ip.law360.com/articles/145121>. It remains unclear how many firms may retain the change. See Nick Brown, *Law Firms Fall Back In Step With Lockstep*, July 15, 2010, <http://ip.law360.com/articles/181193>.

those who may not be.¹¹³ A “merit” system also could as a practical matter implement modest to significant pay reductions for many associates.¹¹⁴

4. *Increased Attention To Discounting And “Creative” Fee Arrangements.*

Traditional pricing has come under greater scrutiny. Though many large firms announced increases in their “rack” (*i.e.*, standard) rates in early 2009 and again in early 2010, those increases were generally more modest than prior years’, and discounting appears rampant.¹¹⁵ In addition, “creative” billing arrangements, such as flat fees, volume discounts, contingent fees and “success fees” (discounted fees with enhancements for defined levels of success in the engagement), are the watchword of the day.¹¹⁶ Values like predictability and shared risk are

¹¹³See note 112, *supra.*

¹¹⁴David Lat, *A Peek Inside the Winston & Strawn Black Box*, Apr. 23, 2010, <http://abovethelaw.com/2010/04/a-peek-inside-the-winston-strawn-black-boxand-additional-info-on-stealth-layoffs/> (law firm associate: “Their ‘black box’ excuse for a new ‘merit system’ appears to be just a pretext for screwing associates out of market salaries while still being able to claim to the public that, on paper, Winston has raised to market”); Triedman, *Associate Pay Cuts: Allison, Cost-Cutting Strategies*. Again, we express no judgment about whether this will ultimately prove to be a “good” or a “bad” development for associates or for partners. Opinion is divided on whether the experiment is wise or will succeed. *See, e.g.*, Erin Fuchs, *Shift from Lockstep Pay Rife With Perils, Experts Say*, Jan. 8, 2010, <http://ip.law360.com/articles/142513>. We simply observe that experimentation is underway, and has a number of potentially important causes and potentially significant effects.

¹¹⁵Rate increases at large firms in 2009 were small or nonexistent, on average 2.5%. *See* Karen Sloan, *Reality dawns on hourly rates*, NAT. L. J., Dec. 7, 2009, at 1. On discounting, *see* Debra Cassens Weiss, *Why Law Firms Are Like Hotels: ‘Rack Rates’ Are Negotiable, Real Rates Vary by Client*, May 26, 2010, http://www.abajournal.com/weekly/article/client_beware_law_firm_rack_rates_are_negotiable_and_real_rates_vary_even_f; Meredith Hobbs, *Despite Down Economy, Law Firms Say They’ll Raise Billing Rates*, FULTON COUNTY DAILY REPORT, Jan. 15, 2010, <http://www.law.com/jsp/article.jsp?id=1202438334088> (“Firms acknowledged that the rates they charge may not correlate with what clients actually will pay”); Shannon Henson, *Lateral Market to Feel Impact of Recession in 2010*, Jan. 1, 2010, <http://ip.law360.com/articles/140662> (“Large law firms that have traditionally held their ground on discounts have started to yield”). London’s “Magic Circle” firms have reportedly reduced their partner rates to levels last seen five years ago. Tina Peng, *Partner Rates Plummet at Top London Firms: Report*, Sept. 22, 2009, <http://www.law360.com/articles/123691>.

¹¹⁶A survey of chief legal officers that law-firm consultants Altman Weil conducted in the summer of 2009 found that nearly 40 percent of client companies *are* putting some pressure on law firms to change the “value proposition” in their delivery of legal services. Anne Urda, *General Counsel Keep Billable Hour Hanging On*, Nov. 6, 2009, <http://ip.law360.com/articles/122992> [hereinafter Urda, *General Counsel Keep Billable Hour*] (but also suggesting that alternative fees currently consume no more than 2% of corporate legal spending). *See* Jerry Kowalski, *Alternative Fee and Billing Arrangements: A Primer*, Apr. 1, 2010, <http://ip.law360.com/articles/155660>; *Firms report using alternatives to the billable hour*, NAT. L.J., <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202436026951> (chart displaying type and extent of use of alternative billing arrangements by 2009 *NLJ* 250 firms). Apparently, many general counsel still value the familiarity and arithmetic ease of the traditional hourly billing model. *See* Lee Stephen McPhee, *NOT Dead (Just Beaten Up)*, Apr. 2, 2010, http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202447313892&Its_emNOTem_Death_Just_a_Little_Beaten_Up_The_Billable_Hours_a_Survivor_Baby=&src=EMC-Email&et=editorial&bu=Corporate

often proffered to support such arrangements, but clients are, if anything, more vigilant and intolerant than ever about paying premium fees for routine work.¹¹⁷ Indeed, one feature of the current unrest among pricing models is strong pressure on the client side to push and hold overall cost down, with “creative” billing providing cover for both sides to do so, at least during this period of reduced demand.¹¹⁸

5. Proliferation Of Specialty “Boutiques.”

The lower-priced, lower-overhead boutique enjoyed a resurgence as small groups of partners left BigLaw to set up more nimble and flexible specialty shops.¹¹⁹ From October 2008 through September 2009, 114 Am Law 200 partners left their firms to start or join small practices, up from 70 the year before.¹²⁰

[%20Counsel&pt=Corporate%20Counsel%20Daily%20Alerts&cn=cc20100401&kw=It's%20NOT%20Dead%20\(Just%20a%20Little%20Beaten%20Up\)%3A%20The%20Billable%20Hour's%20a%20Survivor%2C%20Baby; Urda, General Counsel Keep Billable Hour, *supra*.](#)

¹¹⁷A 2008 Altman Weil survey of general counsel found 75% had had their 2009 budgets cut; and that most expected to take more work in-house, and to press outside counsel for greater “efficiency” and lower fees. Denise Oliveira, *General Counsel to Reduce Reliance on Firms: Survey*, Dec. 9, 2008, <http://ip.law360.com/articles/79627>. See also Emily Heller, *General counsel pressuring firms amid recession*, NATL. L.J., March 30, 2009, <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202429503156>.

¹¹⁸See *Q&A with FMC Technologies GC Jeffrey Carr*, Mar. 30, 2010, <http://ip.law360.com/articles/157416> (“We did advise all of our outside firms that we were expecting existing matters to be handled below current matter budgets. We also advised that we were expecting new matters to have budgets 10 to 15 percent below historical budgets for similar types of matters”). Karen Sloan, *Firms’ Billing Rates Inched Up During 2009, NLJ Survey Shows*, NAT. L.J., Dec. 7, 2009, <http://www.law.com/jsp/article.sp?id=1202436087594> (“Firms also reported that they are generating a larger percentage of revenue from alternative billing arrangements, which have grown in popularity as legal departments have looked for ways to cut costs”); Urda, *supra* note 116; Debra Cassens Weiss, *64% of Law Departments Have or Will Implement Rate Freezes, Survey Says*, ABA J., Nov. 20, 2009, http://www.abajournal.com/news/article/law_departments_cut_costs_by_squeezing_law_firms_freezing_staff_salaries/.

¹¹⁹See Claire Zillman, *Economy Model*, AM. LAW., Feb. 2010, http://www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202439217388&Economy_Model [hereinafter Zillman, *Economy Model*] (Full disclosure: One of the authors is Of Counsel to one of the firms profiled in the Zillman article). See also David Lat, *A Hot New Trend: Leaving BigLaw to Start Your Own Firm*, Aug. 20, 2010, <http://abovethelaw.com/2010/08/a-hot-new-trend-leaving-biglaw-to-start-your-own-firm/#more-31932>; Zack Needles, *More Small and Solo Corporate Practices Emerging*, THE LEG. INTELLIGENCER, Apr. 14, 2010; Erin Coe, *Rash of IP Boutiques Look to Cash In Post-Recession*, Feb. 2, 2010, <http://www.law360.com/articles/143421>; Shannon Henson, *Recession Offers Attorneys Chance to Branch Out*, Oct. 28, 2009, <http://ip.law360.com/articles/128352>; Nate Raymond, *Boutiques Slicing into Big Firms’ Pie*, N.Y.L.J., Jan. 4, 2010, <http://www.law.com/jsp/article.jsp?id=1202437343394>; Anne Urda, *Boutiques Use Size, Billing to Thrive in Tough Times*, Apr. 23, 2009, <http://ip.law360.com/articles/90493>. Some observers have also noted that the reduced leverage of these firms tends to give ambitious associates more access to training and hands-on experience. Jacqueline Bell, *Boutique Biz Model Puts Associates in Driver’s Seat*, Dec. 10, 2009, <http://ip.law360.com/articles/131608>.

¹²⁰Zillman, *Economy Model*. More generally, mid-market and mid-sized firms with the benefit of lower overhead and lower pricing also enjoyed more market attention. Nick Brown, *Midsized Firms Make*

D. What Now?

By restructuring as they did, many firms managed to keep partners' profits at least flat in 2009, and in some cases even drive them higher.¹²¹ The recessions of the early 1980s, early 1990s, and early years of the new century each produced retrenchments of various kinds in the markets for legal personnel and their services, but in each case as the recession abated associate salaries, new hiring, big-firm rates and partner profits all resumed their previous upward path at least as steeply as before.¹²² Of course, many things about the current recession and its impacts on large law firms are unprecedented, certainly as a matter of degree if not of kind. Are these temporary setbacks in trends that, as previously, will be pulled by familiar market forces back onto the path they have followed assiduously for the last 40 years? Or are new trends emerging from, or being revealed by, the sudden and drastic changes the economy has visited on us?

The *American Lawyer's* 2009 survey of Am Law 200 managing partners produced an intriguing contradiction. 56% of those responding believed that the "economic downturn [had] produced a fundamental shift in the legal marketplace." But 70% of the same managing partners

Big Splash in BTI Top 30, Nov. 13, 2009, <http://ip.law360.com/articles/134065> (referring to particular firms of 200-300 lawyers as "midsize"); Heller, *supra* note 117 (noting that general counsel are replacing large national firms with "smaller regional firms" that charge significantly lower hourly rates).

¹²¹Overall, in 2009 Am Law 200 firms saw modest declines in gross revenue, but flat or even slightly increased profits per partner. Aric Press & Greg Mulligan, *Lessons of the Am Law 100*, AM. LAW., May 1, 2010, http://www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202448340864&Lessons_of_The_Am_Law_&hbxlogin=1; Drew Combs, *No Place to Hide*, AM. LAW., June 1, 2010, http://www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202458447280&src=EMC-Email&et=editorial&bu=The%20American%20Lawyer&pt=Am%20Law%20Daily&cn=Am_Law_Daily_06012010&kw=No%20Place%20to%20Hide&hbxlogin=1. See also Zeughauser Group March 2010 report, <http://www.zeughauser.com/assets/Uploads/ZGAlert-2009FinancialResultsThroughMarch1.pdf> (average decline in top 100 firms of 3.8% in revenues, and average decline of 0.8% in PPP, with second-hundred firms faring better, averaging 2.3% increases in revenues and 9.8% increases in PPP. Individual firms varied, of course. See, e.g., Richard Lloyd, *THE AM LAW 100: Latham's Profits Bounce Back*, AMLAW DAILY, Feb. 17, 2010, <http://amlawdaily.typepad.com/amlawdaily/2010/02/al100latham.html> (revenues down 5%; PPP up 5% to \$1.9 million); Drew Combs, *THE AM LAW 100: Profits, Revenue Rise at Gibson, Dunn*, AMLAW DAILY, Feb. 16, 2010, <http://amlawdaily.typepad.com/amlawdaily/2010/02/al100gibson.html> (revenue up 4%; PPP up 1.6% to \$1.9 million); Goldhaber, *supra* note 104 (Shearman & Sterling's revenue down 8.6%; PPP up 4.2% to over \$1.7 million); Elie Mystal, *Boston Legal Enjoys Record Profits Per Partner*, Feb. 5, 2010, http://abovethelaw.com/2010/02/boston_legal_enjoys_a_record_p.php. Paul Weiss's managing partner publicly claimed record 2009 profits of \$2.69 million per partner "without resort to layoffs," despite documented firings of substantial numbers of the firm's staff attorneys and apparently reliable reports that many senior associates had been informed they had "no future" at the firm, and were encouraged to leave as well. See Elie Mystal, *What Did Paul Weiss Just Say?* Feb. 1, 2010, http://abovethelaw.com/2010/02/what_did_paul_weiss_just_say.php#more. Other firms were less successful. See, e.g., Dimitra Kessenides, *THE AM LAW 100: Howrey's PPP Plunges 35 Percent*, Feb. 22, 2010, <http://amlawdaily.typepad.com/amlawdaily/2010/02/howrey.html> (revenue down 16%; PPP down 35% to \$846,000); Nate Raymond, *THE AM LAW 100: Debevoise Sees Profits, Revenue Slide*, Feb. 26, 2010, <http://amlawdaily.typepad.com/amlawdaily/2010/02/al100debevoise.html> (revenue down 12%; PPP down 16% to \$1.9 million).

¹²²See generally Part I.B, *supra*.

said that the recession had *not* “produced a fundamental shift in [their firm’s] business model.”¹²³ Similarly, an Altman Weil survey conducted in the spring of 2009 explored whether U.S. firms larger than 50 lawyers were reconsidering their basic paradigm, but found little evidence of intent to implement fundamental change.¹²⁴

Is that fundamental change in business model coming? Will firms’ hands be forced by economic pressures beyond their control? Before addressing these questions, we now turn to the economic models of large law-firm growth and structure that have developed over the last 25 years, and test their predictions against the facts we know to date.

II. CURRENT ECONOMIC MODELS OF LAW-FIRM GROWTH, AND THEIR LIMITED EXPLANATORY FORCE.

This section surveys the most influential models of law-firm growth and structure.¹²⁵ They raise a number of questions to which they, and we, can offer only imperfect answers. The most basic of these are why elite firms got big in the first place; why they have consistently gotten bigger for many decades rather than, say, distributing the increasing number of practitioners in this sector of the bar in a greater number of smaller firms; and why they have gotten bigger in the form and structure they have rather than some alternative. Experience and empirical inquiry have cast doubt on the explanations offered to date, but have not produced any definitive answers.

However this story is told, client demand is an essential part of any plausible explanation. Though it is possible that reductions such as those discussed in Part IV in the cost of producing legal services, or in the cost of certain inputs, might cause firms to increase in size even if

¹²³*Law Firm Leaders Survey 2009: The Year Ahead*, AM. LAW., <http://www.law.com/jsp/tal/PubArticleTAL/jsp?id=1202435771906>.

¹²⁴Pete Brush, *Legal Industry Armageddon Talk Overblown: Survey*, May 12, 2009, <http://www.law360.com/articles/101086> (quoting Altman Weil principal Tom Clay: “We wanted to know if all the noise in the marketplace about a new law firm business model was translating into real change. We didn’t find much evidence of that beyond the expected staffing cuts, overhead reduction and extra attention to clients that any downturn would bring”). The survey polled 687 U.S. firms with 50 or more lawyers. 208 firms responded, including 32% of the 250 largest. *Id.* It asked firms which changes in the economic environment they perceived as temporary, and which permanent. The top four areas of permanent change identified were greater price competition, a longer partnership track, more contract lawyers and more non-hourly billing. The top four changes identified as temporary were reduced first-year classes, reduced associate salaries, lower profits per partner and reduced leverage. *Id.* These respondents thus expected a return to the established pattern of expanding associate ranks and rising salaries as the economy recovered. Significantly, the largest law firms (over 500 lawyers) differed from the overall group on leverage, with about 40 percent of those firms perceiving leverage reductions as a permanent change in the landscape. *Id.* Meanwhile, while some consultants tend to see more basic changes coming (Anne Urda, *Law Firm Model Headed for Overhaul: Experts*, Sept. 21, 2009, <http://www.law360.com/articles/113689>), opinion is divided (Gina Passarella, *Law Firm Model Isn’t Broken After All, Consultant Says*. LEG. INTELLIGENCER, Dec. 18, 2009, http://www.law.com/jsp/law/careercenter/lawArticleCareerCenter.jsp?id=1202436666765&Law_Firm_Model_Isnt_Broken_After_All_Consultant_Says).

¹²⁵In the interests of concision, we will inevitably oversimplify. We apologize to the authors and our readers in advance.

demand held constant, we think a significant part of the explanation for firm growth is simply that the country and the world (or at least parts of them) have gotten a lot richer over the last 40 years, and that much of the increase in wealth involves the manipulation of intangibles (such as intellectual property rights, and the property interests represented by securities), and the regulation of such manipulation, both of which created steadily increasing demand for complex, specialized, high-margin legal services. Moreover, as general counsel have progressively moved more routine and repeat-play work in-house, the docket of outside corporate counsel has become increasingly weighted toward more complicated, sizeable and unusual transactions and disputes, and the number and magnitude of such matters that companies face has grown significantly during the same time.¹²⁶ Demand for high-end legal services thus has not only generally increased, but has shifted toward the more specialized and labor-intensive side of the scale.

That said, demand is only the beginning of the discussion. Increasing overall demand will, all other things being equal, call for more supply—that is, more lawyers in this sector of the Bar. But sheer demand alone will not dictate whether those lawyers aggregate in fewer larger firms or more numerous smaller ones. All other things being equal, there are economies of scale available to the elite law firm, but these economies appear to exhaust themselves at sizes that are both relatively modest, and smaller than most firms in this practice sector today (or for that matter a generation ago).¹²⁷ And, all other things being equal, there are well-recognized *diseconomies* of scale, such as conflicts of interest, and the costs and frictions of managing and coordinating firm functions, which increase in number and complexity as a firm becomes larger and more far-flung, that should tend to slow or discourage growth beyond a scale most elite firms long ago exceeded. Nor will overall demand alone tell us how those firms come to be configured, for example how the incidents of ownership and control (such as management authority, shares of the profits, and the paths of advancement to both) are distributed. As we noted at the outset, prior efforts to address these essential questions have proved surprisingly ineffective. In the pages that follow, we explore those efforts and their shortcomings.

A. *The Centrality of “Human Capital” (Gilson & Mnookin).*

The touchstone economic analysis of the professional firm is Ronald Gilson’s and Robert Mnookin’s 1985 exploration of “Sharing Among the Human Capitalists,” and their follow-on

¹²⁶See JOHN P. HEINZ ET AL., *URBAN LAWYERS: THE NEW STRUCTURE OF THE BAR* 287 (2005); John P. Heinz, Robert L. Nelson & Edward O. Laumann, *The Scales of Justice: Observations on the Transformation of Urban Law Practice*, 27 *ANNUAL REV. SOCIOLOGY* 337, 342 (2001); Randall S. Thomas, Stewart J. Schwab & Robert G. Hansen, *Megafirms*, 80 *N.C. L. REV.* 115, 136-52 (2001); Nelson, *Explaining Growth* at 747-49. Galanter and Palay acknowledge that “changing scale and complexity” of large-firm legal work is a “plausible” explanation for law-firm growth but (in 1991) “little more than pure surmise” based on “speculative ruminations in the press and in the corridors of law firms and law schools.” Galanter & Palay, *Tournament* at 113. Thomas, Schwab and Hansen document in the mergers and acquisition context something inescapable to any casual observer: the lawsuits and the deals keep getting bigger and more numerous over time. In Part IV.B, *infra*, we suggest that one reason for these increases is the increasingly larger body of durable information relevant to most disputes and transactions that has been created by the digital communications revolution.

¹²⁷See Sander & Williams, *Theorizing* at 393-94 (surveying commentary)

work on associate career patterns in large law firms.¹²⁸ It is pathbreaking work: the first to recognize the economics of elite law firms as a subject worthy of study and to apply rigorous economic scrutiny; the first to focus on isolating relevant variables and examining them in a context in which analysis can be tested empirically; and the first to explore the implications of the fundamental insight, which grounds most later work in the area, that a law firm’s principal assets get up and go home at the end of every day. Gilson and Mnookin thus begin their examination with the “recognition” that an individual’s ability to earn a living as a lawyer is “human capital”; the “lawyer’s earnings thus represent the return on his investment in human capital.”¹²⁹ And they portray the economics of law firms as driven primarily by the desire of the firm and its professional constituents to exploit their “human capital” to its best (that is, most profitable) advantage, which in turn creates the need to manage agency costs and opportunistic behavior that could impair that effort for one constituency or another.¹³⁰

B. The Role Of Human Capital In The Economic Relations Among Law-Firm Partners.

Gilson and Mnookin begin with the important question why law firms exist at all.¹³¹ By considering the ability to practice law a “capital asset,” they call into play economic principles bearing on the optimum strategies to exploit such assets, principally portfolio theory.¹³²

1. The Theoretical Primacy Of Diversification.

This leads to their argument that diversification is a critical force in the binding lawyers to a firm, and organizing the firm’s production of legal services.¹³³ Because it is difficult to diversify the risks specific to one individual professional’s life and practice alone, they theorize, lawyers band together in firms so that each individual’s personal risks (such as a less productive period owing to personal upheaval or illness) and practice risks (such as specialization in a practice area that waxes and wanes with the cycles of the economy) can be diversified across

¹²⁸Ronald J. Gilson & Robert H. Mnookin, *Sharing Among the Human Capitalists: An Economic Inquiry into the Corporate Law Firm and How Partners Split Profits*, 37 STAN. L. REV. 313, 357-60 (1985) [hereinafter Gilson & Mnookin, Profit Sharing]; Ronald J. Gilson & Robert H. Mnookin, *Coming of Age in a Corporate Law Firm: The Economics of Associate Career Patterns*, 41 STAN. L. REV. 567 (1989) [hereinafter Gilson & Mnookin, Associate Careers]

¹²⁹Gilson & Mnookin, Profit Sharing at 324.

