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

Bernard A. Burk
David McGowan*

I. Introduction 4
II. The Arc of the Large Law Firm: Which Past Is Prologue? 8
A. Gradualism: The Late Nineteenth Century Through the "Golden Age" of the Early 1960s 8
B. Explosive Growth: 1970 to the Brink of the Great Recession 11
C. The Great Recession 27
D. What Now? 39
III. Current Economic Models of Law Firm Growth and Their Limited Explanatory Force 41

* 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. The authors presented an earlier version of this paper at the Georgetown Law Center for the Study of the Legal Profession's Conference on Law Firm Evolution: Brave New World or Business as Usual? in March 2010. Our appreciation to program directors Milton C. Regan and Carole Silver. For their many thoughtful suggestions, we thank Ian Ayres, Nora Engstrom, Gillian Hadfield, William Henderson, Michael Madison, Paul Oyer, William Perlstein, Duane Quaini, and Nancy Rapoport. We thank the Arthur and Toni Rembe Rock Center for Corporate Governance at Stanford University, and its Co-Directors, Joseph Grundfest and Daniel Siciliano, for lending institutional support. We also thank the editorial staff of the Columbia Business Law Review for their excellent work in preparing this paper for publication. All errors remain entirely and proudly our own, and we look forward to learning more about them from future readers.

A. Diversification of "Human Capital" (Gilson & Mnookin) ... 44
1. Experience Shows Full Diversification Is Rare and Not Correlated with Superior Profits ... 47
2. Weaker Notions of Diversification That May Be Relevant to Firm Growth or Structure ... 52
B. The Role of Human Capital in the Economic Relations Between Partners and Associates ... 54
1. Mutual Uncertainty and the "Up or Out" Rule ... 54
2. The Promotion-To-Partner Tournament (Galanter & Palay) ... 55
C. "Reputational Bonding" (Ribstein) ... 61
IV. Personal Relational Capital's Role in Making a Professional Partnership's Internal Referral Network a Binding and Growth-Stimulating Mechanism ... 64
A. The Shift in Primacy from a Firm's Institutional Reputation and Connections to Those of Its Individual Principals ... 65
B. The Organizational Implications of Personal Relational Capital's Primacy for the Firm as a Whole ... 66
C. The Internal Referral Network's Ability to Create Value, Stimulate Growth, and Bind the Firm Together (Loosely) as It Grows ... 70
V. Cost-Based Factors Affecting Law Firm Growth and Structure ... 76
A. How Transaction Costs and Technological Change Can Affect the Size and Shape of Professional Firms ... 76
B. Questions This Analysis Raises That It Cannot Fully Answer ... 87
1. Why Is Discussion of These Forces Almost Absent from the Law Firm Literature to Date? ... 87

2. Why Have These Issues, Which Have Been Developing For Many Years, Suddenly Come to the Fore During the Recession? 90
VI. Implications and Predictions 92
A. Implications for Law Firms and Practitioners..... 93
B. Implications for Legal Education 102
VII. Conclusion 116

This Article addresses three deceptively simple questions. First, why have law firms grown for over forty years, up to the onset of the recent recession, as quickly as they have? Second, why did law firms grow in the unusual configuration widely observed during that time? Third, should lawyers, clients, law students, and law schools expect these familiar trends in growth and configuration to reassert themselves as the economy improves, as they have after every recession since the 1970s? The various academic approaches to these questions to date are grounded in such notions as diversification, asset specificity, "tournament" theory, and reputational and agency-cost concerns at the level of the firm as a whole. We argue that these approaches do not explain or predict actual events very well, and thus offer little guidance for the future.

We suggest two perspectives that appear more consistent with the available empirical evidence, and thus may better predict future trends. The first perspective shows that when lawyers with appropriately complementary reputations and connections ("relational capital") join together in a firm, they can each better exploit the value of their own relational capital and thus jointly create value greater than the sum of their individual contributions. The positive feedback created by an internal referral network among firm members generates growth for the firm and provides a bond among its members, albeit a relatively weak one. This perspective is new to the literature on law firm economics, and helps explain why large firms have long continued to grow despite apparent diseconomies of scale. It also suggests why firms may grow to large sizes yet be brittle enough to shed partners

regularly in the process—and in some cases suddenly splinter altogether.