¹³⁰This model focuses almost entirely on the interactions among lawyers—specifically, relations among owners (partners), and relations between partners and associates. Nonattorney staff are essentially ignored—principally, it would appear, because they have little active role in the dynamics on which the authors focus (or at least not until relatively recently; see Part IV.C.1, *infra*).

¹³¹Gilson & Mnookin, Profit-Sharing at 324.

¹³²*Id.*

¹³³Portfolio theory shows that capital assets produce optimum long-run returns, and thus are of greater value, as part of a properly diversified portfolio. That is because diversification can eliminate the risk specific to a particular asset (“unsystematic risk”) by balancing it out with the risks and benefits of other assets in the portfolio, leaving only the unavoidable “systematic” risk in the economy as a whole to which all assets are collectively subject. See *id.* at 322-24.

numerous personnel and complementary practice and industry specialties in order to optimize the returns to the group's human capital as a whole.¹³⁴

As Gilson & Mnookin point out, the benefits of diversification can accrue to those contributing their human capital to the joint enterprise—that is, to the partners in the firm—only if they consistently divide the collective returns on their human capital in equal shares.¹³⁵ Otherwise, there is no diversification: The “winners” and “losers” in any given year don't balance out the risks and benefits they agreed to share *ex ante*, and the firm is effectively reduced to an aggregation of nondiversified solo practitioners, each still bearing at the very least a large fraction of the specific risks of their own individual lives and practices.¹³⁶

Gilson and Mnookin recognized that the sharing necessary to achieve diversification creates risks of opportunistic behaviors. These behaviors include partners' not doing their fair share of the work while receiving an equal share of the profits (“shirking”); or subverting equal sharing by demanding a greater-than-equal share of the profits on the basis of their greater immediate contribution or value (“grabbing”), or by withdrawing their human capital (*i.e.*, their future services and ability to attract future demand) and taking it to another firm that rewards it more handsomely (“leaving”).¹³⁷ Gilson & Mnookin see many features common among large law firms as “organizational forms that provide self-enforcement of the [hypothetical *ex ante*] sharing bargain” necessary to achieve the benefits of diversification.¹³⁸

The “most significant constraint” on “grabbing” and “leaving,” Gilson and Mnookin believe, is “firm-specific capital”—that is, human capital that is more valuable deployed within the law firm than it would be elsewhere.¹³⁹ In simplest terms, grabbing and leaving work only if opportunistic partners can withdraw their human capital from the firm and make more money on it elsewhere.¹⁴⁰ If they can't, leaving would be self-defeating, and threatening to leave in an

¹³⁴*Id.* at 324-29.

¹³⁵To the extent that law partners share profits in anything resembling this fashion, of course, they do so according to a “lockstep” seniority system (analogous to, but motivated by different organizational needs than, the “lockstep” associate compensation discussed in note 111, *supra*, and accompanying text, by which associates of equal seniority are paid the same regardless of relative achievement or “merit”). A “lockstep” system allocates progressively greater proportions of the profits to more senior classes of partners. *See id.* at 341-42. Gilson & Mnookin suggest that the seniority-based differentials between lockstep classes are another organizational tool to avoid opportunistic behavior, and are consistent with a diversification strategy. *See id.* at 343-45.

¹³⁶*Id.* at 331.

¹³⁷*Id.* at 336-38.

¹³⁸*Id.* at 339.

¹³⁹*Id.* at 354.

¹⁴⁰*Id.* Applying ordinary market-valuation principles, they posit that “the value of firm-specific capital is the capitalized value of the difference between a firm's earnings as an ongoing institution and the combined value of the human capital of its individual partners, if this human capital were deployed outside the firm in its next most productive use.” *Id.*

effort to grab will not be credible, and thus unlikely to succeed.¹⁴¹ Examples of firm-specific capital include a firm's stable relationship with a client (to the extent that individual partners could not take that relationship with them to another firm);¹⁴² the development and possession of "client-specific information" regarding the client's business, service preferences and practices that would be costly to duplicate elsewhere;¹⁴³ and the firm's general brand-name reputation for quality.¹⁴⁴

Because firm-specific capital constrains grabbing and leaving, "the absence of firm-specific capital contributes to instability," especially in a firm inclined to equal sharing of profits among partners.¹⁴⁵ Gilson and Mnookin's 1985 article presciently predicts that "[i]t will become increasingly difficult both to build and to sustain firm-specific capital in the future because of the increased sophistication of purchasers of legal services."¹⁴⁶

2. The Diversification Theory's Failure To Withstand The Test Of Experience.

Notwithstanding the theoretical elegance of Gilson's and Mnookin's thesis, the available historical and empirical evidence suggests that diversification (in the sense familiar from portfolio theory) plays little or no actual role in the structure and organization of large law firms. While law firms may diversify across clients in select lines of business, there is little evidence that firms tend to diversify significantly across lines of business, possibly because they tend primarily to pursue the highest attainable margins.

Few actual instances of the lockstep compensation needed to achieve the benefits of financial diversification. If returns to diversification were high, we would expect to see widespread use of the lockstep compensation necessary to achieve them, both historically and currently. Neither appears to have occurred.

¹⁴¹*Id.* at 355-56. This analysis does not expressly take into account the many nonmonetary benefits of partnership, such as pride in affiliation with a prestigious institution, power (respect of colleagues and subordinates, and influence over policy, personnel or resources, for their own sake, rather than as a means to enhance the value of the powerful partner's practice revenues), congenial colleagues, or a shared vision of the firm's future or place in society. But it doesn't pretend to be more than an *economic* model, and in a for-profit firm economics obviously matter. *See id.* at 376 (noneconomic concerns such as the socializing forces of "firm culture" are important to law firm organization and governance even though they cannot be explained in neoclassical economic terms)..

¹⁴²*Id.* at 357-58.

¹⁴³*Id.* at 358-60.

¹⁴⁴*Id.* at 360-68. This species of firm-specific capital depends to a significant degree on the reputational value's attaching to the firm as a whole rather than to particular lawyers. *Id.* at 362, 365, 369. It also depends on the difficulty of determining quality both *ex ante* and *ex post* the delivery of the services, and the agency costs of refining that uncertainty about quality (which in turn depend on the sophistication of the buyer-client). *Id.* at 360-63.

¹⁴⁵*Id.* at 381.

¹⁴⁶*Id.* at 381, 384-86.

Gilson and Mnookin simply assumed in 1985 that lockstep compensation then was, or until recently had been, pervasive among elite law firms, particularly the most successful ones.¹⁴⁷ Indeed, the authors' question why lockstep compensation was purportedly so widespread was what prompted them to undertake the analysis that portrays the economic value of diversification as "crucial to understanding why law firms exist at all and why they take their familiar form."¹⁴⁸ But sociological and historical studies indicate that if lockstep partner compensation had ever been widespread, by 1960 it was typical for partners in elite firms instead to divide profits based in significant part on recent individual contribution, a practice the literature generally refers to as "marginal product" compensation.¹⁴⁹

¹⁴⁷See Gilson & Mnookin, *Profit Sharing* at 315 (positing a "[t]radition[]" of "seniority-based division of partnership income" without citation), 319 ("large, well-established firms . . . were generally assumed to divide the pie by some sort of seniority-based system where a partner's share was largely determined by how long he had been a partner"; no evidence other than reference to two specific firms); 341 ("Many established corporate law firms traditionally have divided profits on the basis of a seniority system"; no evidence beyond reference to two specific firms), 353 n.63 (criticizing another article for assuming a productivity-based profit division formula at most firms "because no underlying data are disclosed"; then asserting—without disclosing any underlying data—that "[a]s a historical matter, we believe the assertion to be substantially inaccurate, and even today, as our discussion indicates, to be a seriously incomplete description of how many large and successful partnerships divide profits"). See also Gilson & Mnookin, *Associate Careers* at 567 (positing a "long standing reliance on [profit division based on] seniority that emphasizes risk-sharing"; no evidence), 571-72 ("Until recently, [profit division] in many firms took the form of what we have called a sharing model in which the profits were divided based on a lock-step seniority system without regard to the actual productivity of any particular partner"; citing only their *Profit Sharing* article (which contains no empirical data)), 572 ("during the bulk of the period in which the modern corporate law firm has existed, firms have followed a sharing model of dividing their profits"; no citation).

¹⁴⁸*Id.* at 324; see also *id.* at 321 ("How a firm divides profits . . . reflects the extent to which it has captured the gains from diversification . . ."), 327 ("facilitating specialization" is another way law firms "provide . . . an opportunity to diversify"), 329 (a full-service law firm sharing profits "on a predetermined basis rather than in accordance with actual outcomes" is "an institutional innovation that allows lawyers to take advantage of gains from diversification"), 331 (the law firm is "a means of capturing the gains from diversification"), 347 ("The absence of income sharing, however, does mean that the arrangement involves no element of diversification of human capital").

¹⁴⁹Galanter & Palay, *Tournament* at 30-32 and authorities cited, including Spencer Klaw, *The Wall Street Lawyers*, 57 FORTUNE 140, 198 (1958) (mentioning one "equal shares" firm, but observing that generally a partner made "a good deal more" if he "consistently attracts important new clients"); Martin Mayer, *The Wall Street Lawyers Part II: Keepers of the Business Conscience*, 212 (1269) HARPER'S MAGAZINE 50, 51 (1956) (suggesting partner compensation at most firms was then proportional to the revenues for which the partner was responsible); ROGER SIDDALL, A SURVEY OF LARGE LAW FIRMS IN THE UNITED STATES 43, 48 (1956) (noting a wide variety of compensation schemes among 42 firms surveyed, though not specifying how many of them were seniority-based). The available evidence is concededly limited. Until *Bates v. Arizona* ushered in the specialty legal press in the late 1970s (see note 20, *supra*), elite firm partners were exceptionally reticent about their compensation and finances—backed up by then-prevailing ethical standards suggesting that public discussion of firm finances could amount to prohibited lawyer advertising. Galanter & Palay, *Tournament* at 20-21, 30-31, 69-70; Smigel, *supra* note 8, at 18 (compensation a "taboo topic"), 92 ("The subject of percentages and salaries is particularly 'hush,

The authors also incorrectly predicted in 1985 that “ten years from now, a number of the most successful firms will still have seniority based systems” because of the advantages they believed that practice diversification provides.¹⁵⁰ But an *American Lawyer* survey of the 100 largest U.S. law firms by revenue ten years later showed that only four out of 70 respondents characterized their partner compensation systems as lockstep.¹⁵¹ Thus, although a small number of successful firms still employ lockstep today, the overwhelming majority don’t, and probably didn’t even in 1985.¹⁵²

No empirical evidence of any financial benefits from diversification. Although Gilson and Mnookin insist that substantial economic returns accrue to diversification, no one has ever managed to measure these returns, or establish empirically that they even exist. In fact, available empirical evidence pointedly suggests that returns to diversification are simply not significant in large law firms’ organization or finances.

For example, no one has ever shown that any effort at diversification in building a large law firm actually raises the value of the firm’s “portfolio” of human capital as Gilson & Mnookin predict.¹⁵³ A leading sociologist of elite law firm culture found no evidence that diversification was a management objective in such firms.¹⁵⁴ Nor has any empirical evidence emerged that any particular diversification strategy (conscious or not) consistently produces recognizable financial advantages.¹⁵⁵

hush”); Hoffman, *supra* note 70, at 58 (“On no subject is the blue chip bar more secretive”). Galanter and Palay note trenchantly that “[t]he persistent reports about the secrecy of these matters . . . suggest that there was more to keep secret than an ‘equal shares’ formula.” Galanter & Palay, *Tournament* at 31 n.86.

¹⁵⁰Gilson & Mnookin, *Profit Sharing* at 386.

¹⁵¹*Part I: The Meaning of Partnership in 1996*, in Supplement, Partnership Retreat Notebook, AM. LAW., June 1996, at 8.

¹⁵²Gilson & Mnookin make clear that the advantages of diversification can be achieved only if the opportunistic behaviors that may attend lockstep compensation are overcome with appropriate organizational protections. Gilson & Mnookin, *Profit Sharing* at 352-53. But nothing unique about the organization or management of the few remaining successful lockstep firms is immediately apparent. As discussed below, some degree of equal sharing is likely built into many predominantly marginal-product compensation systems. But this limited sharing appears to serve goals other than the financial diversification Gilson and Mnookin make their centerpiece. See notes 167-168, *infra*, and accompanying text.

¹⁵³The authors provide one hypothetical example of how complementary practices (securities and bankruptcy) in a firm might balance each other’s risks over time. But the numbers in the hypothetical are invented to illustrate how the theory *could* work, and the authors concede it “may not be accurate.” Gilson & Mnookin, *Profit Sharing* at 327-28 & n.27.

¹⁵⁴Nelson, *supra* note 37, at 64-66 (extensive interviews with many partners at four large Chicago firms showed no significant interest in diversification as a goal of growth).

¹⁵⁵For a study finding no empirical support for a financial diversification explanation of law-firm organization, see Luis Garicano & Thomas M. Hubbard, *Specialization, Firms, and Markets: The Division of Labor Within and Between Law Firms*, 25 J. LAW ECON. & ORG. 339 (2009). Garicano and

In fact, recent empirical studies suggest that the more successful large law firms, rather than diversify, have tended to *concentrate* their practices in areas that support more substantial and fee-insensitive matters.¹⁵⁶ A recent empirical study of partner mobility found that “upstream” lateral movement—that is, movement from a less to a more profitable firm—was more likely in several practice areas characterized by the substantial and price-inelastic engagements they were capable of generating, many of which were focused around securities and capital markets (securities, M&A, private equity, high-end white-collar criminal defense, antitrust, intellectual property). By contrast, partners concentrating in lower-margin practices (real estate, trusts and estates, labor and employment) tended to lateral “downstream” to less profitable firms.¹⁵⁷

Hubbard do find support for an information-sharing explanation of firm boundaries, which is consistent with the referral network explanation we suggest in Part III.

¹⁵⁶Number of offices—the principal means by which a firm would diversify geographically—has been shown to correlate with *lower* profitability, suggesting at a minimum that this diversification strategy (if that is what it is) is not cost-effective. Henderson, *Single vs. Two-Tier Partnerships* at 1735 n.163. The commonly articulated justification for geographic expansion is a scale or scope argument—that a national or international footprint is imperative to compete for certain large, geographically dispersed projects of national or multinational businesses, such as the acquisition or divestiture of a business unit with assets located in multiple jurisdictions. See Galanter & Henderson, *Elastic Tournament* at 117, 122 (suggesting various motivations for geographic expansion). Similarly, size in and of itself does not appear to be a meaningful diversification strategy either. Although profitability undoubtedly depends on many different factors, William Henderson’s recent empirical study of partnership structure in the largest U.S. firms found no correlation between firm size (which could be a means of diversifying against risk of personal stumbles) and profits per partner. *Id.* Studies from the 1990s were mixed on the correlation between firm size and profitability. See Kyle Chadwick & Ramsey Hanna, *Predicting Profitability*, AM. LAW. July-Aug. 1994 at 63 (size correlated with profits); David. H. Maister, *Where Profits Come From*, AM. LAW., Sept. 1993, at 1993 (size “zero factor” in profits); S.S. Samuelson & L.J. Jaffe, *A Statistical Analysis of Law Firm Profitability*, 70 B.U. L. REV. 185 (1990) (size correlated). However, the two studies finding size correlated with profitability did not control for prestige, which Henderson’s study shows is the most powerful predictor of profitability. Henderson, *Single vs. Two-Tier Partnerships* at 1696.

Henderson also conjectures that because lockstep profit division is not feasible except in a single-tier partnership, a single-tier structure should be more closely associated with a sharing model. *Id.* at 1703. We doubt both the premise and the conclusion. There are almost no large lockstep firms left (see note 151, *infra*, and accompanying text), and thus most larger single-tier partnerships—the great majority—apparently divide profits on some marginal product basis rather than in lockstep. More importantly, Henderson’s analysis concludes that single-tier partnerships are highly correlated with prestige. And “[w]ithout controlling for prestige,” Henderson points out, “which presumably generates higher and more inelastic demand for a firm’s services, a researcher might incorrectly conclude that the single-tier structure (which highly correlates with prestige) is a primary determinant of law firm profitability.” *Id.* at 1696 n.24.

¹⁵⁷Galanter & Henderson, *Elastic Tournament* at 135-38. Theoretically, there could be countercyclical and complementary “hedging” elements hidden in the more limited range of subject areas in which the most profitable firms have tended to concentrate, but they are not immediately obvious. The more intuitive diversification strategy would be for a firm to hedge its bets by spreading out over multiple disparate areas of practice. Labor and employment, for example, tends to become more active during

Similarly, Gilson and Mnookin predicted that “boutique law firms—those that specialize in a single area—will not represent the wave of the future.”¹⁵⁸ They believed that the lack of diversification would prove a significant competitive disadvantage, and that “[a]s a result, one would expect that the unit price diversified firms charge for any specialty would be lower than that charged by undiversified—boutique—firms.”¹⁵⁹ But boutique firms in a range of specialties, from labor to bankruptcy to land use to various kinds of intellectual property work, have survived and thrived over the years since this prediction, and have enjoyed a new resurgence during the current recession.¹⁶⁰ And by and large their success has been predicated on their ability to provide quality services, less encumbered by multiple offices and other big-ticket infrastructure, at a *lower* price than the large general-practice firms, rather than the converse as diversification enthusiasts theorized.¹⁶¹

It is, of course, possible that the erosion of “firm-specific capital” because of changes in the marketplace (most particularly the increasing sophistication of general counsel and other players on the buy side) has gradually made lockstep, and therefore any significant benefits from diversification, unachievable for most firms.¹⁶² But the evidence seems to indicate that portfolio-style diversification has not been a significant factor for any firm for quite some time, if ever.¹⁶³

economic downswings, when reductions in force, pay and benefits create more issues and disputes than in good times. But employment (characteristically a lower-margin regime focused more on spot counseling and smaller disputes) is a practice whose specialists have tended to lateral “downstream” to less profitable firms since 2000. *Id.* And the lateral movement of specialists in bankruptcy, the classic countercyclical practice that Gilson and Mnookin use in their hypothetical example of practice diversification (*see* note 152, *supra*), shows no correlation with greater or lesser profitability of the hiring firm. *Id.* In the longer term, partners can probably diversify more effectively by investing excess income elsewhere rather than manipulating their law firms’ staffing structure or practice mix.

¹⁵⁸Gilson & Mnookin, Profit Sharing at 386.

¹⁵⁹*Id.* at 324 n.36

¹⁶⁰*See* notes 119-120, *supra*, and accompanying text; Sander & Williams, Theorizing at 396 (noting in 1992 the continuing viability of boutique firms).

¹⁶¹*Id.* It could be argued that larger non-boutique firms are enjoying the advantages of diversification by charging as much as or more than the boutiques, and achieving greater profits. But as demand fell during the recession, larger firms shed personnel rather than reducing rates, and allowed boutiques to compete with them successfully on price, suggesting that the financial advantages of diversification were not available to them as theorized. *See* notes 98-101, 119-120, *supra*, and accompanying text. And as discussed above, the available empirical evidence suggests that the most successful partners are moving “upstream” to *less* diversified firms.

¹⁶²*See* Gilson & Mnookin, Profit Sharing at 384-86, 387.

¹⁶³We briefly note one other anomaly in the article’s analysis. The authors rely on conventional principles of market information theory to postulate that

the methods that firms use to demonstrate the quality of their services should vary substantially depending upon the level of sophistication of the prospective client. Where firms are attempting to attract relatively unsophisticated potential clients, we would expect their quality assurance efforts to take the form of signaling: investments in assets—such as public relations efforts, direct advertising or fancy offices—that lose their value were the

3. *Weaker Notions Of Diversification That May Be Relevant To Firm Growth Or Structure.*

While the comprehensive risk-hedging of portfolio theory does not appear to have had any material role in law-firm growth or structure, there are weaker notions of diversification that may have some relevance to firm size. For example, even firms that concentrate in a given high-margin field or cluster of fields would prefer not to tie their fortunes to a single client, which might disappear through acquisition or mismanagement, or gain undesirable leverage over the firm if it represented too great a fraction of the firm's revenue.

Some degree of scale within firms should help lessen dependence on particular clients and (in this milder sense) "diversify" the firm's revenues among companies even if not among market segments, which is the sense more familiar from finance theory. However, the firm size necessary to achieve this weaker form of diversification would not appear to come anywhere close to the size of any large elite law firm at any time over the last 40 years. This strategy's ability to explain observed law-firm growth or structure thus is very limited.

Similarly, as Gilson and Mnookin themselves point out, full-on lockstep compensation is not required to achieve some degree of diversification: Any aspect of a compensation system that does not strictly tie each partner's compensation to the unique marginal value of his or her individual contributions over the period for which compensation is determined shares some risks and benefits more generally among the partners. To that limited extent, the system allows some benefits of whatever diversification in personnel and practice mix the firm has achieved to filter through.¹⁶⁴ Although elite firms overwhelmingly employ predominantly marginal-product compensation systems, our anecdotal understanding is that very few attempt to measure and reward each partner's annual contributions in a vacuum completely separate from prior years' performance or other factors. For example, most predominantly marginal product compensation systems in the real world are, to a greater or lesser degree, "sticky" over time.¹⁶⁵ That is, when a particular partner's marginal product has gone up or down significantly compared with the prior year's, her compensation under the system will often rise or fall less (and thus over time more slowly) than the year-over-year change alone would otherwise dictate. This smoothing effect will tend to distribute over the partnership as a whole some of the excess risk or benefit that may disproportionately befall particular partners in particular years (which may include the line-

firm subsequently to render low quality services." . . . "The posited relationship between client sophistication and the value of advertising by lawyers since its legalization appears to be by lawyers rendering essentially consumer services—divorce, personal injury, personal bankruptcy, or immigration. By way of contrast, firms seeking to serve significant commercial clients do virtually no advertising at all.

Id. at 363 & n.85. Surely the explosion of elite law-firm spending in the intervening 25 years on "public relations efforts, direct advertising [and] fancy offices" reflects no parallel expansion of client ignorance; to the contrary, everyone agrees that client sophistication has risen to great and unprecedented heights during that time. The source of this large and growing investment in marketing on the sell side thus remains a puzzle

¹⁶⁴Gilson & Mnookin, *Profit Sharing* at 348.

¹⁶⁵Remarks of William Perlstein, managing partner of WilmerHale LLP, at the Georgetown Law Center for the Study of the Legal Profession Conference on Law Firm Evolution, March 22, 2010.

drawing fortuities that can result because of the need to measure performance as of a particular reference date, when critical events may have occurred soon before or after).¹⁶⁶

More generally, if lawyers are risk-averse, they may accept something less than their true marginal product in exchange for a hedge against income reduction—in essence buying a limited form of income insurance from their partners with part of their marginal product.¹⁶⁷ This is particularly true because compensation systems are not one-round games. They work (or fail) over time, and risk-averse lawyers might rationally prefer some degree of revenue smoothing, in which cuts in their income lag reductions in their productivity and gains lag increases, rather than absolutely strict, annual “what have you done for us lately” compensation. This smoothing effect need not—and, in the absence of a comprehensively hedged personnel and practice mix not apparent at any elite firm, does not—reflect diversification in the strict sense of finance theory, nor does it create the financial benefits such diversification might theoretically achieve. But it may be valuable to the lawyers participating in the system, and certainly requires some degree of scale to be put into practice. In fact, the strategy ought to work particularly well as part of a referral network, which we advance in Part III below as an explanation of firm growth and cohesion.¹⁶⁸

Once again, the scale necessary to achieve the benefits of this weaker form of diversification should be modest compared to the sizes and structures we actually see, so its value in explaining them is again quite limited. And whatever value such weaker versions of diversification may provide does not necessarily imply that the firms that employ them are particularly robust. A firm that offers an income floor and revenue smoothing at higher income levels than its competitors will be in a good position to cherry-pick high producers from those competitors. Firms that do well at such competition will form virtuous feedback cycles in which

¹⁶⁶This smoothing can be achieved by (among other strategies) averaging particular productivity measures over a number of years, setting maximum or minimum partner compensation levels irrespective of extraordinarily high or low productivity in any given year, or setting maximum amounts by which compensation share may rise or fall year-over-year. The governors may be asymmetrical (for example, allowing compensation share to rise faster than it is allowed to fall in order to avoid the departure of rising stars). The mechanism doesn't matter for these purposes; any such device will have the limited diversification-capturing effect described in the text to a degree dependent on the nature and extent of the non-systemic risks that effectively become shared as a result.

¹⁶⁷For example, suppose partner A's book of business implies compensation of \$10 and partner B's book implies compensation of \$7 (and that A and B are otherwise similarly situated). Suppose also that A is risk-averse. It is not irrational for A and B to agree to a compensation system in which A receives \$9.50 and B receives \$7.50 in exchange for B's promise to accept \$5 so that A may receive \$9 if A has a bad year (revenues implying marginal product compensation of \$7) and B has an average one (\$7 again). Obviously such deals are harder to hold in place over time the larger the income gap, or the differential income variability, between B and A, or a class of Bs and a class of As.

¹⁶⁸As discussed below, an internal referral network implies firms composed of lawyers with complementary, related capabilities, to whom referrals are plausible, rather than different and unrelated capabilities, which would tend to increase financial diversification. Available empirical evidence suggests that large law firms are, and are becoming, more like the former than the latter. See notes 214-215, *infra*, and accompanying text. This suggests another reason why true financial diversification is neither a goal nor an effect of firm growth in the real world.

their partners do consistently better than their peers. Firms that do poorly in such competition will form vicious feedback cycles, which may threaten the viability of the firm.

C. The Role Of Human Capital In The Economic Relations Between Partners And Associates.

1. Mutual Uncertainty And The “Up Or Out” Rule.

Turning to the relations between partner and nonpartner attorneys within a firm, Gilson and Mnookin ask why the “up or out” model of associate advancement had become so widespread in elite law firms, and why at the time of publication (1989) it was becoming less so.¹⁶⁹ They point out that firing all associates who fail to make partner is facially counterintuitive for both employer and employee: The firm loses its investment in years of training and socializing its candidates, at least some of whom have proved to be able and congenial professionals, as well as any firm-specific capital created by the associate’s acquired knowledge of and relations with existing clients and familiarity with the firm’s manner and style of practice.¹⁷⁰ On the employee side, some associates would be perfectly happy to stay on at the firm despite not making partner, and in departing will lose the value of any firm-specific capital they acquired during their years of apprenticeship, which they will have to recreate with time and effort somewhere else.¹⁷¹

Again the authors find an explanation in the dynamics of human capital. They point out that, at the time of hiring, the firm does not know which of the many new associates in the entering class will prove to have the skills and the desire to become partners seven to ten years hence. The associates spend that time working to gain skills and prove themselves. But some may walk out early, taking their training and possibly some of the firm’s clients with them. For their part, the associates need assurance that, at the end of the tryout period, those qualified will in fact be promoted. For the partners have an incentive simply to continue paying the senior associates a salary, and to appropriate the benefits of their training while keeping the firm’s profits undiluted by promoting as few partners as possible. To the extent senior associates have acquired firm-specific capital, they are more valuable at the firm than elsewhere, and can be offered a portion of that incremental value (but less than a full partner’s profit share) to stay at the firm as permanent associates (or nonequity partners). If the firm chooses this opportunistic approach, many of its senior associates will have to choose between taking the half-loaf the firm offers, or losing the extra value of the firm-specific capital they have invested years to acquire, and making less at a new and unfamiliar job—which they will have to find in the devalued state of having failed to make partner at their current firm.¹⁷²

In this context, Gilson & Mnookin characterize the up-or-out rule as a “bonding device”—an organizational structure “that will assure associates at the time they are hired that the firm will

¹⁶⁹Gilson & Mnookin, Associate Careers at 567-68.

¹⁷⁰*Id.* at 572-75.

¹⁷¹*Id.* at 575.

¹⁷²*Id.* at 576-78.

treat them fairly at the time they are considered for partnership.”¹⁷³ A bonding device is needed because the intangible characteristics assessed in partnership decisions and the lack of complete information shared with associates make it inherently difficult for them to determine whether their peers are being fairly evaluated.¹⁷⁴ When a firm requires itself either to promote senior associates or to place them out, the authors reason, it prevents itself from profiting opportunistically by keeping partnership-quality associates on at a salary. The policy thus stands as a guarantee to the associates of the firm’s *bona fides* in its partnership decisions.¹⁷⁵

2. *The Promotion-To-Partner Tournament (Galanter & Palay).*

Relying on empirical data regarding law-firm growth, Marc Galanter and Thomas Palay offer a significant refinement: Focusing on the economic relations between the firm and its associates, they agree that the parties’ mutual uncertainty at the inception of their relationship regarding the eventual value and use of their human capital (the firm’s uncertainty as to which associates will prove worthy of promotion and allow the firm to profit from its investment in the associates; the associates’ uncertainty that the worthy will in fact be promoted) drives these issues.¹⁷⁶

Rather than relying on an up-or-out policy as the principal mechanism bonding the firm’s good faith in its promotion decisions, however, Galanter and Palay conclude that the firm shows its good faith to each class of associates by conducting a rank-order promotion-to-partner “tournament”—that is, it consistently promotes the same *percentage* of an associate class, choosing them in rank order of quality relative to one another rather than some absolute standard.¹⁷⁷ This tactic allows those considering entering or coming up through the system to appreciate that they have a definable chance of success despite the lack of information concerning the candidates that precede them and the difficulty of discerning the intangible qualities essential to a partner’s success.¹⁷⁸

Galanter and Palay reasoned that, for this bonding strategy to work and allow firms to attract the quality personnel they need to service their clients and provide for succession, they

¹⁷³*Id.* at 578.

¹⁷⁴*Id.* at 587.

¹⁷⁵*Id.* at 578-81. The authors suggest that firms soften the risk of nonpromotion by devoting resources to outplacement for their unsuccessful candidates. *Id.* at 582-83. Where outplacement is less available (for example outside New York City, where the authors assume there are fewer high-quality alternatives to firm service) they suggest that firms adjust the associate risk calculus by making more partners. *Id.* at 584-86.

¹⁷⁶Galanter & Palay, *Tournament* at 89-110.

¹⁷⁷*Id.* at 100-108.

¹⁷⁸*Id.* It also raises issues well illustrated in a timeworn joke, which we reproduce here for those less timeworn than we: Two hikers are confronted by an angry bear. One turns to the other and says “Let’s run for it.” The other hiker responds, “Are you crazy? We can’t outrun a bear.” The first replies, “I don’t have to outrun the bear. I just have to outrun you.”

had to maintain the show of good faith the tournament represented year after year.¹⁷⁹ This need, they believe, created an institutional “imperative” for exponential growth (the same percentage of larger and larger classes of associates being promoted year after year) that drove the explosive expansion of large law firms in the 1980s and, they predicted in 1991, beyond.¹⁸⁰

3. *The Tournament Theory’s Lack Of Engagement With The Basic Economic Forces Surrounding It, And Lack of Empirical Support As Anything More Than A Metaphor, Particularly After 1990.*

Though the focus on the dynamics of promotion and tenure and their effects on the overall structure of the firm have grounded a great deal of scholarship in the area since, there is much about tournament theory that is doubtful. Specifically, tournament theory is peculiarly disengaged from the basic market forces surrounding it; it enjoys empirical support that is equivocal at best for the period up to 1990; and it is inconsistent with the empirical evidence of firms’ practices since 1990.

Lack of engagement with demand for or cost of high-end legal services. Fundamentally, *Tournament of Lawyers’* theory that the organizational expedient of a rank-order tournament became a primal force driving law-firm growth puts the cart before the horse. The tournament model simply presumes that growth, without more, perpetuates itself—firms need to keep adding associates to maintain the leverage that makes winning the tournament profitable enough to induce new lawyers to throw their hats into the ring notwithstanding long odds of winning.

But this explanation is detached from the demand and cost factors that necessarily nourish and limit growth. The most—and probably the only—economically rational explanation for the increased hiring of the last 40 years is increased demand for large law firms’ services: Does anyone seriously believe that law-firm management would indiscriminately hire exponentially increasing numbers of associates to show their *bona fides* to their employees and recruits that they would continue to do so in the future if they did not anticipate having enough work for all of them to do?¹⁸¹ And though studies differ on whether average associate hours across large law firms stayed roughly the same or increased up until the Great Recession, no one doubts that most associates at most firms remained fully occupied, even as their numbers increased

¹⁷⁹Gilson & Mnookin had considered rank-order tournaments as a possible bonding mechanism. They rejected its utility in the large law-firm context because the partnership decision depends not only on the candidates’ qualities, but on predictions regarding the firm’s future success, which the firm may opportunistically misrepresent just as it may misrepresent its evaluations of partnership candidates: “A firm may falsely represent [at the time of a partnership decision] that its needs, for partners generally or within a particular specialty, have changed since the firm made its representation concerning the percentage of associates who would become partners.” Gilson & Mnookin, *Associate Careers* at 580 n.38.

¹⁸⁰Galanter & Palay, *Tournament* at 88-89, 100-08.

¹⁸¹*See* Nelson, *Explaining Growth* at 742 (observing that the model should be shown to explain the actual behavior of partners and firms). To be fair, *Tournament* provides a thorough and thoughtful, if inconclusive, discussion of several possible theories of increasing demand that could help account for both the rapidity of the growth of firms in this sector of the bar and the distinct upward “kink” in their growth rates after 1970. *Id.* at 112-16.

precipitously.¹⁸² Moreover, the fact that the price of those services—hourly rates—increased steadily, steeply and more quickly than inflation implies strong and relatively price-insensitive demand over that period.¹⁸³ In other words, supply rose to meet demand.

Relatedly, nothing in the model seems to account very well for buy-side constraints on the tournament, such as the unwillingness of sophisticated clients to pay for training junior associates, especially as their rates rose to levels previously commanded by accomplished and experienced practitioners.¹⁸⁴ Yet these developments are widely considered of fundamental importance to the changes in the profession over the last 30 years.

Nor does the theory take any meaningful account of costs. Advances in technology or knowhow that would change the number or the nature of the personnel who would most cost-effectively perform certain tasks—such as those we discuss in Part IV.B below—cannot be accounted for by a self-perpetuating growth cycle divorced from these concerns.

Lack of empirical support for tournament-style growth up to 1990. Tournament theory is also not well supported by the historical empirical evidence. Sociological inquiry has uncovered no evidence that partners or firm managers feel bound to a fixed growth-rate.¹⁸⁵ And the empirical data on which Galanter and Palay relied to support their tournament hypothesis are, as they themselves candidly admit, roughly as consistent with an exponential growth curve (which is the essential product of a rank-order tournament in this context) as they are with a linear one (which does not support the existence of such a practice).¹⁸⁶ Even considered as a geometric growth curve, the data are not particularly consistent with the fixed-rate curve a tournament implies, and are more consistent with other common patterns of population growth.¹⁸⁷ The data also show an upward “kink” in growth rates around 1970 (whether the rate is considered exponential or linear) that is exogenous to any feature of the rank-order tournament model proposed, and thus presumably owes its cause to some other phenomenon or force, such as

¹⁸²Henderson, *Single vs. Two-Tier Partnerships at 1710* (average annual associate hours across the Am Law 200 stayed steady at around 1850 from 1985-2003); Bruce A. Green, *Professional Challenges in Large Firm Practices*, 33 *FORD. URB. L.J.* 7, 8 (citing sources suggesting the number is considerably higher).

¹⁸³See notes 64-66, *supra*, and accompanying text; Galanter & Palay, *Tournament* at 88 n.17 (pointing out that a reduction in price might increase total hours and total revenues, but would indicate an increase in supply rather than demand).

¹⁸⁴See notes 64-66 93, *supra*.

¹⁸⁵See Sander & Williams, *Theorizing* at 402 & n.33, 403.

¹⁸⁶Galanter & Palay, *Tournament* at 83-84, 156-69. For a thoughtful exposition of the alternative interpretations of the data, see Nelson, *Explaining Growth* at 739-43. Moreover, Galanter & Palay tend to examine firm growth in the *aggregate*, while tournament theory requires fixed rates of promotion at *each individual firm* to provide the necessary assurances to current and future hires at that firm. Individual firm promotion rates do not appear to be as stable as a tournament would dictate. Sander & Williams, *Theorizing* at 408-10.

¹⁸⁷See Sander & Williams, *Theorizing* at 404-07

increased demand or the practical ability of existing firm structures to accommodate such demand.¹⁸⁸

Broad inconsistency with events over the twenty years since the theory was published.

Finally, the tournament model fails to explain the changes in typical large-firm structure over the last twenty years. If any rank-order tournament ever existed, developments since 1990 have transformed advancement and tenure in a way that makes it at most a distant memory. As Marc Galanter and William Henderson thoroughly chronicle in their empirical study published in 2008, just as the Great Recession was beginning, “the large law firm sector has gradually transitioned from the classic promotion-to-partner tournament, which was characterized by a fairly constant and reliable set of rules that limited the options of associates and partners, to [an] elastic model, which promotes, laterally hires, or de-equitizes partners in order to maximize profits for a proportionately smaller equity class.”¹⁸⁹ They show how erosion of the stability of partnership status has reshaped the typical large law firm into a “core and mantle” configuration, in which a smaller and more concentrated “core” of true equity partners, typically distinguished by their ability to attract and control law business, control the firm’s management and profits, surrounded by a “mantle” of long-term nonpartner attorneys with service roles, such as nonequity partners and permanent associates.¹⁹⁰

Galanter and Henderson “call this ‘later’ form the ‘elastic tournament’ since it involves a stretching of the tournament so that it does not end with the promotion to partnership, but instead becomes ‘perpetual’ or unending as partners work longer hours, accept differential rewards, and fear de-equitization or early, forced retirement.”¹⁹¹ This career-long battle of all against all may share the tumult and drama of a metaphorical tournament, but it is no longer a rank-order

¹⁸⁸See Galanter & Palay, *Tournament* at 110-16. And in the midst of concern about not only a short-term drop in workload but possible longer-term structural reductions in market demand for large-firm services overall, the largest firms in America (whose partnerships had in the aggregate increased in size at a surprisingly steady rate for many years) increased no more than 1% in 2009. See notes 60, 100, *supra*; Gilson & Mnookin, *Associate Careers* at 580 n.38 (anticipated future demand for the firm’s services must rationally be factored into partnership decisions). In fact, partnership size among these firms probably shrank in 2009 due to “de-equitizations” of equity partners, and “partnership” promotions that created only nonequity partners, factors that the *National Law Journal* statistics relied on here do not reliably take into account.

¹⁸⁹Galanter & Henderson, *Elastic Tournament* at 141-42. See also Henderson, *Single vs. Two-Tier Partnerships*.

¹⁹⁰Galanter & Henderson, *Elastic Tournament* at 110-13, 141-42.

¹⁹¹*Id.* at 112. The authors stress that “the shift to the elastic tournament is not the product of unrestrained greed or the loss of the profession’s moral compass. Rather, the elastic tournament reflects a wide-scale adaptation to major structural changes in the marketplace, including the globalization of corporate clients, the bureaucratization of corporate legal departments, the lower cost and greater availability of information, and erosion of cohesive firm culture due to sheer size and geographic dispersion.” *Id.* at 142.

promotion of a fixed proportion at a fixed time designed to dispel fears of opportunism by those in charge—in other words, it is not a “tournament” in the original theoretical sense at all.¹⁹²

The “elastic tournament” is not so much a theoretically-grounded model of growth and structure that allows for extrapolated prediction as it is a sociological description of intra-firm structures and relations in the early 21st century (though a nuanced, detailed and very accurate one).¹⁹³ Its basic insight seems to be that lawyers, young and old, are on their own, and need to have either secure and profitable books of their own business or secure relationships with those who do. Firms may play a role in either model, but the role will be secondary, and lawyers cannot count on the firm to take care of them. At this point it is not clear what the “tournament” metaphor adds to the basic if uncomfortably hardheaded advice that your career is your own responsibility, and that you cannot count on anyone else to safeguard it.

D. “Reputational Bonding” (Ribstein).

Larry Ribstein’s work posits a model in which the value to practitioners of organizing in a firm “derives from its function of minimizing agency costs between lawyers and clients.”¹⁹⁴ At one point, Ribstein felt this function could sustain law firms, but now believes it is inadequate to do so; he therefore predicts the “Death of Big Law.” We do not share his skepticism, in part because we believe his insights support a certain degree of growth and cohesion when applied to the individual lawyers within a firm rather than the firm as a whole, and in part because other forces Ribstein and others fail to take into account (such as those discussed in Part III below) appear to drive large firms to grow and (at least loosely) cohere.¹⁹⁵

¹⁹²See Wilkins & Gulati, *Reconceiving the Tournament at 1587* (the tournament model does not accurately reflect the circumstances and practices of typical large firms, but “the tournament *metaphor* remains a valuable aid for constructing a model that accurately describes elite firms”).