The second perspective analyzes large law firms using familiar economic principles concerning technological innovation and transaction costs, principles that have been largely overlooked in the literature on large firms. 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 we also conclude that the evolving configuration of large law firms has profound implications for practicing and aspiring lawyers, as well as for the law schools that prepare students for the increasingly global and competitive market for their services.

I. INTRODUCTION

Why have so many American law firms grown so much and in the configuration they have over the last forty years? 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? These questions have spurred a good deal of academic theorizing over the last twenty-five years, but the theories advanced to date have not explained actual events very well, and thus would seem unreliable guides to predicting future trends.

These questions are not merely of academic interest. The answers matter vitally 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 roughly two hundred law schools charged with preparing those graduates for the increasingly global and increasingly competitive market for their services.

Current events raise these issues more pointedly than ever. During 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. At the same time, a significant number of elite-firm partners left large, profitable firms to form or join smaller, boutique firms with lower overhead, a configuration that the *American Lawyer* calls the "Economy Model."[1] During the same period, market and cost trends that had been visible for some time became more pronounced, or at least more commonly discussed. These trends include "outsourcing" routine tasks within a lawsuit or transaction; "downsourcing" such work within the firm from full-cost associates to low-cost staff, contract lawyers, or non-lawyer specialists; and "insourcing" to in-house staff recurrent tasks that are commoditized or dependent on client-specific knowledge. These practices call into question 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 forty years. Opinions vary as to whether these longstanding trends will reassert themselves. One leading academic has proclaimed the "Death of BigLaw."[2] 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.[3]

---

[1] Claire Zillman, *Economy Model*, AM. LAW., Feb. 2010, at 56, *available at* http://www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202439217388.

[2] Larry E. Ribstein, *The Death of Big Law*, 2010 WIS. L. REV. 749 [hereinafter Ribstein, *Death of BigLaw*].

[3] *See* Drew Combs, *Law Firm Leaders Survey 2009: The Year Ahead*, AM. LAW. (Dec. 1, 2009), http://www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202435711003 [hereinafter *Am Law 2009 Survey: Associates*]. It's tempting to characterize this reaction as Chicken Little meets Dr. Pangloss: the sky is falling, but it's the best of all possible worlds (this phrase shamelessly stolen and slightly adapted from Charles Fried,

Fundamental changes are indeed afoot. Although rumors of the "Death of BigLaw" have been greatly exaggerated, it is leading a much more interesting and challenging life. We believe, however, that the recent economic downturn is not the root cause of those challenges. The recession simply laid bare economic forces that have been building for some time, and compelled greater responsiveness to those forces. These phenomena will drive significant evolution in the structure and practices of the large, elite law firm, but they do not threaten the viability of the large law firm as such.

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

We then propose two new perspectives. The first perspective suggests that competition gives each lawyer within a firm incentive to develop and personally profit from his or her own connections and reputation. When these individuals' "relational capital" is appropriately complementary, firm structure fosters a mutual referral network within the firm that allows each lawyer to exploit these assets more fully than he could on his own. Such reciprocal gains in the value of each lawyer's relational capital stimulate firm growth and help bind the firm together—though only somewhat loosely—as it grows. This insight helps explain why firms have continued to grow despite ordinary diseconomies of scale, though with a certain brittleness reflected in the lateral mobility and comparatively sudden failure of firms that is common today.

The second perspective applies long-established economic principles concerning transaction costs and technological innovation to the elite law firm, where they have been largely overlooked. We argue that reductions in transaction costs and in the cost of certain key inputs to legal services

---

Affirmative Action After City of Richmond v. J.A. Croson Co., *A Response to the Scholars' Statement*, 99 YALE L.J. 155, 155–156 (1989)).

help to explain a number of the trends documented in recent years. Reductions in clients' transaction costs—particularly in relation to finding more than one suitable service-provider and distributing pieces of a larger project among them—have increased competition among large firms and are forcing firms to adjust their business and staffing models.