¹⁹³The typical large-firm structure Galanter & Henderson document in 2008 is, however, strikingly well predicted by three forces Gilson and Mnookin identified in 1989 as already eroding the typical “up or out” path of associate advancement: (1) An asserted shift in prevalence from sharing- to productivity-based partner compensation schemes, which makes judging merit less “subjective” and more “mechanistic” (and thus easier for associates to monitor, reducing the need for an indirect “bonding mechanism”), and which allows for differential compensation of a poorly chosen partner who proves less “productive” (Associate Careers at 587-89); (2) an increase in demand for associates, making evaluation and outplacement more difficult because of the sheer numbers involved (and possibly the lower or more variable quality of the pool overall) (*id.* at 589-92); and (3) the falling prevalence of firm-specific capital acquired by associates in favor of more easily transferable technical knowledge and skills (*id.* at 592-93). The first and third of these trends, the authors point out, predict “new categories of lawyers identified only after they complete the apprenticeship period and do not meet partnership standards; while the second predicts “new categories of nonpartner lawyers so identified from the time they are initially hired.” *Id.* at 593.

¹⁹⁴Larry E. Ribstein, *The Death of Big Law*, at 5 (March 2010 draft), abstract at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1467730 [hereinafter Ribstein, *Death of BigLaw*].

¹⁹⁵See Part III, *infra*.

1. Reputation's Function As A "Bond" In The Dual Sense Of "Guarantee" And "Tie That Binds."

In Ribstein's model, several elements combine to create a firm's reputation for quality and faithfulness that clients value. The firm invests in a reputation and effectively posts that reputation as a "bond" (guarantee) when it undertakes a representation. Young lawyers may piggyback on the firm's reputation until they develop their own, and firms protect their reputations by training and monitoring such lawyers. Senior lawyers have an incentive to monitor junior lawyers (and each other) because they risk losing their capital in the firm (and, in a traditional partnership, their own assets) if the mistakes or misconduct of their colleagues creates liability for the firm. This mutual interest also creates a certain institutional "bond" in a different sense—connectedness—among the practitioners. In addition to economic concerns, monitoring by senior lawyers works in this model because those lawyers are the product of a winnowing process—the familiar "tournament" in the literature—that selects high-quality lawyers for partnership and instills firm cultural values in them on the way up.¹⁹⁶

2. Reputational Bonding's Failure To Fully Explain Historical Developments.

Ribstein's reputational bonding model suggests some reasons why large firms grew over the past 40 years but ultimately cannot explain the speed or extent of the growth. Brand-name firms may provide quick access to large numbers of capable lawyers, and the brand itself may act as a bond assuring some level of competence and honesty. Both phenomena should provide some competitive advantage, particularly with respect to the large, complex and time-pressured matters that tend to generate high margins.¹⁹⁷

As Ribstein candidly acknowledges, however, there are problems with this model, too. For example, keeping enough bodies around to handle peak load problems creates excess costs if such problems become less common or less demanding. Firms either must absorb the costs, which drags down profits; cover them with busywork, which clients will (rightly) perceive as churning and which will harm the firm's reputation; or cut the costs by laying off excess staff, which doesn't leave the firm as well equipped for the next client crisis (though it does fit observations from the most recent recession).¹⁹⁸

More fundamentally, Ribstein points out that leveraging reputation implies an increase in scale and scope that makes monitoring more difficult, placing the firm's reputation at risk and putting reins on the very growth it spurs. We think even firms of moderate size by modern standards (say, those with more than 200 lawyers) long ago passed the point at which they can achieve effective monitoring at the level of the firm as a whole. And as leverage increases,

¹⁹⁶*Id.* at 5-10. Large firms also may provide fast response times for urgent matters by employing enough lawyers so that they can throw existing staff at a problem rather than resorting to spot-market purchases of contract lawyers. This approach entails relatively high fixed costs, but these are acceptable if they can be spread across many cases and clients, smoothing out the peaks and valleys in utilization. *Id.* at 9-10.

¹⁹⁷*See* Ribstein, *Death of BigLaw* at 5-10.

¹⁹⁸*See id.* at 9-10.

monitoring even at the level of a practice-group or supervising partner on a particular matter becomes increasingly diffuse.¹⁹⁹

If that point is right, however, it calls into question the degree to which clients actually accept the brand-name reputation of an entire firm as a reliable proxy for quality in a specific matter. This is not to say that reputation is irrelevant, of course. But its force and nature has changed. In the “golden age” of the elite firms, client relations were broad and stable at the firm level: A client typically gave a single firm all its outside work, and depended on the firm’s overall brand for quality and responsiveness to bring it the right personnel when a new need arose. The firm subordinated individual partners’ status and notoriety to the firm brand, for example by putting the firm name rather than the name of individual partners on work product.²⁰⁰

In 21st-century markets, however, clients typically divide their work among many lawyers and many firms. Familiar observations about corporate demand abound: Clients hire lawyers, not firms; they are perfectly willing to unbundle their buying and outsource low-margin work to contract attorneys who neither enjoy the blessing of the firm’s brand nor put it at stake (especially if the client has insisted on the use of such outsourcing in the first place).²⁰¹

Ribstein is concerned that these changes in the marketplace cause partners to devote too much time and effort to burnishing their individual reputations and books of business, and not enough time to the tasks needed to build truly firm-specific capital. The very real risk he identifies is that “without the right incentives, the firm is only a collection of individuals sharing expenses and revenues that has little or no value as a distinct entity.”²⁰² This observation leads him to the pessimistic conclusion mentioned earlier: That the large law firms are dead but don’t know it yet.

And yet *some* centripetal force has continued to hold together greater and greater numbers of larger and larger firms, despite the increasing attenuation of the traditional ties that bind. As we discuss in the following section, many of Ribstein’s observations seem more plausible at the level of individual partners rather than firms, and when applied at that level may, along with other forces, help explain the growth and cohesion widely observed in the world but not yet adequately explained in theory.

III. FIRM-BRAND AND PERSONAL REPUTATION, AND THEIR ROLES IN MAKING A PARTNERSHIP’S INTERNAL REFERRAL NETWORK A BINDING AND GROWTH-STIMULATING FORCE.

William Henderson’s 2006 empirical study of partnership structure finds that a firm’s “prestige” is the single most powerful predictor of its profitability—more than the firm’s size,

¹⁹⁹*See id.* at 6, 9-10.

²⁰⁰*See* Galanter & Palay, *Tournament* at 14-17. A modern relic of that practice is the tradition of authenticating the opinion of counsel in a transaction by the handwritten name of the law firm, without identifying the signing partner.

²⁰¹*See* notes, 32, 75, *supra*, and accompanying text; Part IV.B, *infra*.

²⁰²Ribstein, *Death of BigLaw* at 7-10, 22.

partnership structure, leverage or location.²⁰³ The prestige rankings on which the study relied were based on the surveyed perceptions of mid-level large-firm associates, so there is some risk that these associates inferred prestige from the compensation of their peers, or even directly from firms' reported profits per partner, making the correlation tautological, rather than identifying prestige as an independent variable that could drive profits.²⁰⁴

But the point is provocative nonetheless: In an age when *individual* partner qualifications most often drive client buying decisions, why would *firm* prestige most powerfully predict profits? We believe that new and important insights into large-firm growth and structure can be found in the relative roles of firm-brand and individual partner reputation in building an internal referral network within a service partnership, and that internal network's binding and growth-stimulating force.

We start with an illustrative example. In today's law firm, one kind of referral comes to an individual lawyer whom a client has found trustworthy in the past, inquiring, in substance, "do you know anyone who can deal with a riparian rights issue in Tasmania?" Note that in this scenario the reputational bond is between the client and the individual contact partner, not the client and the firm. And note further that the client has no particular reason to believe that the lawyer on the other end of the line knows anything about the arcane subject of the inquiry, but rather is relying on that lawyer's judgment and connections to help find someone who does. We believe this fact pattern is common.

In these circumstances, the contact partner may well respond, as many of us have at one time or another, "why yes, I have a leading authority on Tasmanian water law just down the hall from me [or perhaps in our Sydney office]. Let me give her a ring."²⁰⁵ If our Tasmanian rights expert mishandles the matter, she likely will hear about it most strongly from the contact partner,

²⁰³Henderson, *Single vs. Two-Tier Partnerships* at 1696, 1717-18, 1727.

²⁰⁴Vault, which conducted one of the mid-level associate surveys on which Henderson relies, discusses prestige in the annual *Guide to the Top 100 Law Firms* published contemporaneously with the Henderson study:

Why does law firm prestige matter? . . . Working for an esteemed law firm means being exposed to a greater variety and volume of work, as well as more prominent and high-profile cases and deals. . . . Most importantly, working for a preeminent firm will give you instant credibility in the job market and will mark you as someone to be taken seriously throughout your career.

BRIAN DALTON, VAULT GUIDE TO THE TOP 100 LAW FIRMS, 2006 EDITION 1 (2005) (cited in Henderson & Zaring, *Young Associates* at 1093 n.20).

²⁰⁵In a similar and also common circumstance, the contact partner observes in the course of an engagement that the client has a need for additional legal services beyond his particular expertise. "I saw that Tasmanian riparian rights dispute in the due diligence," he advises his in-house contact. "You know, my colleague Molly Magee is an absolute whiz at Tasmanian water law. Let me set up a call with her." Once again, the contact partner is not selling his own expertise, but his judgment and reliability at recognizing the client's need and finding a good person to fill it.

who will have heard about it from the client even though the contact partner had no role in the actual services provided.²⁰⁶

A. Brand And Personal Reputation.

In the context of this typical fact pattern, we offer the following observations about firm-brand and personal reputation:

First, firm brand still matters, albeit less than it did 50 years ago. We suspect that it is relevant for all firms, but for most of them it is no more than a weak signal regarding quality of control of internal agency costs, and thus a weak asset. For example, firm reputation apparently matters to the extent in-house counsel don't want to be second-guessed for giving an important matter to counsel that no one in senior management or on the board has heard of. Just as no one ever got fired for buying IBM (at least once upon a time), no one is going to second-guess an in-house lawyer for hiring (say) Skadden on a matter of consequence. But the in-house lawyer making the call will also have selected a particular partner or partners at Skadden to lead the engagement, and will have done so by exploring their unique personal qualifications and experience relevant to the task.²⁰⁷

Second, firm-brand and personal reputation are mutually reinforcing. As just discussed, the lead partner's affiliation with a brand-name firm is part of the quality-signaling apparatus the partner brings to the table in marketing her personal reputation to clients (or her credibility to courts, regulators and adversaries). Conversely, the firm's reputation is enhanced by its individual partners' attracting and effectively addressing high-profile, high-stakes work.

And *third*, a lawyer's personal reputation still serves a quality-signaling function as to persons and resources well beyond the individual lead partner sitting at the table. It thus has value similar to firm-brand reputation in its agency-cost saving function for the client. A client choosing the lead partner for a particular complex case or deal accepts, more or less blindly, the team the partner will bring to the task to assist her. The client largely assumes that the lead partner who has proven to have the most appropriate skills and experience will have access to,

²⁰⁶There are of course the common agency problems lurking here: The contact partner may be tempted to "cheat" and introduce an underemployed California real estate lawyer sitting down the hall to the referral source as the firm's Tasmanian water rights authority. The risk that the colleague will fail, tarnishing the contact partner's and the firm's reputations and exposing the firm to potential liability, should inspire the contact partner to consider recommending the real Tasmanian lawyer he knows at a competing firm two floors down. If the internal expert-for-a-day produces substandard work that the client fails to recognize as such (or overbills to acquire expertise that she was touted as possessing already), the lawyers have behaved badly and the client was ill-served. But the point remains that the lawyer had incentives to refer the matter inside the firm rather than out (even at the risk of the referral source's welfare), and it is those incentives' effects that we are exploring here as a possible explanation for large-firm growth.

²⁰⁷In our experience, the keystone question in this inquiry is "how many of these [specific kinds of cases or transactions] have you done before?" The second-person pronoun is critical; the response "several of my partners have done quite a few" will likely kill the interview, and at best produce the query "then why aren't they here?"

and know how to choose, colleagues and subordinates (conceivably dozens of them on a sufficiently large or complicated matter) with the skills and experience necessary to get the job done right. Similarly, the contact partner who receives a call seeking assistance on a matter outside his expertise proves worthy of the caller's trust by pointing the way to suitable expertise, the ultimate quality of which will reflect on his reliability and judgment in the eyes of the client. Thus, like firm-brand reputation, the personal reputation of the lead or contact partner with which the client is typically concerned implicates much more than the characteristics of the particular individual attending the pitch or receiving the call.

That, in turn, suggests that individual partners' interests in fostering and preserving their own reputation should induce them to engage, and encourage their firms and their subordinates to engage, in monitoring, selection and training very similar to those that prior scholarship reasons will result from the need for reputational bonding at the firm level.²⁰⁸ Indeed, it may suggest that an implicit client skepticism of firm reputational bonding as firms grew too large and variable in quality to monitor at the firm level pushed reputational scrutiny down to the level of the supervising partner, who had fewer direct and indirect reports to answer for than the firm as a whole, and would have to answer personally to the client or referral source for any failing.

B. Firm-Brand And Personal Reputation's Role In Building An Internal Referral Network Within The Partnership.

Separately and more importantly, a professional partnership therefore can be seen as an internal referral network. In any firm in which a role in business generation is rewarded—and we are confident that a role of the kind the contact partner served in the above hypothetical is rewarded, in one way or another, in just about every non-lockstep firm in America²⁰⁹—the contact partner is going to have financial incentives to surround himself with two kinds of people: One is an array of competent specialists in matters that support the rates the firm customarily charges. The contact partner will then be able to profit from his connections by being able to refer matters outside his expertise within his firm, and be rewarded with a share (measured however the firm's compensation system measures these things) of the bounty he helped create.²¹⁰ And the same partner will also want to surround himself with other partners

²⁰⁸See note 196, *supra*, and accompanying text.

²⁰⁹Similar (albeit more indirect and diluted) incentives exist in firms with lockstep compensation. In those firms, the partner may not receive any special reward for being the contact partner or the expert who can handle the job, but the overall network of partners' connections with outside referral sources, and their ability to bring into the firm matters they cannot handle themselves, contribute to the overall pot the partners share, and thus will be an important characteristic in choosing those invited into the lockstep club.

²¹⁰Some such specialists will be more senior lawyers with a narrow expertise, or more junior lawyers who are learning their trade and can support at some appropriate level the lead partner's practice, in each case without leveraging their skill to occupy others. In today's law-firm labor market, these will likely be salaried associates, counsel or nonequity partners depending on their seniority and level of expertise. Others receiving internal referrals will be supervisory lawyers capable of winning the client's trust and helping to land a substantial matter requiring others' support. These will more likely be other equity partners with practices of their own. In either case, however, both *what* you know and *whom* you know are essential to winning the right to do the work.

who are as well connected with their own outside referral sources as possible, so that when a similar “do you know anyone” call comes to one of them, he may be in a position to benefit in the same way that the Tasmanian water rights specialist benefited from his internal referral.²¹¹

What this means more broadly is that an individual partner with excess human capital—that is, the ability to attract and control more legal work than she can do herself—will experience incentives to affiliate in partnership with as many other partners with as much excess human capital of their own as possible.²¹² Put slightly differently, one rainmaker will want to affiliate with as many other rainmakers as possible, each with the greatest connections and reputation possible, because her own chances of profiting from her own skill and connections increase with the number of potential internal referrals she can make and receive. And the greater the number of rainmaking partners in a firm, each supporting a leveraged practice of their own, the larger the firm will be overall.²¹³

Significantly, a referral-network explanation of firm cohesion implies firms that look quite different from those implied by a financial diversification theory: Diversification implies firms that develop disparate capabilities that are to one degree or another unrelated to each other. A referral network theory, by contrast, implies firms that focus on overlapping or related capabilities for which referrals are plausible, and for which a firm might provide each partner the proper incentive to refer work to the most efficient producer rather than hoarding it.²¹⁴ Though hoarding problems exist, as does the temptation to refer to less expert practitioners within the firm rather than more expert or cost-effective competitors outside it, the empirical evidence

²¹¹As Ronald Coase presciently observed, “although my aim . . . was to explain why firms emerge within markets, we must also admit that there may be markets within firms.” Ronald H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937), reprinted in *THE NATURE OF THE FIRM: ORIGINS, EVOLUTION, AND DEVELOPMENT* 54 (Oliver E. Williamson & Sidney G. Winter eds., 1991) [hereinafter Coase, *Nature of the Firm*].

²¹²This observation is consistent with the theoretical findings that members of professional service firms have an incentive to monitor the quality of their peers and thus are likely to organize as partnerships (or, in our experience, to function that way regardless of legal form). See Jonathan Levin & Steven Tadelis, *Profit Sharing and the Role of Professional Partnerships*, 120 *Q. J. ECON.* 131 (2005). For a theoretical model supporting the referral explanation we have observed and explain in the text, see Luis Garicano & Tano Santos, *Referrals*, 94 *AM. ECON. REV.* 499 (2004).

²¹³This structure will also create incentives to acquire and maintain a stable of narrow specialists like the Tasmanian water-rights expert who, while not leveraged rainmakers in their own right, will be available to all the high-prestige partners when needed. These specialists will make economic sense when the overall demand for their expertise within the firm is sufficient to make them profitable (so a Tasmanian water-rights expert may be an imperfect example, unless there is a large water-rights practice in the firm’s Sydney office). They will probably occupy salaried nonpartner positions, but will collectively contribute to firm size and growth overall. And the more rainmakers in the partnership are in a position to receive requests for highly specialized expertise, the larger the stable of such experts the firm will be able to afford and wish to maintain.

²¹⁴See Garicano & Santos, *supra* note 212.

discussed above appears to indicate that complementarity of skills within firms is common, while the differentiation implied by diversification is not.²¹⁵

C. The Internal Referral Network As A Binding And Growth-Stimulating Mechanism.

This view of a professional partnership as an internal referral network helps explain an enduring puzzle that the economic literature to date has failed to solve: The marginal product compensation systems that overwhelmingly predominate among elite firms attempt to incentivize partners to productivity (and deter their departure) by allocating to each of them the financial benefits they individually create. But as commentators have pointed out, this focus on individual contribution should leave little room for the firm to be anything more than “a collection of individuals sharing expenses and revenues that has little or no value as a distinct entity”—that is, one whose value is no greater than the sum of its parts, and should thus enjoy no financial returns in growing larger.²¹⁶ In fact, an aggregation that is so loosely bound together should prove to be *less* than the sum of its parts: One would expect ordinary diseconomies of scale, such as multiplying conflicts of interest and the complexities and institutional friction inherent in splitting the pie according to each individual’s marginal contribution among greater numbers of increasingly unfamiliar colleagues, to sap the firm of more of its collective value the larger it grew, and thus make growth beyond a certain scale affirmatively unprofitable. What force, then, has consistently driven lawyers with excess human capital to band together in partnerships that have continued to get bigger and bigger for generations?

Part of the answer may be that a partnership’s internal referral network increases the value of each partner’s reputational and relational capital relative to the value of that capital in isolation from the partnership by giving each partner more chances to exploit that capital than they would have as a sole practitioner (or in a smaller firm). A partner with well-connected colleagues is more likely to receive a referral from which the partner can personally benefit than is a principal with the only book of business in the firm in two general ways: First, well-connected colleagues will generally try to refer a matter they cannot handle themselves within their own firm before looking outside it, because keeping the referral in-house allows the referring partner to share in the proceeds. And second, the more specialized expertise there is within the firm for each individual partner to tap into, the more likely it is that an outside referral source’s request for specialized knowledge can be met in a way that allows the contact partner to refer it within the firm. The more successful the partnership’s rainmakers are generally, the more substantial and price-inelastic the matters they will be able to attract, and the more they will be known among competitors, clients and potential clients for having done so. Partners’ prestige likely will reflect on one another, and the internal referral network will enhance both the makers’ and the recipients’ individual reputations, as well as their ability to profit from their own connections and reputation.²¹⁷

²¹⁵See notes 156-157, *supra*, and accompanying text.

²¹⁶Ribstein, *Death of BigLaw* at 7, 10, 22. See also Gilson & Mnookin, *Profit Sharing* at 346-52.

²¹⁷Individual line lawyers within the firm who are not a part of the core referral network (generally, persons not equity partners) will be limited to the lesser and more general benefit they enjoy from affiliation with the firm and its name-brand. As discussed above, this value is real, but weaker than that

In short, the reputational and relational human capital of an individual elite law-firm partner should be more valuable when she is surrounded by others with similar characteristics. And the greater the surrounding partners' reputational and relational capital, the more valuable each individual partner's own reputational and relational capital is likely to become. Thus, an individual partner with a strong personal reputation, many referral sources and other connections, and high prestige will seek partnership with others with the greatest levels of the same characteristics that she can find. And the human capital-enhancing power of the firm's internal referral network should create financial incentives for firms to get bigger by adding more, and more connected and successful, partners to the network, which should also result in the firm's ability to support greater numbers of skilled and specialized service-providers. To the extent this positive feedback loop actually works in the real world, then, it helps explain how the value of a large law firm with a marginal product compensation system could be greater than the sum of its parts, how this phenomenon could create positive financial returns to growth beyond minimum scale, and how an institutional focus on each partner's personal reputation and marginal product may, counterintuitively, actually help make that so.

This view of a professional partnership as an internal referral network may also help explain two trends among elite firms that may at first seem contradictory. As just discussed, the first is why such firms got so big, and kept getting bigger. If there can be positive returns to the size of this internal referral network, then firms should grow in order to obtain them. At the same time, however, nothing in the referral network concept implies a high degree of asset specificity. An individual partner's reputational and relational capital will lose little of its value if the partner takes it to another partnership whose members have personal capital that is similar, greater, or "better" (e.g., more complementary or less prone to creating conflicts) than the partners in the old firm.²¹⁸ Thus these networks thus may be both inclined to grow large, and at the same time to be fragile, or perhaps more accurately brittle, in the sense that partners with excess business may splinter off and move from one network to another with relatively little loss in the value of their personal human capital "portfolios."²¹⁹

On this view, the firm's brand is not irrelevant, but it is still relatively weak. The firm needs to be well enough regarded so that clients assume, sight unseen, that the Tasmanian water rights specialist at Howrey is probably about as good as the Tasmanian water rights specialist at

attaching to an individual marquee name. This is all a question of degree, of course: Some partners are more eminent than others, and serve a more prominent role in enhancing the firm brand; associates on the track to partnership are working to accrue the notoriety that will qualify them for an invitation into the network.

²¹⁸One firm-specific feature is the effort necessary for the rainmaker to familiarize herself with the referral network with which she is affiliating. This is something, but is lessened in importance by the fact that there are individual and firmwide incentives to assist the mobile partner in making up the information deficit at her new firm: Upon moving laterally, the new partner can expect information proffered from many sources within the new firm on the features of her new internal network.

²¹⁹The model thus is more like switching cell phone service from AT&T to Verizon, and less one of exploiting specific assets that would be less valuably exploited in a different environment (as it might be if, for example, all my friends have AT&T too, and I will lose the benefit of the cheap in-network rates with them that AT&T offers if I switch).

Orrick. But nothing more is needed for a partner with lots of outside referral sources to keep them when moving from Howrey to Orrick.

We offer this explanation of firm growth and cohesion tentatively. Besides the absence of empirical testing at this point, we recognize that “cross-selling” has been a justification for firm growth for at least a generation, with what we anecdotally understand to have been mixed results.

We also recognize that there are many countervailing tendencies that can frustrate the internal referral process and reduce its benefits. Among others, the simplest may be ordinary diseconomies of scale on a number of axes. More specifically, internal referral networks work only if partners with more business than they can personally handle can trust that (i) the lawyers to whom they refer matters will handle them competently enough to preserve the referring partner’s reputation with the referral source; and (ii) they will be personally rewarded most generously for conduct that most effectively and efficiently causes the referral network to serve its value-enhancing purposes. Size and geographical dispersion, as well as rapid growth, can make it harder for firms to satisfy the first condition.²²⁰ In addition, because of irreducible imperfections in measuring and apportioning credit and benefits, most marginal-product compensation systems create unintended incentives for opportunistic behavior, such as client hoarding or manipulation of the system’s reward-sharing variables. These behaviors may lessen a referring partner’s confidence in the second condition.²²¹ And in an “elastic tournament” of all against all, there will inevitably be squabbling among the skilled and energetic contestants over money, turf, resources, influence and pretty much anything else anyone finds desirable. These administrative costs (and the misallocations they cannot help but produce) also add to the unavoidable inefficiencies of any compensation scheme.

But even with all these imperfections and human frailties taken fully into account, we believe that the insights discussed here suggest good reasons why big law firms have kept getting bigger (at least until the current recession systemically depressed demand overall) without finding some “natural” size limit, and why such firms also appear to be brittle and in extreme cases vulnerable to failure or acquisition even as they keep growing.²²² They also provide a

²²⁰These challenges, along with the obvious additional overhead costs of maintaining separate branch offices, may be another reason why the number of a firm’s branch offices is negatively correlated with firm profitability. See Henderson, *Single vs. Two-Tier Partnerships* at 1735 n.163; note 156, *supra*.

²²¹See Gilson & Mnookin, *Profit Sharing* at 346-52.

²²²We recognize that it is not difficult to find individual examples inconsistent with our hypothesis: Some of the most profitable firms in America, for example Wachtell Lipton and Cravath, have relatively small partnerships. But the question is how much internal referral network size correlates with profitability across this entire market sector. One way to test that proposition would be to examine whether the size of a firm’s equity partnership correlates with profitability. Unfortunately, currently available data are not adequate to the task. Henderson (and others) have appropriately cast doubt on whether *overall firm size* (in numbers of lawyers) correlates with profitability, but that includes associates and long-term nonpartners, such as nonequity partners and permanent associates; it may also include staff or contract attorneys. See note 156, *supra*. The test we have in mind correlates the size of the firm’s *internal referral network* with profitability. That network should be at least loosely measurable by the number of equity partners—in the 21st-century “elastic tournament” environment, these are the

context for the partner mobility study's finding that partners with the most leveraged and high-margin practices tended to move "upstream" to firms with similarly profitable partners.²²³ And they suggest why a firm's overall prestige is well correlated with its profitability even though individual partner qualifications usually drive client hiring decisions.

IV. COST-BASED FACTORS AFFECTING GROWTH.

A. *Coase And Schumpeter: Transaction Costs And The Effects Of Changing Times.*

1. *Coase's Theory of the Firm.*

Few scholars have focused on Ronald Coase's *Theory of the Firm* in this context (with Larry Ribstein and a forthcoming paper by Milton Regan and Palmer Heenan being notable exceptions).²²⁴ But we believe the theory provides important insights into the wax and wane of big-firm growth, and the apparent increase in the formation of high-margin boutiques.²²⁵

Coase famously argued that firms²²⁶ form to economize on transaction costs, yielding the claim that the boundaries of the firm are set by the relative costs of internal coordination versus market transactions.²²⁷ Thus, for each product or service a firm offers, the firm decides on the

individuals selected for their ability to attract and control (and therefore internally refer) legal work. But partnership counts currently available do not reliably include only equity partners. In addition, the various forces reducing this strategy's power to enhance profitability that are surveyed in the text paragraph preceding this one also make the strategy's effectiveness dependent on good management, which may dilute any correlation that does exist. That said, we look forward to future inquiry on the question.

²²³See notes 156-157 *supra*, and accompanying text. To elaborate, because each rainmaker's reputational and relational capital is more valuable in proximity to others with the same characteristics, rainmakers will tend to affiliate with others with the greatest reputation and contacts complementary to their own that they can. Such rainmakers will generally "trade up" as far as they can, but at the same time the more profitable firms "upstream" should generally accept only lateral partners whose relational and reputational capital (over the foreseeable future) is anticipated to be worth more than that of the average partner already at the new firm. As these incentives operate over the medium to long term, partners of roughly comparable long-term capital value should end up aggregating together. At any given moment, individual capital may vary widely among the partners—some of them (often less senior ones) will be increasing their human capital, while others may be waning in reputation or influence. But their presence at the firm should represent a guess that the present value of their human capital over the period they are expected to remain is comparable to or greater than their other partners'.

²²⁴Milton C. Regan, Jr. & Palmer T. Heenan, *Supply Chains and Porous Boundaries: The Disaggregation of Legal Services*, forthcoming FORD. L. REV. 2010 [hereinafter Regan & Heenan, Supply Chains].

²²⁵See notes 119-120, *supra*, and accompanying text.

²²⁶We speak here not just of law firms, but of any business organization.

²²⁷Ronald H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937), reprinted in *THE NATURE OF THE FIRM: ORIGINS, EVOLUTION, AND DEVELOPMENT* 18 (Oliver E. Williamson & Sidney G. Winter eds., 1991) [hereinafter Coase, *Nature of the Firm*]. A prediction related to this claim is that assets that are not easily redeployable to other uses tend to be owned, while assets that may be easily redeployed

basis of cost whether to make the particular product or service, and each of the inputs that goes into making it, or to buy it from a third party.²²⁸ The producer's "make or buy" decisions (if wise) lower its costs of production, and allow it to sell what it produces at a competitive price that will draw buyers.

Law firms of course provide a broad range of services, from proofreading, file maintenance, and document processing to legal research and analysis, complex negotiation, and trial work. Often those basic services are bundled together to address a larger project: Handling a piece of complex litigation, for example, will involve many people and many services ranging from simple clerical work such as proofreading and filing to skilled professional work such as brief drafting and argument. Although in many instances law firms provide their clients with an integrated package of all the services necessary to produce what the client needs (a completed contract and a closed deal; a filed brief and an argued motion), it is not logically or legally necessary that they always do so using only their own personnel and resources. In fact, as everyone knows, sometimes they don't.²²⁹

From a Coasean perspective, then, the rise of large law firms might be explained to some degree on the theory that such firms developed skill at producing and integrating the whole range of constituent undertakings that combine into high-end legal services, and thus offered clients lower cost relative to what the clients would have borne had they individually procured their own proofreading, file maintenance, document review and so on from sources separate from the firm providing them legal analysis, deal negotiation or trial work.²³⁰ In other words, law firms allow clients to economize on transaction costs by offering "one-stop shopping" for a particular engagement, thus saving the client the time, effort and expense of locating and assembling its

tend to be bought in markets. (A transaction in which nonredeployable costs must be sunk presents a significant risk of hold-up, particularly after both sides have transformed a situation with many potential contracting parties into a situation that may be or resemble bilateral monopoly.) See, e.g., Paul Joskow, *Asset Specificity and the Structure of Vertical Relationships: Empirical Evidence* in Winter, *supra* at 117, 125. The lateral mobility noted above shows that the services provided by big-firm lawyers are not specific enough to any given firm to preclude redeployment.

²²⁸Coase, *Nature of the Firm* at 48.

²²⁹And there are many inputs that law firms have always bought from third parties rather than making themselves. Law firms don't typically manufacture file folders or copy machines, for example.

²³⁰Ribstein notes this possibility, though he seems not to find it compelling, because "clients and law firms could mitigate these costs by making long-term contracts that do not require a single firm to own hard assets or employ a lot of lawyers full time." Ribstein, *Death of BigLaw* at 10.

constituent pieces from disparate sources.²³¹ And the definition of the “engagement” is extremely flexible; in a very significant sense, it is pretty much whatever the client says it is.²³²

These principles go a long way toward explaining some widely observed changes in the market for legal services over the last 30 years. Back in the “golden age” circa 1960, many companies did not have in-house lawyers at all, or had only a few. Those lawyers tended to be relatively unsophisticated about issues integral to the effective functioning of a modern law department—how to find the right people for particular kinds of specialized tasks, and how to coordinate their efforts with the client company, with one another and with outside counsel. Instead, they chose to hand whole tranches of legal work over to their outside general counsel, who were adept at finding and hiring good people, assigning appropriate people to particular tasks, and coordinating the efforts of those involved to produce the desired work product.²³³

As discussed above, over time in-house counsel became more knowledgeable and sophisticated (more and more of them having served in elite law firms themselves), legal services became a more significant input to many financial and industrial companies’ businesses, the price of outside counsel continued to rise, and management began to put pressure on general counsel to manage legal costs.²³⁴ And as a result, the Coasean forces just described began to take hold, in two distinct but related ways.

First, general counsel began to consider “make or buy” decisions on legal services for their companies—that is, to consider which of the services they were buying from outside counsel could be more cheaply produced with their own personnel in-house. This inquiry required identifying what kind of tasks could be handled more efficiently by permanent in-house personnel (such as routine work requiring knowledge about the particular company’s business or practices, which when bought were often handled by a revolving-door array of associates in an outside law firm), learning how to find and manage lawyers appropriate for these tasks, and learning how to coordinate their efforts with the client and outside counsel—in other words, how to run their own specialized in-house law firm and define its efficient areas of practice. As companies invested in these skills (by hiring more sophisticated general counsel, and encouraging them to invest time, effort and resources in learning about these issues), companies’

²³¹Basic rational actor logic suggests that a client should use one law firm for a full bundle of the constituent services necessary to complete a particular project unless the sum of (1) the cost of some constituent service(s) from one or more different providers (factor costs), plus (2) the cost of finding the cheaper provider(s) (search costs), plus (3) the cost of coordinating use of the cheaper provider(s) for some services and the law firm for the rest (coordination costs) is less than what the law firm will charge for all the services except the cheaper one(s) the client decides to carve out and hand to someone else.

²³²For a discussion of the considerations driving outsourcing both for clients and for law firms, see generally Regan & Heenan, Supply Chains.

²³³See notes 69-70, *supra*, and accompanying text.

²³⁴See generally Part I.B, *supra*.

costs for legal services fell to the point where it was cheaper to make some services rather than buy them, and the size and scope of in-house law departments increased accordingly.²³⁵

Second, as the projects referred to outside counsel began to concentrate on less routine and more substantial matters requiring special (but not firm-specific) expertise, client companies began to depend less on a single outside firm to bring them a person appropriate to a new task. From a Coasean perspective, the value to in-house counsel of an outside firm's internal referral function was bounded by the cost the in-house lawyer would incur in performing her own search: The lower that search cost is, the less valuable is outside counsel's internal search function. The value of that function is further reduced by agency issues—the client may be concerned (justifiably) that the lawyer getting the “do you know anyone” call will be tempted to introduce one of his colleagues even if he knows someone outside his firm is less costly or more qualified.

Clients came to know these forces because more client representatives had lived them. And search today is not all that costly, particularly as to projects for which firms are willing to front substantial information in the form of an elaborate pitch. Moreover, social networks are tight and getting both broader and (strikingly) tighter as technology both expands the universe of people you may learn about, and allows you to learn a greater number of things about them. Want to hear how a particular lawyer actually argued in a similar case? An MP3 file may be available and easy to download in very little time.²³⁶

As the search-cost-saving value of big firms diminishes—in other words, as it becomes cheaper for clients to use the market—one would expect buyers to dissect the services they were purchasing further, and for big firms to offer fewer functions themselves as clients became more willing to shop for them elsewhere. If and to the extent Coase is right that firms form to economize on transaction costs, and if that economization represented a significant fraction of what firms were selling, then as the relative costs to clients of market transactions falls, one would expect to see firms shrink, or grow more slowly as this trend put brakes on growth stimulated by other forces.

2. *Schumpeter's Insights On Technological Change And Its Effects On Cost and Demand.*

The transaction-cost approach links the shape of firms to the relative costs of internal production versus market transactions. Technological change is perhaps the greatest influence on such costs. It therefore potentially affects the shape of all firms, and the very existence of

²³⁵See notes 71-76, *supra*, and accompanying text; *Q&A with FMC Technologies GC Jeffrey Carr*, Mar. 30, 2010, <http://ip.law360.com/articles/157416> (“Since we are always less expensive than outside counsel, we do a make-or-buy on all legal issues—asking ourselves do we have the capacity (time) and the capability (expertise) to handle the matter. Only if the answer to both of those questions is ‘no’ do we go outside”).

²³⁶See Rees Morrison, *Goodbye legal guides and directories of lawyers; hello online searches and social networks*, Aug. 6, 2010, http://www.lawdepartmentmanagementblog.com/law_department_management/2010/08/goodbye-legal-guides-and-directories-of-lawyers-hello-online-searches-and-social-networks.html.

some. This point is as famously associated with Joseph Schumpeter as transaction-cost economics is with Coase.²³⁷

Schumpeter was more concerned with disturbance than with equilibrium. He found economic history unruly and thus focused on the contingencies that struck at the foundation of existing ways of doing things rather than minor modifications having marginal effects.²³⁸ Schumpeter accordingly defined innovation in terms of a development's power to establish a new production function, rather than merely altering the output of an existing function due to changes in the factors of production. He argued that, so defined, "innovation is the outstanding fact in the economic history of capitalist society."²³⁹

Using this definition, we can distinguish between two types of forces in the markets we are examining. The first involves rationalization within an existing market structure due primarily to increasing client sophistication or lateral movement among lawyers. These forces would tend to put pressure on margins, and force firms to pursue efficiencies, without regard to technological change.

The second type of market force depends on changes—largely though not exclusively technological—that increase demand for some types of legal services or lower the costs of producing others. We discuss a number of those changes in the following section.

B. Changing Technology And Practices Driving Changes In The Costs Of And Demand For Legal Services.

1. The Digital Trend Toward Fixation In A Tangible Medium Of Expression.

One of the most striking changes in the business environment, and the legal environment that serves it, is the rapid decrease in the cost and effort necessary to create and maintain durable information. In a longstanding process that considerably accelerated in the 1990s, electronic record-keeping became progressively less cumbersome, less expensive and more widely available within the workplace (and the home). Even more importantly, the widespread accessibility of networked computers created a new and equally universal communication medium—email and related technologies—that made durable communication both instantaneous and simple. Communications that might not have occurred, or that would have occurred only orally face to face or by telephone, transitioned over a rather short period of time to a medium that left them memorialized, potentially forever, in digital form, and inexpensively stored for future retrieval. Similarly, more formal and functional documents, such as contracts and spreadsheets, moved to the digital realm, where they could be nearly costlessly transmitted,

²³⁷See, e.g., JOSEPH A. SCHUMPETER, BUSINESS CYCLES 87-88 (1939).

²³⁸And though Schumpeter championed mathematical economics, he was not himself a particularly mathematical economist. In this respect he was similar to Coase, whose criticisms of "blackboard economics" are well known, and whose own work is highly attuned to real-world concerns. (See Coase's "instructive day spent in the office of a purchasing agent, I think Union Carbide, listening to his telephone conversation." *Id.* at 92 (quoting Ronald H. Coase, *The Nature of the Firm: Origin*, 4 J. LAW ECON. & ORG. 3, 14 (1988)).

²³⁹See Schumpeter, *supra* note 237, at 87-88.

edited and commented on by wider networks of participants, with the entire process preserved for future examination.

Lower costs of generating and storing data such as documents and e-mail have led to increasing amounts of such data, and thus increased burdens on clients and firms to store and search the data when needed for some legal purpose. In litigation, digital communication and storage innovation has so transformed the discovery process as to require amendments to the Federal Rules of Civil Procedure and Evidence, and the corresponding rules of many states.²⁴⁰ The effort involved in gathering and processing electronically stored documents and information has increased with the volume of potentially relevant material. These developments have required increasing person-power to review and organize such materials into usable form, and bring what is most directly useful to the fore in particular contexts.

Transactional lawyers confront the same issues when volumes of company information become pertinent to their work—for example in due diligence in securities transactions, and in antitrust and other regulatory scrutiny in mergers and acquisitions.²⁴¹ In short, cases and deals have not only gotten larger and more complex in absolute terms, but even those of comparable scale and complexity have gotten more labor-intensive over time as the underlying volume of accessible and potentially relevant information has multiplied.²⁴²

Accompanying and often in response to these circumstances, firms took advantage of technology to develop strategies to help cope with the electronic information explosion. Any survey of these technologies is beyond the scope of this Article (and likely would be out of date by the time it is published), but as technology brought instantaneous transmission and storage of electronic documents and communications, it has also brought software and knowhow facilitating large-scale storage, retrieval, compilation and manipulation of electronic databases, as well as widely distributed document and information processing.²⁴³

These technologies broke down the previously more indissoluble mass of information in (for example) a cache of documents into smaller and more easily manipulable pieces that could

²⁴⁰See FED. R. CIV. P. 16(b), 26(a)(1), 33, 34, 37, 45 (amendments adopted 2007); FED. R. EVID. 502 (adopted Sept. 19, 2008)

²⁴¹See Montgomery Kosma, *As M&A Heats Up, Expect Antitrust Reviews*, THE RECORDER, Feb. 5, 2010, <http://www.law.com/jsp/ca/PubArticleCA.jsp?id=1202442014957&src=EMC-Email&et=editorial&bu=Cal%20Recorder&pt=RECORDER%20Cal%20Law%20News%20Alert&cn=20100205&kw=As%20M%26A%20Heats%20Up%2C%20Expect%20Antitrust%20Reviews> (“major corporations are starting to handle increasing regulatory burdens is to keep their outside counsel focused on high-complexity legal questions, while augmenting their team with outsourcing specialists who have expertise in managing high-volume, document-intensive analysis and synthesis tasks”); Gabe Acevedo, *Could Legal Technology Take Cravath System Back to the Future?*, Feb. 25, 2010, http://abovethelaw.com/2010/02/could_egal_technology_take_th.php (the SBC-AT&T merger in 2005 involved the largest “second request” in history, involving over 700 attorneys and 25 million documents).

²⁴²See, e.g., Kosma, *supra* note 241, (“document review can account for more than 75 percent of the cost in a merger investigation”).