This Article also suggests that cost reductions resulting from technological advances in the management and storage of information have accelerated these processes. These changes have no particular growth valence on their own. For example, while they may allow large firms to get larger, these cost reductions also help drive the outsourcing, downsourcing, and insourcing trends discussed above. They also make it possible for smaller firms to enjoy significant economies of scale without bearing the high fixed costs commonly associated with such economies. These developments may make the boutique practice model more robust than conventional academic analysis has suggested in the past.

Part II 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 forty years. Part III 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 IV explores the role of firm brand and individual partner reputation in a professional partnership's internal referral network, and their possible explanation of law firm growth and other observed developments. Part V considers the explanatory power of the transaction-cost and technological considerations just mentioned in light of current events. Finally, Part VI notes some implications of our analysis, and offers predictions both for the elite sector of the bar and for the future of legal education.

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

A. Gradualism: The Late Nineteenth 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 twentieth century.[4] 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.[5]

The firm's client base predominantly comprised substantial business organizations and wealthy "captains of industry" with ongoing legal needs requiring the attention of a range of skilled and experienced specialists as well as numerous competent subordinates.[6] These clients had few or no in-house attorneys.[7] Their relationships with their outside counsel tended to be durable and exclusive, to extend broadly over a wide array of subjects, and to range from matters of great complexity and importance to routine services such as lending documentation and ordinary commercial disputes.[8]

The proprietors of the enterprise were usually partners in a partnership and were small in number relative to the total number of practitioners and others the firm employed. The

---

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

[5] *Id.* at 4–19.

[6] *Id.* at 5, 11, 16.

[7] *Id.* at 33–34, 48–52. For example, a 1959 survey of 286 manufacturing companies found more than half had no in-house legal department at all. NAT'L INDUS. CONF. BD., *Organization of Legal Work*, *in* 16 CONF. BD. BUS. REC. 463, 463 (1959).

[8] *See* Ronald 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*]; *but see* GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 33–34, 48–52 (noting the lack of quantitative and qualitative precision in available empirical data).

proprietors shared the profits and managed the firm.[9] Highly qualified but inexperienced junior lawyers called "associates," selected for their potential for promotion to partnership, competed for a limited number of such positions at the end of a lengthy apprenticeship.[10] That apprenticeship was widely patterned on the "Cravath

[9] GALANTER & PALAY, TOURNAMENT, *supra* note 4, 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. Legislative recognition of limited liability partnerships has lessened the need for other structures, and the partnership is likely to predominate in the future. The technical form of the enterprise is not material 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.

[10] *See* Marc S. Galanter & William D. Henderson, *The Elastic Tournament: The Second Transformation of the Big Law Firm*, 60 STAN. L. REV. 1867, 1873 (2008) [hereinafter Galanter & Henderson, *Elastic Tournament*]. *See also* GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 26–28. Although these firms considered themselves pure meritocracies, they hired almost exclusively from a small number of elite institutions that at that time did not draw freely from the population at large. 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 . . . ." ERWIN SMIGEL, THE WALL STREET LAWYER: PROFESSIONAL ORGANIZATION MAN? 37 (1969). Women and racial, ethnic, and religious minorities were almost completely excluded. GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 25–26. Paul Cravath 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). Thus even at the height of its stability, success, and professional independence, the elite American law firm was acutely aware of the need to construct and show itself—even more than to do the best work—to attract, please, and retain "the best clients."

System" attributed to Paul Cravath in the early twentieth century, which centered on rigorous long-term training and a "graduated increase in responsibilities" over time.[11]

Essentially only two classes of professionals were found at the firm: partners and partnership-track associates.[12] Growth came almost entirely from within. Partners were selected from within the firm, and lateral hiring of partners or associates, other than from government service, was rare.[13] Associates who did not make partner were generally placed out.[14] Partner departures other than at the end of a career were uncommon.[15]

By about 1960, this structure was firmly established as the model for the elite law firm, and was accompanied by significant stability and success.[16]

---

[11] GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 9. *See also id.* at 14–15; 2 SWAINE, *supra* note 10, at 2–12.