²⁴³See, e.g., http://gabesguide.com/?page_id=51 for a list of over 40 document review “platforms.”

be “coded” into searchable databases by many independent people. And with appropriate training and direction, those people did not need all the legal learning and sophistication of a typical elite-firm associate to accomplish the task.²⁴⁴

These developments have resulted in the routinization and commodification of services of this kind. And because the documents and the database can be electronically stored centrally and distributed outward instantly anywhere in the world, the team of persons examining and compiling information about the documents in the database can be anywhere that is supplied with reliable electric power, personal computers and a fast Internet connection, with the results of each contributor’s efforts instantly available as they accrue.

2. Changing Practices On The Supply Side: Downsourcing, Insourcing and Outsourcing.

On the supply side, such changes have led firms to offer new technology-based services, and have led clients and firms alike to substitute less credentialed lawyers, and some nonlawyers, instead of elite lawyers in providing these services. Large law firms can conduct document and information processing with an atomized *ad hoc* team of personnel scattered throughout multiple branch offices, each individual contributing from a computer in his or her office (or home) via the firm’s intranet or the Internet. Whether to offer a price advantage or at the insistence of the client, such projects are also more and more subject to what we call “downsourcing”—that is, being staffed less by high-priced associates, and more by pushing the work “down” to lower-cost (and lower-rate) non-partnership-track staff attorneys and nonattorney staff, or a flexibly available corps of contract lawyers and staff who either deal directly with the firm or are supplied to the firm by temp agencies on a per-project basis.²⁴⁵

²⁴⁴An email, for example, can be “coded” and later searched for in a database with reference to its author(s), recipient(s) (including “cc”(s) and “bcc”(s)), and date by someone with basic clerical skills; and with somewhat more literacy and sophistication, by reference to any number of parties, subjects, themes or issues customized to the needs of the project at hand. Rapid full-text searching of electronic documents, and software that can transform hard-copy documents to text-searchable digital form, add to the data and data-mining tools available.

²⁴⁵See Regan & Heenan, Supply Chains at 130-31; Liz McKenzie, *Contract Attys Sitting Pretty as Associates Deferred*, Feb. 9, 2010, <http://www.law360.com/articles/148068> (“Clients are looking to firms to perform solutions for cost control, and one of those is using contract attorneys for lower-level work”; “[m]ore and more clients are saying if you can’t figure out how to get lower-level work done at lower rates, then we’ll find a way to do it ourselves”); Jocelyn Allison, *Firms Roll Out 5 Cost-Cutting Strategies for 2010*, Jan. 1, 2010, <http://ip.law360.com/articles/139219> (“If law firms want to keep [legal process] work, they’re either going to have to outsource it themselves or create some department or division of their firm that can do more of those routine tasks at a lower rate”); Jocelyn Allison, *Temp Attorneys Boon for Some, Liability for Others*, June 12, 2009, <http://ip.law360.com/articles/101669> (“overall increase in the demand for temporary attorneys in recent years in part because of the sheer volume of document review needed in the age of electronic discovery and because of the value” and cost reduction demanded by both clients and law firms). As these sources relate, these tactics have been especially popular during the recession, when temporary and contract staff offer lower overhead and more flexibility in the face of uncertain demand than do permanent associates or staff attorneys.

Taking the next logical step, client companies that find themselves regularly required to undertake these kind of projects have begun to take repetitive and routinized document and information projects in-house. Such “insourcing” commonly involves creating a permanent staff familiar with the company and its records, and developing standardized document “hold” and gathering protocols rather than absorbing the cost of having outside counsel reinvent these wheels in every new case or transaction.²⁴⁶

Clients have also begun to rely on, and to insist in appropriate cases that outside counsel employ, specialty companies that supply these services. The practice has become sufficiently widespread as to have acquired its own acronym—“LPO,” for legal process outsourcing. These companies have developed expertise in the use of the relevant information technology, and in supervising and maintaining staffs of legally literate personnel experienced in document processing, with labor costs dramatically lower than those of large law-firm associates. They have organized here in the United States, and abroad in nations with English-literate workforces, including the Philippines, South Africa and especially India. And beyond *process* outsourcing, labor-cost savings overseas are so substantial that a nation like India, with a large number of low-cost workers who are not only English-literate but legally educated, is home to numerous service companies that outsource basic substantive legal research and document drafting for British and American companies and law firms.²⁴⁷

²⁴⁶See Regan & Heenan, *Supply Chains*. As noted above, such developments are consistent with the notion that knowledge of a particular client’s information systems is a highly specific asset, and thus one of which client would likely seek control to reduce agency costs.

²⁴⁷As the *Times of London* recently reported:

Much of the work that Pangea3 and similar [outsourcing] firms deal with, such as drafting derivatives contracts or conducting due diligence for mergers and acquisitions, was once the preserve of trainees and associates at big City [of London] law firms. Some of those firms racked up annual revenues of more than £1 billion during the boom years, in part by billing out teams of junior lawyers for up to £300 an hour for even the most routine tasks. However, those firms, in a drive to cut costs, are beginning to send that sort of work to cheaper jurisdictions, such as India, South Africa and the Philippines. . . . Studies suggest that there are as many as 10,000 lawyers in [India] working for outsourcing providers, and total revenues in the sector are expected to double this year to \$1 billion (£613 million) and rise to \$4 billion within five years.

Rhys Blakely & Alex Spence, *Brief for India’s outsourcing lawyers: keep it cheap*, THE TIMES OF LONDON, Jan. 15, 2010, http://business.timesonline.co.uk/tol/business/industry_sectors/support_services/article6988773.ece (paragraph breaks omitted) (noting that “[w]hereas a new recruit at a “magic circle” firm in London can expect a starting salary of about £60,000—rising to more than £90,000 at the best paid firms—Pangea3 can pay a good Indian law graduate as little as 350,000 rupees (£4,700) a year”). The *New York Times* reports that American lawyers are beginning to move overseas to accept management positions in outsourcing firms. Heather Timmons, *Outsourcing to India Draws Western Lawyers*, N.Y. TIMES, Aug. 4, 2010, <http://www.nytimes.com/2010/08/05/business/global/05legal.html?ref=general&src=me&pagewanted=all>. The volume of offshoring work and its market penetration are increasing. Regan & Heenan, *Supply Chains* at 130-31; Anthony Lin, *Law Firm Inks \$852 Million Outsourcing Deal*, May 19, 2010, http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202458488111&Law_Firm_Inks__Million_Outsourcing_Deal=&src=EMC-Email&et=edi

Despite continuing anxiety within law firms about quality and the ability to exercise quality control, these methods appear to be delivering services of quality comparable to that provided by the original staffing paradigm of large numbers of high-priced, high-margin, heavily credentialed junior associates. The reasons are not difficult to discern. Associates assigned to these tasks after having been recruited as the best and the brightest destined for high-stakes and high-profile endeavors can prove bored, dispirited and inattentive after months of document review, regardless of the generosity of their salaries. Their talents and accomplishments are not needed for the tasks they have been assigned, and their lack of experience with this—or any other—kind of legal work often makes them markedly less efficient and effective than experienced paralegals and less-credentialed contract lawyers who have done similar work before, who are familiar with the technology, the process and the types of documents and information once again arrayed on their computer screens, and who understand that this is the job they were hired to do and willingly took it.²⁴⁸

For our purposes, several summarizing observations about these trends are in order. First, developments in technology and knowhow have made these changes in practice possible. Second, outsourcing, insourcing and down sourcing of appropriately chosen tasks offer significant potential cost savings to buyers (clients), apparently without material sacrifice in quality. And third, clients' growing sophistication with innovations of this kind, coupled with the natural urge to lower their own cost of legal services, and law firms' natural urge to offer competitive price advantages, are making these practices more common, especially in the budget-conscious environment of a serious recession.

3. Technological Change And The High-Margin Boutique.

The cost-reducing effects of technical change have two countervailing effects on firm size. First, technology lowers the costs of communication and coordination within a firm. (Imagine

torial&bu=Corporate%20Counsel&pt=Corporate%20Counsel%20Daily%20Alerts&cn=cc20100520&kw=Law%20Firm%20Inks%20%24852%20Million%20Outsourcing%20Deal (\$852 million, ten-year deal between Indian LPO company Integreon and British law firm CMS Cameron McKenna); Kian Ganz, *Four-year-old LPO UnitedLex targets \$35-40m revenue, bags BT legal outsourcing contract*, Mar. 30, 2010, <http://www.legallyindia.com/20100330624/Legal-Process-Outsourcing-LPO/four-year-old-lpo-unitedlex-targets-35-40m-revenue-bags-bt-legal-outsourcing-contract>; Alex Aldridge, *Tech Lawyers Say 'Uh Oh' As Microsoft Outsources Legal Work to India*, LEGAL WEEK, Feb. 23, 2010, http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202444082821&Tech_Lawyers_Say_Uh_Oh_as_dMicrosoft_Outsources_Legal_Work_to_India=&src=EMC-Email&et=editorial&bu=Corporate%20Counsel&pt=Corporate%20Counsel%20Daily%20Alerts&cn=cc20100222&kw=Tech%20Lawyers%20Say%20Uh%20Oh'%20as%20Microsoft%20Outsources%20Legal%20Work%20to%20India (“Microsoft has been outsourcing basic intellectual property (IP) and patent renewal work to [legal outsourcing provider CPA Global] for five years, using a team of about 70 CPA staff,” and now is expanding the services to include other legal research; other large companies such as global mining giant Rio Tinto use similar services).

²⁴⁸Moreover, managing large-scale document- and information-processing projects, and the personnel who perform such tasks, takes a range of specialized skills that large-firm lawyers often haven't acquired and don't possess. The accumulated management knowhow of outsourced specialists in this particular kind of work, and the stable of appropriately skilled workers they have accumulated, tested and trained, is part of the cost-reducing value they bring to undertakings of this kind. *See generally* Regan & Heenan, Supply Chains.

running a manual conflicts check for a 1,000 lawyer firm.) To whatever extent firm size may in the past have been limited by diseconomies of scope or scale, technology allows firms to operate efficiently at larger scopes and scales than before.

Pointing the other way, cost shifts that correlate with disaggregation also allow smaller groups of lawyers to enjoy economies of scale in various inputs important to providing complex legal services without incurring the costs that go along with the scale. Communication and computer services are notable examples. For example, documents may be stored offsite and accessed from anywhere, while billing may be automated and done directly by lawyers (who by using networked computerized billing have eliminated a volume of what used to be secretarial effort in recording and billing their time).

Because of technology, it is possible for a group of lawyers to leave a large firm and set up their own shop with only modest costs for the physical relocation of files, and minimal costs for services that formerly needed substantial volume to be cost-justified. Lower costs for such inputs and (importantly in major cities) for rent may translate to margins that are high in relation to the profession as a whole, even if not quite as high as those earned at the most lucrative firms.

And in providing services, the downsourcing, insourcing and outsourcing of labor-intensive portions of a larger project, such as document gathering and review in a complex lawsuit, allow a small firm to compete more effectively with much larger firms for some kinds of large or complex cases and transactions previously the special preserve of firms big enough to maintain the troops on staff to handle them. In other words, if the client is going to demand that a firm use contract lawyers or a third party for document review anyway, who cares whether the lawyers that do the core legal work have 10 lawyer colleagues or 1,000? The discussion above implies that it might matter to the lawyers, who may be concerned about the size of their internal referral network, but as search costs fall, it may not matter to the client.

In fact, clients may come to prefer boutiques for the same reasons boutique structure may revive some of the advantages to reputation Ribstein identified in his model of large-firm growth. Small shops may be more attentive to dispositional attributes that translate imperfectly into the sorts of behavior captured by the notion of agency cost. In English, that means that if small firms do not pursue leverage to maximize profits, they may select their members and more junior professionals more carefully than large firms may. Any bad or dissonant behavior will affect a larger fraction of a small firm than a big firm, and such behavior as well as quality lapses will be easier to observe. The result may be a more plausible “reputational bond.” Smaller shops also will often be flatter (that is, less leveraged), so that more experienced lawyers do a larger fraction of the work, and will be more available to supervise and train less experienced lawyers.²⁴⁹ This staffing will reduce to some extent the risk of error from pushing unfamiliar work down to unseasoned associates.

No benefit is without its cost, of course. Flatter firms will not provide partners the same opportunity to escape such basic tasks as research, drafting, and discovery as big firms do. Large-firm partners with books of business commonly joke about the last time they used

²⁴⁹See, e.g., Jacqueline Bell, *Boutique Biz Model Puts Associates in Driver's Seat*, Dec. 10, 2009, <http://ip.law360.com/articles/131608>.

Westlaw or read a case, to say nothing of drafting or responding to discovery. Attorneys serving in a flatter model may need to find other sources of levity.

C. *Questions This Analysis Raises That It Cannot Fully Answer.*

1. *Why Is Discussion Of These Forces Almost Absent From The Law-Firm Literature To Date?*

The previous sections discuss powerful and long-recognized economic forces that appear to have direct application to important changes afoot in the markets for elite-firm lawyers and their services. Why, then, has the economic literature concerning such firms over the last 25 years almost completely disregarded them? We have a few thoughts.

To begin with, the literature concerning elite law firms has focused almost exclusively on the incentives and conduct of the firms' licensed professionals, rather than their more numerous nonlawyer support staff. Explaining why half to three-quarters of the personnel that have populated these institutions for the last century has been almost entirely overlooked is probably better left to social scientists, but it has focused economic analysis of the firms' growth and structure in a very significant way: Firm "size" and "growth" have always been measured in number of lawyers, not the overall number of firm employees or even timekeepers; "structure" has referred to the relations among partners, or between partners and nonpartner attorneys; economic and labor relations between the firm and its nonattorney staff have been ignored.

One reason for this selective focus may be that the many technological changes that have increased productivity and transformed the way law is practiced over the last hundred years have had little effect on the basic boundaries of core "lawyer-work" in general, and the lawyer-work of elite-firm associates in particular.²⁵⁰ For example, invention of the typewriter, carbon paper and then the copy machine eliminated an entire category of support staff—the scribes who copied out documents and pleadings by hand. Similarly, the pervasion of computers in the workplace has reduced the practice of dictation and of longhand drafting and editing. One could say that this has made typing as much lawyers' work as secretaries', but it would be more accurate to say that it has only changed the *manner* in which lawyers do what they've always done—commit their thoughts to writing and revise their written work. The lawyers are still doing the drafting and revising; their direct use of technology just allows them to do so more efficiently, and use less secretarial help in the process. As a result, it is the secretaries' workloads that have changed, with concomitant reductions or eliminations of steno pools, typing pools and word processing centers.

With the expansion of the durable information base underlying more and more large-firm services, and the increase in the proportion of a large firm's work focused on coping with those materials, gradually a task that straddles the outer limit of what comprises lawyer-work has become an increasingly significant part of many of the projects entrusted to outside counsel.²⁵¹

²⁵⁰See, e.g., Galanter & Palay, *Tournament* at 7-8 (describing technological innovations and their effects on productivity and practice).

²⁵¹See, e.g., note 86, 240-242, *supra*, and accompanying text; Kosma, *supra* note 241 ("document review can account for more than 75 percent of the cost in a merger investigation").

Document and information gathering and processing was, so far as we can tell, always part of the elite-firm associate's regimen (and at the same time also entrusted to experienced paralegals and similarly skilled nonlawyers).²⁵² But the increasing numbers of highly compensated junior associates being billed out at top dollar to address these tasks to the substantial exclusion of any "real" lawyer-work has focused increasing attention on this set of tasks. It has raised bitter complaints on the associates' part that this was neither why they went to law school nor what they'd been recruited for. And it has raised equally bitter complaints on the part of clients about being charged \$250 to \$300 per hour for work that could be obtained from less credentialed but competent staff or contract lawyers, or experienced paralegals or other legally literate nonattorney staff, at a cost as little as one-tenth that amount.²⁵³

The Coasean forces that are driving this work out of the hands of elite-firm associates are not likely to abate. Downsourcing, insourcing and outsourcing has raised significant questions, and is changing views, about what falls within the appropriate scope of what lawyers in traditional firm job classifications should be doing. In this respect the issue is, if not unique, then uniquely substantial in its impact on patterns of practice within the profession.

2. Why Has This Issue, Which Has Been Developing For Many Years, Suddenly Come To The Fore During The Recession?

The digital information expansion has been going on for years. Big-firm rates have been increasing for decades, and increasing especially steeply in the last decade. The volume and acerbity of clients' complaints has risen in tandem with rates—complaints that they don't want to pay elite-firm associate rates for paralegal-level document and information gathering and processing that results in associates' not being trained for anything else. Downsourcing, insourcing and outsourcing were all established phenomena well before 2008.

Yet the recession increased both discussion and actual use of these strategies significantly.²⁵⁴ This raises two conundrums: Why did elite firms achieve the scale and structure they did in the face of the gathering forces we believe are reshaping commercial law firms today? And now that these forces are more powerfully affecting market behavior, why should the economic downturn have any particular relevance to economic factors, such as increasing

²⁵²Galanter & Henderson, *Elastic Tournament* at 110, Galanter & Palay, *Tournament* at 65-66.

²⁵³See notes 86-93, *supra*; Timmons, *supra* note 247 ("Thanks to India's low wages and costs and a big pool of young, English-speaking lawyers, outsourcing firms charge between one-third and one-tenth what a Western law firm bills per hour"); Debra Cassens Weiss, *Lawyer's Lament: Pressure to Review 80 Documents an Hour, at \$23 an Hour*, Oct. 21, 2009, http://www.abajournal.com/weekly/lawyers_lament_pressure_to_review_80_docs_an_hour_for_23_an_hour; Anonymous, *Down in the Data Mines*, ABA J., Dec. 1, 2008, http://www.abajournal.com/magazine/article/down_in_the_data_mines/ (contract lawyer doing document review at \$35 per hour).

²⁵⁴See, e.g., notes 245-248, *supra*, and accompanying text; Blakely & Spence, *supra* note 247 ("Studies suggest that there are as many as 10,000 lawyers in [India] working for outsourcing providers, and total revenues in the sector are expected to double this year to \$1 billion (£613 million) and rise to \$4 billion within five years"). Any reliable measure of the adoption and resource-consumption rates of these practices awaits further research, but the trend seems undeniable.

client sophistication and technological innovation's effects on cost structures, that preceded and appear quite independent from it? In short, why now?

Our best guesses focus on various forms of habituation in the marketplace. We can think of three:

First, while clients over the last 30 years have abandoned the notion of a single outside counsel firm in favor of the piecemeal shopping of particular transactions, disputes or subject matters (a company's 1934 Act work or its FDA compliance, for example), they seem to have hesitated at times to dissect work below the project level. In other words, clients carefully chose a particular lawyer for a particular lawsuit or transaction, but less frequently considered disaggregating the information-processing function within a project that had traditionally been viewed as a unit. Although some of this may have been attributable to higher search costs and coordination costs when disaggregation was less common and less familiar, we suspect that familiar habits of thought and practice also may have slowed clients' inclinations to think outside the proverbial box (or perhaps more accurately, think smaller than the proverbial box that held a single case or deal).

Second, the economic incongruities that these gradually eroding practices put in place slowed the development of the infrastructure necessary to support widespread disaggregation, even as economic forces pressed in that direction. Firms were only too happy to throw as many associates as they could hire into legal process work at \$250 to \$300 per hour or more, and jacked associate salaries into the stratosphere to obtain enough of them to staff the work as long as their clients would pay the rates that allowed them to do so. Associates who could earn \$150,000 to \$200,000 per year doing that work (however resentfully) were never going to accept substantially less in-house or with an LPO company to do the very same thing. And that in turn made it more difficult for law departments and outsourcers to acquire the personnel necessary to propagate insourcing and outsourcing.

And *third*, rhetoric lagged reality: The widely articulated view had long been that the elite firms hired the "best" graduates of the "best" schools to devote to the "best" work that the "best" clients had to offer. Elite law firms were not generally retained to do just a good enough job on routine work and, as the drumbeat for the "best" reflects, neither the firms nor their clients were inclined to think of themselves in that more prosaic light. We suspect that outside lawyers and their clients both were slow to reconsider the credentials and qualifications necessary to do adequate legal process and similarly routinized work, even as 28% of recent law graduates (a good deal more than the *crème de la crème* by any measure) found themselves working in private firms of over 100 lawyers, many in richly compensated, dead-end positions that provided them with little opportunity for professional development or growth.²⁵⁵

The recession, with its widespread law-department budget cuts and thousands of large-firm layoffs, seems to have awakened everyone involved to the forces that had been building for years, and brought those forces more fully into play. Clients triaged their legal work, and as to what was indispensable, began to scrutinize which constituent tasks truly needed high-end staffing and which required not the "best," but just those good enough to accomplish the task

²⁵⁵See notes 86-92, *supra*, and accompanying text.

cost-effectively. Law firms economized by shedding expensive associates whose services were no longer in demand at prevailing rates, instead spot-contracting with foot-soldiers in the new army of the unemployed for legal process and similar work at much lower cost and more flexible commitment. Out-of-work associates often had few options other than lower-wage contract or staff attorney positions, and legal process outsourcers had greater access to licensed lawyers with legal process experience and a need for work. In short, the recession did not create the technological and cost-structure changes that had been slowly reshaping the market for legal services, but it did expose them in high relief, redistribute the workforce involved in them, and accelerate the market's internalization of them.

With these developments in mind, we finally turn to the questions posed at the end of Part I: What can we expect in the market for legal services as the recession recedes?

V. IMPLICATIONS AND PREDICTIONS.

As Yogi Berra (or was it Neils Bohr?) said, predictions are hard, especially about the future.²⁵⁶ They are, however, a good way to test economic models. In our view, the analysis of the previous sections implies several things. Many of them are not controversial, and indeed may already be considered the new conventional wisdom. We hope we have contributed to the discussion here by shifting the analysis underpinning that new conventional wisdom from the outdated and incomplete models described in Part II to more demand- and cost-driven approaches, which we believe offer more explanatory, and thus predictive, force. With all appropriate trepidation and humility, then, we offer the following extrapolations:²⁵⁷

A. *Implications For Law Firms And Practitioners.*

Disaggregation of legal services, and the price competition that causes and results from it, will accelerate. Corporate clients are not going to become any less sophisticated, and will in increasing numbers scour their legal work for tasks that can be routinized, commoditized and conveniently handed to low-cost providers or handled more economically in-house.²⁵⁸ Technology will continue to lower the cost of coordinating with economically-priced, appropriately skilled workers wherever in the world they may be found. Downsourcing,

²⁵⁶Our ability to tell them apart is limited by our knowledge of their respective locations and momentum. In all events, we've never seen them together in the same room.

²⁵⁷As John Kenneth Galbraith reportedly quipped, "The only function of economic forecasting is to make astrology look respectable." Our analysis up to this point shows, if nothing else, how often even the most thoughtful and perceptive investigators can miss the mark. We seriously debated just making the joke about quantum mechanics, embracing indeterminacy, and quitting while we were ahead. But ultimately we figured that any reader who has stuck with us this long deserves some tea leaves. And a cookie. So enjoy your snack, and we'll get back to business as best we can.

²⁵⁸See, e.g., notes 71-76, 245-248, *supra*, and accompanying text.

insourcing and outsourcing will become more prevalent as clients insist on them, and elite law firms do what is necessary to remain competitive.²⁵⁹

The number of highly compensated partnership-track associate positions at large firms will fall. Legal process and similar routinized and commodified work will less and less support elite-firm associates' rates. As such work is pushed down and out at large firms, fewer conventional partnership-track associates will be needed to staff it. As a result, large firms will not return to the recruiting and hiring patterns that preceded the recession. Even after the current glut of laid-off and deferred associates is re-absorbed into a future expanding economy (or leaves the legal sector), there will be significantly fewer high-paying private-sector jobs for new law graduates. The days when a quarter or more of the nation's new law graduates will hire on as highly compensated BigLaw associates are over. Leverage may fall even further than it has to date.²⁶⁰

The number of well-compensated, indefinite-term nonpartnership positions at large law firms will increase. Possibly slowing the decrease in leverage resulting from reduced hiring and retention of associates, long-term nonpartner attorney positions (variously denominated nonequity partners, senior associates, counsel or the like) will increase. These positions will increasingly be offered to highly qualified specialists, former "service partners," and other

²⁵⁹See, e.g., Clay & Seeger, 2010 Law Firms in Transition at 5 (2010 Altman Weil survey of firms over 50 lawyers found 39% of respondents used contract lawyers in 2009, 53% expected to in 2010, and 52% expect that contract lawyers "will become a permanent part of their staffing plans"). Gina Passarella, *Outside Shot: In-House Departments, Law Firms Rely More on Project Attorneys*, THE LEG. INTELLIGENCER, July 6, 2010, http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202463299917&Outside_Shot_InHouse_Departments_Law_Firms_Rely_More_on_Project_Attorneys=&src=EMC-Email&et=editorial&bu=Corporate%20Counsel&pt=Corporate%20Counsel%20Daily%20Alerts&cn=Corporate%20Counsel%20Daily%20Alert&kw=Outside%20Shot%3A%20In-House%20Departments%2C%20Law%20Firms%20Rely%20More%20on%20Project%20Attorneys; Elie Mystal, *Outsourcing: It's Not Just About The Money*, June 9, 2010, <http://abovethelaw.com/2010/06/outsourcing-its-not-just-about-the-money/#more-20794> ("The 'smart firms' aren't trying to make their juniors become as cost-efficient as LPOs; those firms are trying to show an ability to direct the appropriate grunt work to LPOs—the very same grunt work that used to keep armies of junior associates very busy").

²⁶⁰One example of this trend is the strategic planning memorandum circulated among associates and counsel at O'Melveny & Myers in August 2009. The memorandum acknowledges management's dissatisfaction with the firm's current business plan, noting that its litigation practice, "which depended heavily on high charge hours levels by associates, counsel and partners to offset the impact of discounted rates and increased write-offs of expenses and time, has been under pressure for at least three years"—that is, since before the current recession began. The memo notes that "[d]ocument review and production have been outsourced altogether or client-directed to contract attorneys, thus eliminating much of the work formerly assigned to junior associates." Similarly, it predicts that transactional practices "will not be able to deploy and charge for large numbers of associates in the deals that will be done when the economy rebounds." The firm's new strategic plan expressly aims to reduce leverage to as low as 2 to 1 in some practices—a level not seen at many large firms for 30 years or more. David Lat and Elie Mystal, *The New BigLaw Business Model, According to O'Melveny & Myers*, Sept. 16, 2009, http://abovethelaw.com/2009/09/omelveny_myers_strategic_plan.php. See also Elie Mystal, *NALP 2010: New Litigators Be Warned*, Apr. 29, 2010, <http://abovethelaw.com/2010/04/nalp-2010-new-litigators-be-warned/>; notes 62-63, *supra*, and accompanying text.

skilled and experienced practitioners who are useful in supporting the firm's practice. These personnel will be generously compensated, will have some standing within the firm, and will have some level of opportunity to become equity partners if they develop significant business of their own.

The number of staff and spot-contract positions at large law firms, compensated at levels comparable to nonattorney staff and limited to legal process and other routine work, will increase. Aside from the classes of well-compensated nonpartners (associates, nonequity partners, counsel), a completely separate underclass of staff and contract attorneys will develop at many firms. Their work will be limited to routinized and commodified work such as legal process, and possibly the kinds of routine legal work large companies are increasingly outsourcing abroad.²⁶¹ As competition between their work and that of third-party LPO and other outsourcing providers reduces the rates at which their efforts can be charged to clients, they will be billed out at lower rates, paid less, and have even less standing at their firms.²⁶² These are becoming the assembly-line jobs of the 21st century: tedious, repetitive, rushed and pressured by emphasis on quantity over quality, and even subject to ergonomic and repetitive stress injuries. Such workers may begin to organize to protect themselves.²⁶³

The fewer conventional associate positions that remain available at large firms will in some respects be more professionally rewarding than the greater number available before the recession. As repetitive and commodified work becomes a smaller part of the typical associate workload, associates may get greater access to more challenging and responsible tasks; and as the number of partnership-track associates falls, they also may get more access to supervision and training.²⁶⁴ As it always has, however, the job will still typically involve a fair complement

²⁶¹See Justin T. Miller, *Second-Tier Associates, A New Trend in Big Law*, July 14, 2010, <http://www.law.com/jsp/ca/PubArticleCA.jsp?id=1202463535998&src=EMC-Email&et=editorial&bu=The%20Recorder&pt=The%20Recorder%20News%20Alert&cn=20100715&kw=Second-Tier%20Associates%2C%20a%20New%20Trend%20in%20Big%20Law%20Premium%20Access%20Required>. For example, London firm Freshfields recently chose to react to anticipated demand by increasing use of contract and outsourced staff. *Freshfields Expects More Work Than It Can Handle*, Apr. 15, 2010, <http://lawshucks.com/2010/04/freshfields-expects-more-work-than-it-can-handle/>.

²⁶²The extent to which a law degree will remain a necessary qualification for these jobs (or will provide a pay differential for those in these ranks who possess it) remains to be seen, but will depend in part on how explicitly "legal" their workload becomes. The proportions in which such positions are eventually distributed between staff employee or spot-contract positions directly for firms and such positions at LPO or other outsourcing specialists (which are in turn retained by firms and client companies) is unclear. But the number of people doing this kind of work on these kinds of terms will undoubtedly increase.

²⁶³*Cf.* Richard Acello, *E-Degree*, ABA J., Jan. 1, 2010, <http://www.abajournal.com/magazine/article/e-degree> (reporting advocacy for standards and certification for e-discovery workers).

²⁶⁴Our analysis suggests the possibility of some degree of return to the Cravath model in something closer to its original form than has generally been seen in recent years. In the Cravath System as originally conceived, elite firms actively acculturate and train associates, and provide them graduated amounts of responsibility, to prepare and select those deemed suitable for partnership. This is to some degree inconsistent with retaining greater numbers of experienced nonpartners to provide experienced and specialized client services: To have permanent nonpartner attorneys taking work senior associates could

of drudgery, long hours, stress and relatively poor chances of promotion. The typical “elastic tournament” partner probably won’t get markedly more pleasant to work for either. But at least associates may end up doing more of something that more closely resembles traditional law practice, and gaining more useful professional skills and experience in the process.

Equity partnerships will grow more slowly, and be more rigorously limited to those demonstrating success in business generation. Because the highly leveraged work that tends to provide law firms the greatest profit margins will be under continuing cost and price pressure, margins will erode, and higher-margin work will become more scarce. Relentless pruning of partnerships through de-equitizations and dismissals will continue, further focusing profits and power in an increasingly narrow equity “core” achieved only through control of substantial amounts of profitable law business.²⁶⁵ After this shakeout, many equity partnerships will continue to grow (or begin to grow again), by both lateral acquisition and internal promotion, but

be doing could interfere with the training and selection process traditionally focused on younger candidates for partnership in the traditional Cravath model.

This aspect of the Cravath System may eventually prove to be outdated, however: One of the significant trends in the evolution of the “elastic tournament” over the last 20 years is the erosion of firm-specific capital. This has correspondingly reduced the need for, and use of, bonding devices such as the “up or out” rule or any feature of a rank-order promotion-to-partner tournament (if the latter ever existed), which have been explained as bonding mechanisms used to attract and retain qualified associates in an environment in which both parties have firm-specific capital that is at risk of opportunistic misappropriation. *See* notes 173-175, *supra*, and accompanying text. There are, of course, alternative models that may emerge in response to these changes. One could be a firm that hires very few junior lawyers and does not consider most training its responsibility. Such a firm would provide, at most, only the advanced skills training that experienced senior associates get from doing their jobs under partner supervision. It might hire only more experienced lawyers to support the partners, offering no formal partnership track and limited chances for advancement to partnership based principally on business generation. Most partners in such a firm would be acquired laterally. Another possible alternative is a corporate-workforce model of a continuum in the lawyer ranks from bottom to top. In such a structure, advancement in grade and compensation would be based on a periodic evaluation of marginal productivity, and there would be no radical division between the partners and everyone else. Again, we do not advocate any of these systems, nor can we confidently predict which may emerge; we simply observe that they are all plausible reactions to current circumstances.

²⁶⁵For example, the O’Melveny strategic planning memo discussed in note 260, *supra*, asserts that “the Firm must not only recognize and promote its best partners in terms of business development and practice support, but it must also ensure that its compensation system and allocation of workloads within the partnerships reflect the imperative of paying fairly and supporting those partners who carry a disproportionate load as leading practitioners and practice builders. The current ‘upside down’ partnership pyramid needs to be righted with alacrity.” *Id.* *See also* Karen Sloan, *Lateral game is on, but the rules have changed*, NATL. L.J., Apr. 26, 2010, <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202448812975&src=EMC-Email&et=editorial&bu=National%20Law%20Journal&pt=NLJ.com-%20Daily%20Headlines&cn=20100430NLJ&kw=Lateral%20game%20is%20on%2C%20but%20the%20rules%20have%20changed> (active lateral hiring market focuses strictly on substantial portable billings).

generally only of persons selected for their ability to attract and control law business and build the partnership's internal referral network as described in Part III above.²⁶⁶

After the recession-induced shakeout, overall growth in the number of well-compensated lawyer positions at larger firms will continue, but more slowly. In the near term, the shakeouts and reorganizations that the recession and the economic forces described above have brought and will continue to bring into play will cause many firms to shrink, or grow only slowly—particularly as measured by the census of highly-compensated partners, associates and indefinite-term lawyer employees (and excluding the growing underclass of legal process providers who are paid at levels comparable to nonlawyer staff). In the medium term, the tendency for equity partnerships to grow by accreting new rainmakers, who will need subordinates to support them, will cause some, and perhaps many, large firms to resume growth. But given falling costs and pricing for legal process and similar work, they will generally grow more slowly than they have over the last 20 years.

Lateral mobility will remain a significant force, and BigLaw will remain brittle. Partnerships will continue to try and increase profits per partner (and the returns from their internal referral networks) by seeking new partners with reputational and relational capital leading to profitability greater than the partnership's current mean. They will tend to splinter off partners with lower margins and profitability.²⁶⁷ The effect of this phenomenon on growth across large firms as a whole is difficult to predict, because many firms will be both losing and gaining partners as profitability, like water, seeks its own level at each large firm.

Segmentation between a small cadre of “super-elite” firms and a larger group of “semi-elite” firms will become more pronounced. Because some practice specialties generally tend to be more profitable than others, these trends suggest increasing concentration in a more limited array of practices, at least nearer the top of the profitability scale. This process will continue to press the nascent stratification between “super-elite” and “semi-elite” firms Galanter and Henderson see emerging in their empirical data.²⁶⁸

²⁶⁶We would guess, however, that the number of hypertrophic firms (with attorney census above, say, 1,500 or 2,000) may not significantly increase, and would offer a very large international platform as part of their core. This platform would be appealing to some lawyers likely to generate significant revenues. Former White House Counsel Greg Craig's move from a lifelong home at super-elite Williams & Connolly to the more international Skadden may illustrate the point. Though we recognize that repeated predictions that big firms can't possibly get any bigger have been consistently wrong for decades, and we are accordingly very tentative, we wonder whether there is enough demand for more than a handful of players enormous enough to sustain this model.

²⁶⁷See note 223, *supra*. 2009 was a very active year for partner mobility, with 2,775 Am Law 200 partners changing firms. *American Lawyer, Law firm churn hits all-time high*, PHILADELPHIA BUS. J., Feb. 24, 2010, http://philadelphia.bizjournals.com/philadelphia/blogs/law/2010/02/american_lawyer_law_firm_churn_hits_all-time_high.html. 2010 appears to be on a similarly torrid pace. See, e.g., Leigh Camping-Carder, *Lateral Market Sees Busiest Month This Year*, July 1, 2010, <http://ip.law360.com/articles/178556>. The nature and characteristics of the moves have not yet been analyzed.

²⁶⁸See Galanter & Henderson, *Elastic Tournament* at 138; Press & Mulligan, *supra* note 121 (noting in 2009 financial results increasing separation of the first quintile of (predominantly New York-

High-margin specialty boutiques will remain a significant part of the competitive landscape. As technology allows small firms to enjoy scale economies, some may be able to achieve margins that approach the margins of large firms in similar market segments. Boutiques will remain a recognizable part of high-margin practice in the future as some portion of elite-firm lawyers leave profitable large firms to trade some amount of money for smaller scale, lower overhead, greater intimacy and a more direct hand on the tiller.²⁶⁹

One thing this discussion should make clear is that the large American law firm is not dying. The basic conditions that have driven increasing demand for sophisticated legal services for many decades remain in place: The legalized nature of society, business and wealth-creation in this country has not materially changed, and governmental intervention in any number of areas (including the healthcare, energy and financial services industries, among others) suggests more of the same for years to come. As the economy recovers, there will be plenty for high-end specialists to do in contexts and with stakes that will continue to support some degree of premium pricing. The same forces that drew elite lawyers together into larger and larger aggregations also remain in place, and while such phenomena as the erosion of firm-specific capital will continue to impart a certain brittleness to the form, there is no reason to believe that centripetal forces will not, on balance, remain paramount at least up to sizes as large as some of the larger firms today.

By the same token, however, the large law firm is evolving. The suddenness and extremity of the current recession exposed a number of incongruities that had been developing in the large-firm business model over the last ten to twenty years, and the correction of those incongruities is now concertedly underway. Important changes are emerging as a result, the course of some of which we guess at above. But none of them should spawn revolutionary rather than evolutionary development in the way complex and sophisticated legal services are produced and delivered.

B. *Implications For Legal Education.*

Although our topic has been law firms, basic economics implies a relation between demand for legal services and demand for the training and certification necessary to provide them. We therefore offer some observations on what our analysis may suggest about the future of legal education, leaving fuller exploration of this topic for another day.

Law school tuition has risen, steadily and more rapidly than inflation, for some time.²⁷⁰ More and more students thus have been required to borrow greater and greater sums to fund a

based) Am Law 100 firms from the remainder). See also Dimitra Kessenides, *The Am Law 100 2010: Catching Up with the Class of 1985*, May 10, 2010, <http://amlawdaily.typepad.com/amlawdaily/2010/05/classof1985.html>.

²⁶⁹See Abigail Rubinstein, *What Boutiques Can Do To Keep Luring Laterals*, May 5, 2010, <http://ip.law360.com/articles/166217>.

²⁷⁰See Elie Mystal, *Even U.S. News Suggests Law School Tuition Is Getting Ridiculous*, July 15, 2010, <http://abovethelaw.com/2010/07/even-u-s-news-suggests-law-school-tuition-is-getting-ridiculous/#more-26942>; Katy Hopkins, *As Law School Tuitions Climb, So Does Demand*, U.S. NEWS & WORLD REPORT, July 14, 2010, <http://www.usnews.com/articles/education/best-law-schools/2010/07/14/as-law-school-tuitions-climb-so-does-demand.html?PageNr=2>.

legal education, leaving a substantial proportion of today's law graduates entering the job market with \$100,000 or more in debt. Northwestern Law Dean David Van Zandt estimated in early 2010 that the “break-even” salary—that is, the starting salary that in the long run would make three years of law school tuition and forgone income a good economic investment—is \$65,000.²⁷¹ A more detailed economic analysis exploring the wide-ranging variables affecting differently situated students suggests that, for many prospective law students, that break-even point may be significantly higher.²⁷²

Our predictions for the future of the elite sector of the Bar bear directly on the prospects for a college student contemplating a legal career. A bi-modal salary distribution among law graduates began to emerge around the turn of the century, and became steadily more pronounced in succeeding years. By 2008, the starting salary distribution exhibited a large spike in the \$40,000-\$65,000 range, and a separate spike in the \$145,000-\$160,000 range.²⁷³ That high-end salary spike is explained by the quarter or more of all law graduates who were taking large-firm jobs by 2008.²⁷⁴ But that was before the bottom fell out of the BigLaw entry-level market, with thousands of layoffs and new hiring in 2009-2010 at a small fraction of prior levels.²⁷⁵

Even before recessionary forces accelerated the transformation of the legal job market, close to half of all law graduates were starting at less than Dean Van Zandt's \$65,000 “break-even” point.²⁷⁶ Given that the law graduates who were receiving BigLaw offers were generally better credentialed, and therefore generally more attractive to most legal employers, the contraction at the top of the salary scale has pushed a substantial number of highly competitive entry-level job candidates down the scale. They are displacing in the job market many of the graduates who had in past years taken up less remunerative positions in government, in-house at

²⁷¹David Lat, *Changes in Legal Education: Some Thoughts from Dean David Van Zandt*, Feb. 3, 2010, <http://abovethelaw.com/2010/02/changes-in-legal-education-some-thoughts-from-dean-david-van-zandt/>.

²⁷²Herwig Schlunk, *Mamas, Don't Let Your Babies Grow Up To Be . . . Lawyers*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1497044 (draft dated Dec. 15, 2009). Schlunk points out that a realistic assessment of a law-school candidate's prospects is an essential part of any meaningful economic decision whether to pursue a law degree. *Id.* at 3. Some students highly motivated by the economic benefits of elite practice may have scant chance of achieving them. And of course we recognize that whether to attend law school is rarely a purely economic decision. The purpose to which the education is put, and the subjective satisfaction (or dissatisfaction) that the candidate anticipates and later actually experiences from the legal career chosen (or available) is obviously critical. Some highly talented prospective lawyers may not covet BigLaw work no matter how lofty the salary, may be willing to trade time for money in choosing a career, or may be motivated predominantly by political, societal or intellectual passions not measured in dollars and cents.

²⁷³*Id.* at 11 (citing <http://nalp.org/salarydistrib>); see also Henderson, *Bi-Modal Distribution* (spikes around \$50,000 and \$125,000 for 2006 law graduates).

²⁷⁴See notes 54, 96, *supra*, and accompanying text.

²⁷⁵See Part I.C, *supra*.

²⁷⁶See note 273, *supra*, and data cited.

companies (to the limited extent they hire entry-level lawyers) and at smaller private firms.²⁷⁷ In turn, many graduates of less prestigious law schools, and many graduates with less distinguished academic records and similar credentials, are having a very hard time finding jobs remunerative enough to support the levels of student-loan debt common among recent graduates, let alone recoup the investment of time and money law school represents for them. Some are finding that the only law-related jobs available to them (other than the default of attempting to make a living as a solo practitioner, which for many is proving difficult) involve the low-wage legal process and routine work that increasingly is being pushed down and out to contract lawyers, staff attorneys, temps and outsourcing companies.

We see these conditions continuing indefinitely. Even after the economy improves and the pent-up supply of laid-off and deferred associates is absorbed, the economic forces discussed above will leave significantly fewer highly compensated entry-level large-firm jobs available for the foreseeable future. In other words, we believe that the flattening of the high-end spike in the law-graduate salary distribution is not a transient phenomenon, though it likely will be exaggerated in degree by economic conditions and their lingering effects over the next few years.

As a result, for quite a substantial number of prospective students law school has become a much worse value proposition than it was in 2007, and will remain so in the future. In short, as legal labor markets become more competitive, law school will make economic sense for fewer and fewer people.

Angry graduates in search of legal work are already condemning law school as a “scam,” and its matriculants as “hapless lemmings.”²⁷⁸ At the same time, law school applications rose to record levels during the recession, though this may reflect the short-term absence of immediate alternatives in the job market more than any perceived increase in the value of a JD.²⁷⁹ Law

²⁷⁷We do not suggest that these jobs are less fulfilling, just that they pay less, and that this economic differential affected the career choices of many law graduates (as would be expected in any remotely rational market). Many conventionally successful law students (i.e., those who got better grades and/or attended more prestigious schools) seem to have been seduced by the 160,000 sirens singing from BigLaw’s coffers, which may have drowned out questions about what the students might be doing when they got there, whether they would like it, and where it might lead them later in their careers. Judging from the traffic on sites like Above the Law (<http://www.abovethelaw.com>), the Greedy Associates message boards (*see* <http://www.infirmation.com/bboard/clubs-top.tcl>) and Bitter Lawyer (<http://www.bitterlawyer.com>), a great many more leapt blindly into the deep than discovered that they enjoyed the swim.

²⁷⁸Debra Cassens Weiss, *Angry Law Grads, Beef, Blog and Move On; Tuition Makes \$15K Total in 80s Seem Paltry*, Aug. 16, 2010, http://www.abajournal.com/weekly/article/angry_law_grads_beef_blog_and_move_on_big_tuition_pales_next_to_15k_total_i; Leslie Kwoh, *Irate law school grads say they were misled about job prospects*, N.J. STAR-LEDGER, Aug. 15, 2010, http://www.nj.com/business/index.ssf/2010/08/irate_law_school_grads_say_the.html. We wonder when the disappointed may start trying to exploit their expensive knowledge and extensive free time with claims for false advertising or other consumer remedies.

²⁷⁹*See* Karen Sloan, *Hope drives rise in law school applications*, NATL. L.J., July 12, 2010, http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202463410108&Hope_drives_rise_in_law_school_applications&slreturn=1&hbxlogin=1.

school does not yet resemble the lottery that draws people to play basketball in the hope of reaching the NBA, but the relationship between the nominal value of reported wages and the expected value of such wages to any given player is analogous, if less extreme in degree. A law degree has enjoyed a long and widespread reputation as a “golden ticket,” and a disproportionate number of law students reportedly still believed in 2010 that, even though they doubted the prospects of their peers, they themselves would somehow win the employment lottery, or at least break even.²⁸⁰

But the lessons of hard experience will eventually seep into the market. To the extent that market is economic and rational—and we believe that it is more than enough of both to matter—the phenomena we have discussed likely imply that there are more law schools than an increasingly competitive environment will support. Contraction in the number of schools seems probable and likely would be efficient. How far such contraction extends will be a function of the value schools find ways to deliver in relation to the particular needs and pricing of the legal labor markets. We see that dynamic playing out in two general ways:

First, applications to law school should fall. Those deterred from applying should skew generally toward two populations: (i) those whose prospects for economic success in the profession are more marginal, and who are considering a legal education for predominantly economic reasons; and (ii) those who are less sure they are interested in the profession in the first place, and who may be considering law school as a means of deferring rather than making career choices. A reduction in the size of the former group should push toward a smaller but somewhat better-qualified applicant pool overall. The latter group has traditionally included a complement of students who are intelligent, have good verbal skills and broad general interests, studied the liberal arts or social sciences, and have no clear idea what they want to do with their lives. Such students are often attractive law-school applicants and prove adept at the curriculum when they arrive, making them more attractive job candidates at the end of their three years. The winnowing of this population should push toward a somewhat less-qualified applicant pool.

And *second*, among those still committed to pursuing a legal education, there will be increased scrutiny of the value proposition particular institutions offer. In other words, the market among law schools for qualified applicants will become more competitive. We see this playing out in several ways:

²⁸⁰A 2010 survey of pre-law students by the Kaplan test preparation organization showed that although 52% were “very confident” of finding a legal job after graduating from law school, only 16% were “very confident” their classmates would have similar success. A mere 7% lacked confidence in their own ability to find employment upon completing law school. *Kaplan Survey: Despite Challenging Job Market, Tomorrow’s Lawyers Appear to Have a Healthy Outlook on Their Own Job Prospects, But Not Their Classmates’*, Apr. 12, 2010, <http://www.kaplan.com/aboutkaplan/newsroom/Pages/newsroom.aspx?ID=571>. The striking contrast between students’ confidence in their own prospects and lack of confidence in their peers’ has not been lost on industry observers. See Elie Mystal, *The Hubris of Would-Be Lawyers*, Apr. 13, 2010, <http://abovethelaw.com/2010/04/the-hubris-of-would-be-lawyers/> (“There’s no way 52% of pre-law students should be ‘very confident’ about anything other than getting screwed with their pants on”).

Prestige will continue to predominate. Law-school brands have long been, and continue to be, quite powerful. Prospective students rely heavily on relative prestige in choosing a law school, a course no doubt reinforced by the fact that legal employers generally look to the source of an entry-level candidate’s law degree as one of the two most significant signals of the qualities that lead to future professional success (the other being law-school grades or class standing).²⁸¹

On one view, this may seem more than a little odd, as the characteristics to which academics attribute prestige have grown increasingly divorced from the concerns of professional practice over the last two generations. During that time, law schools seeking to maximize their academic prestige have shifted pointedly toward a graduate school model. The most prestigious schools seek new faculty with graduate degrees in disciplines other than the law in addition to a JD; prize scholarship in “law and” something else; and dismiss as “merely doctrinal” the kind of practically-oriented work that was common among the academic giants of the middle decades of the 20th century. Few new scholars practice for any length of time, and after even a short time in the academy are strikingly unfamiliar with the environments most of their students enter. As a result, legal education at prestigious schools has become more theoretical and detached from practice while legal labor markets have become more competitive. Elite academics and elite practitioners often seem to regard one another with mutual lack of interest or even contempt.²⁸²

Despite the disconnect between “prestige” within the academy and “prestige” outside it, we don’t see the primacy of prestige waning anytime soon as a leading determinant of preference, whether among academics, prospective students, employers or clients. More prestigious institutions are likely to continue to attract more candidates whose skills and experiences both appeal to elite schools and make them good bets for success in later life across a broad range of potential mainstream careers.²⁸³ As long as that cycle continues, the most prestigious law schools will likely remain so despite the economic changes we describe: Most employers will continue to choose a Harvard graduate in the third quintile of her class over a so-

²⁸¹This phenomenon does not appear to be limited to elite-firm hiring, but seems to obtain broadly across the market.

²⁸²See generally Brent Evan Newton, *Practicing What They Don’t Preach: Why Law Faculties’ Preoccupation With Impractical Scholarship and Devaluation of Practical Competencies Obstruct Reform in the Legal Academy*, -- S. CAR. L. REV. --- (forthcoming), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1646983 (draft dated July 23, 2010); Richard A. Posner, *Triumphs and Travails of Legal Scholarship*, in *OVERCOMING LAW*, at 82-84 (1995) [hereinafter cited as Posner, *Overcoming Law*].

²⁸³We do not suggest that these candidates’ perceived qualities—described by such concepts as ambition, drive, intelligence, leadership, social skills and the like—are in any sense objective or absolute, and we recognize the pervasive cultural and other constructs inherent in all of them. We simply suggest, descriptively, that elite law schools, like many other societal loci of power and influence, seek out and attract candidates similar to those sought out by the mainstream institutions in which many of those candidates go on to succeed.

called second-tier graduate in the second quintile of his, all other things being indistinguishable.²⁸⁴

These points suggest that law schools will, and to a significant degree already do, exhibit a stratification pattern analogous to the one emerging among elite firms. There are a few super-elite schools, perhaps as many as 20 but maybe fewer than 10, followed by a rapid flattening in the eyes of prospective consumers. Once we move out of the echelon of institutions where prestige swamps any other variable (and presumably also in distinguishing among super-elite institutions), students choosing a law school will look to other qualities. Their future relative importance is difficult to predict, but they can be broken down into benefit and cost factors in the value calculus.

Quantity and quality of entry-level placement will receive increasing weight for schools not among the super-elite. On the benefit side of the ledger, schools outside the super-elite that succeed in placing more of their students in better entry-level positions should generally attract more and better applicants as value scrutiny plays a larger role in candidates' choices. The current vogue of schools' inflating their employment statistics with gimmicks such as hiring unemployed graduates as "research assistants," offering them in free secondments, or even paying employers to give them a try, are already being recognized and discounted, and prospective students can be expected to insist on meaningful post-graduation employment information.²⁸⁵

Schools with loyal alumni hiring networks will enjoy an advantage in entry-level placement.²⁸⁶ So will schools that successfully serve less competitive employment markets, such as those recognized as preparing students for practice in a particular state or region (such as Alaska, Nebraska or Mississippi) less fully served by other institutions.

Cost considerations will become more important. On the cost side, some greater degree of price competition may be expected. To the extent state-subsidized schools offer reduced

²⁸⁴The preferences of legal employers will be driven rather directly by the preferences of their clients. If clients become indifferent to the prestige of their lawyers' degrees, law firms will hire by whatever criteria proves of greater interest to their clients.

²⁸⁵See Kashmir Hill, *The Secret to '100% Employed at Graduation': Duke's 'Bridge to Practice,'* June 10, 2010, <http://abovethelaw.com/2010/06/the-secret-to-100-employed-at-graduation-dukes-bridge-to-practice/#more-11547>; Elie Mystal, *SMU Will Pay You to Hire Their Graduates*, May 14, 2010, <http://abovethelaw.com/2010/05/smu-will-pay-you-to-hire-their-graduates/>; David Lat, *Law School Transparency Group Seeks Data from Law Schools*, July 21, 2010, <http://abovethelaw.com/2010/07/law-school-transparency-group-seeks-data-from-law-schools/#more-27798>.

²⁸⁶This factor is in a real sense a weaker version of prestige. It identifies a brand for which some buyers feel an affinity that, other things being indistinguishable, will drive the purchasing decision. Of course, in any given hiring decision, other things may well not be indistinguishable. That said, prospective students concerned about their eventual prospects for employment should take some comfort from the fact that they will eventually enjoy this leg up in the job market (however modest) over comparable competitors.

tuition to in-state residents, they will likely enjoy an even greater advantage than before as greater numbers of prospective students scrutinize their choices more closely.²⁸⁷

Similarly, schools able to offer more students more financial aid will garner acceptances from more competitive candidates. Indeed, such schools likely will have to worry about over-spending on tuition subsidies as more students factor them into their admissions choices. This money will have to come from somewhere, and increased tuition revenues from increased class sizes are an obvious option. Such increases should generally come from marginally less qualified students. If the extra revenue is spent subsidizing highly competitive students, students will face greater disparities within their classes. These increasing disparities over greater numbers may dilute the school's brand depending on the relative changes in the numbers and the quality of the stronger and weaker students admitted overall. Managing these contesting forces will be an important challenge.

Needless to say, price pressures on tuition will reduce resources available for other operating costs. We suspect that faculty salaries and support will be particularly vulnerable to such pressures in the nearer term because they are generally adjustable in smaller increments and over shorter time horizons than other big-ticket items such as facilities. As legal education becomes more competitive, outside the more elite schools teaching loads may increase in order to offer a more robust curriculum (if that proves to attract students or employers) or accommodate larger numbers, while salaries stay relatively flat.

A word about practical training. As increasing numbers of sophisticated clients refuse to pay high rates for inexperienced lawyers, the debate about new lawyers' practical preparation and who should be providing it has gotten louder and more pointed, though no clearer. The role of practical training in the future of legal education remains murky, with many new initiatives in the academy and the Bar only recently underway.

But the debate has often been unfocused in some important respects. Before the advent of the modern legal academy, aspiring attorneys typically "read the law" in the office of an established practitioner. During this apprenticeship, they learned doctrine, practice, skills and judgment in a practical environment.

As it entered this historical context and for many years afterwards, the institutional American law school provided little or no practical training.²⁸⁸ The law school case method aspires to (and sometimes does) teach students common-law doctrine and its historical antecedents, and how to "think like a lawyer" in using them; it aspires to, and is probably capable of, little more. This was often adequate preparation for a professional environment that

²⁸⁷Some "state" schools charge tuition comparable to private schools. State governments seem unlikely to increase their support for state professional schools, so this market pricing may become more common and thus reduce any price-based advantage that state schools might otherwise enjoy.

²⁸⁸This is not to say, however, that the legal academy did not conceive of itself as a professional school whose mission was to prepare its students for the practice environments in which virtually all would soon find themselves. As Judge Posner has observed, law professors were "*in* the university but *of* the legal profession"; they thought of themselves primarily as "lawyers training the next generation of lawyers." Posner, *Overcoming Law* at 82.

assumed new lawyers would be taught on the job how to do what lawyers actually do, analogous to the articulated clerkship that is a condition to full licensure in the UK and Canada. Such an apprenticeship was the centerpiece of the “Cravath System” that has long anchored the business model of the elite American private firm.²⁸⁹

As the market for legal services became more competitive beginning in the 1970s, however, pressure came to bear on the cost of turning well-educated but practically inexperienced young lawyers into effective practitioners. As just noted, that cost had historically been borne by employers, who had passed it on to their clients to the extent the market would allow. But as the market began to push back, practitioners surveying the labor pool naturally began to feel that, for what they were paying in salaries, they were entitled more to journeymen than apprentices. The employers turned to their own suppliers—the law schools—and demanded, as it were, better finished materials. Law schools began to respond with clinical programs and skills classes, at first and often still today marginalized within the institution and poorly integrated into the traditional curriculum.²⁹⁰

Responses to the economic changes we describe in this Article are still emerging in a range of experimental forms at various law schools and law firms.²⁹¹ We do not presume to predict

²⁸⁹See note 78, *supra*, and accompanying text.

²⁹⁰The law schools that offer clinical and skills instructors institutional prestige, pay and tenure opportunities comparable to mainstream academic teachers’ remain today a distinct minority. Intriguingly, the introduction of clinical and skills education roughly parallels academia’s move away from a mission of preparing lawyers for practice environments to a graduate education model whose curriculum focused increasingly on the theoretical, the abstract, and the other side of the “law and” conjunction. We leave the question of the relationship between these trends to legal historians and sociologists, but it is surely a story worth telling.

²⁹¹On the academic side, greater attention and emphasis is being paid to practical and clinical instruction. Washington & Lee has introduced a novel curriculum for its third year focused entirely on such instruction. The new law school at the University of California at Irvine has recently rolled out a curriculum emphasizing such instruction beginning in the first year, and incorporating mentoring from local practitioners. See Rachel M. Zahorsky, *Irvine by Erwin*, ABA J., Aug. 1, 2009, http://www.abajournal.com/magazine/article/irvine_by_erwin/. On the practice side, some firms have arranged to second promising associates for a period of time to public agencies (such as prosecutors’ or public defenders’ offices) or into a client’s legal department to fill a temporary need in order to secure them useful experience (and keep them busy). See Jocelyn Allison, *In-House Counsel, Firms Turn to Secondments*, Sept. 16, 2009, <http://ip.law360.com/articles/112994>. And a number of large firms have tried to implement formal training programs using in-house and outside teaching (such as the National Institute of Trial Advocacy) designed to pick up some of the slack created by the decreased incentives and opportunities for hands-on instruction and learning in actual practice contexts. More recently, some large firms have begun to experiment with “apprenticeship” programs that devote associates’ first two years predominantly to training, with substantially reduced salary, minimal billable-hour requirements and a developing curriculum of skills instruction. See Jeff Jeffrey, *For some firms, an extra step for the newest recruits*, NAT. L.J., June 29, 2009, <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202431818898&slreturn=1&hbxlogin=1>; Julie Triedman, *Associate Pay Cuts Here to Stay, Say Firms, Analysts*, AM. LAW. DAILY, Dec. 14, 2009, http://www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202436313459&Associate_Pay_Cuts_Here_to_Stay_Say_Firms_Analysts. As discussed above, a growing number of national and international firms are abandoning seniority-based (often referred to as “lockstep”) associate

how new lawyers will get their practical training in the future. They need it, and the successful ones will always get it somehow. We do identify the forces that are spurring a reexamination and reorganization of the responsibility to do so: Private-sector clients are imposing price pressure on outside law firms, and increasingly insisting that the cost of practical training be stripped out of the price they pay for the legal services they buy. Law firms necessarily absorb some of these training costs, but their historical training model has become both ineffective and prohibitively expensive, and the fewer costs they have to absorb the happier they will be. Schools that attempt to lessen these costs for employers will have a labor market advantage relative to their peer schools in attracting more of the kind of students they wish to have.²⁹² The manner in which they do so will depend on what kinds of skills clients will pay for (or law firms think they will pay for) in less experienced lawyers, and what kind of pre-employment preparation law firms think they need their new associates to have in order to implement a more effective and efficient training model of their own.

CONCLUSION

Previous explanations for the growth of large law firms have not adequately explained the full range of empirical observations about their growth and structure. Considering a professional service partnership as a referral network offers what we believe to be the most plausible (though still incomplete) explanation for these observations. Unlike diversification explanations, the referral network approach accounts for the lack of both strong diversification of practice areas and lockstep compensation. Unlike tournament approaches, it is connected to supply and demand. And unlike reputational bonding explanations, it accounts for continuing firm growth despite ordinary diseconomies of scale, and the widespread adoption of marginal product compensation and focus on individual reputational and practice development in successful elite firms. It also recognizes and accommodates what we believe to be the real though weaker reputational effects of particular firm-brands.

We also suggest that increasing sophistication among client-buyers of high-end legal services, as well as developments in technology and knowhow, are increasing competition for disaggregated portions of high-end legal projects previously bundled together. These developments are reducing costs to clients, and influencing the configuration and possibly the overall size of the law firms that have historically provided such services.

Our analysis implies various conjectures, which we offer with varying degrees of confidence. We are confident, however, that the economic forces we identify are salient ones

compensation in favor of “merit”-based compensation that depends significantly on the acquisition of skills and experience. Triedman, *supra*; see notes 111-114, *infra*, and accompanying text.

²⁹²Further, over an extended period of time all but the most elite schools likely will face sharper dichotomies between their labor market constituents and their academic peer groups. Choices that maximize reputation among the academic peer group may lessen reputation in labor markets, and vice versa. Such choices could be avoided either if the determinants of academic prestige shift back from a graduate school model to a professional school model, or if legal labor markets are intractably inefficient in distinguishing the level of practical training possessed by recent law graduates or by law firms (in other words, if there is an irreducible level of ignorance and credulity to both most corporate clients and most prospective law students). Neither prospect seems likely.

and must be part of any cogent understanding of legal labor markets. We do not praise or endorse a great many of the trends we observe, or the events they are catalyzing. Many of them have sown disruption, disappointment and loss in the lives of honest, hardworking people. Many others—particularly those that characterize the 21st century “elastic tournament” environment—have left the lives of the lawyers that live with them impoverished socially and emotionally, bleaker and more isolated. But as other commentators have also observed, these are not the result of narcissism, venality or sociopathy in the elite bar; they are normal and predictable human and institutional responses to changes in technology and markets over which the Bar has no control.²⁹³ But if we wish to improve the lot of those who are suffering the brunt of these developments, we must acknowledge and respect the forces that created them, and fashion remedies that swim with the tide of economic change rather than rail against it.

²⁹³*See, e.g., Galanter & Henderson, Elastic Tournament at 142; note 191, supra.*