[12] GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 28–29. This two-class view may oversimplify. At least some firms had established minorities of long-term salaried attorney-employees who were neither partners nor under consideration for promotion to partner. These individuals at times comprised as much as 10–24% of the attorney census. *Id.* at 28–29, 64–65. Such arrangements apparently fell out of favor, shrinking by attrition during the 1960s, but became more common again beginning in the mid-1970s and afterwards. *Id. See also infra* notes 38–42, and accompanying text.

[13] GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 23–24.

[14] *Id.* at 28–29.

[15] MILTON C. REGAN, JR., EAT WHAT YOU KILL: THE FALL OF A WALL STREET LAWYER 25 (2005) (observing that partners were assured lifetime tenure); *see also* GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 23–24, 30; SMIGEL, *supra* note 10, at 259.

[16] GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 20–22. As Galanter and Palay describe this "golden age,"

> [C]irca 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.

B. Explosive Growth: 1970 to the Brink of the Great Recession

By 1970, this familiar and comfortable arrangement was evolving. Many forces influenced this change and their relative strength is subject to debate. However, 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:

Accelerated growth. Perhaps the most striking and pervasive change is that the number and size of elite firms began to increase at an accelerated rate. After 1975, the longstanding steady growth rate of roughly 5% per year jumps to 8% or more.[17] Those increasing growth rates yielded rapidly increasing size. In the late 1950s there were only thirty-eight law firms in the United States with more than fifty lawyers (over half of which were located in New York City).[18] By the mid-1980s, there were 508 firms with more than 50 lawyers, and the number of firms larger than

Id. at 36.

[17] *See* Robert L. Nelson, *Of Tournaments and Transformations: Explaining the Growth of Large Law Firms,* 1992 WIS. L. REV. 733, 736 [hereinafter Nelson, *Explaining Growth*]; *see also* GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 24, 46, 87–88. The number of lawyers in the U.S. more than tripled between about 1970 and 1990, from about 250,000 to about 800,000. During this period, the ratio of lawyers to the general population grew to more than twice its historic average, at a rate three times as fast as other professions and four times as fast as the general workforce over the same period. *See* Richard H. Sander, *Elevating the Debate on Lawyers and Economic Growth,* 17 LAW & SOC. INQUIRY 659, 663 (1993); 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) [hereinafter Sander & Williams, *So Many Lawyers*].

[18] GALANTER & PALAY, TOURNAMENT, *supra* note 4, 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)).

100 had increased from a dozen to more than 250.[19] Similarly, in 1968 the largest firm in the United States had 169 lawyers.[20] By 1988, the largest firm had 1179 lawyers, and there were 152 firms larger than the largest firm in 1968.[21] By 2008, nearly 700 firms employed 50 or more lawyers, 23 firms had over 1000, the *average* size of the 250 largest American law firms by headcount (the *NLJ* 250) was 535, and the smallest of these firms was larger than the largest firm in the country in 1968.[22] Between 2004 and 2008, the *NLJ* 250 collectively increased in size by about 22,000 lawyers, and by 2008 employed a total of roughly 132,000 attorneys.[23]

Geographic expansion. These firms expanded geographically as well as numerically. While most firms were associated with a single city in 1960, by 1980 87% of the 100 largest law firms had a branch office somewhere else.[24] Growth was often wholesale, by merger or acquisition of a group. Branches proliferated, and their size increased,

---

[19] *See* BARBARA CURRAN ET AL., SUPPLEMENT TO THE LAWYER STATISTICAL REPORT: THE U.S. LEGAL PROFESSION IN 1985, at 5 (1986); *The NLJ 250*, NAT'L L.J., Sept. 22, 1986, at S–1.

[20] *Why Law Is a Growth Industry*, BUS. WK., Jan. 13, 1968, at 78–79.

[21] *The NLJ 250*, NAT'L L.J., Sept. 26, 1988, at S–1, S–4.

[22] *The 2009 NLJ 250: Annual Survey*, NAT'L L.J., Nov. 9, 2009, at S–14, *available at* http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=120243525 4583. *See also* Pete Brush, *Legal Industry Armageddon Talk Overblown: Survey*, LAW360 (May 12, 2009), http://www.law360.com/articles/101086 (nearly 700 firms over 50 lawyers in 2009); Leigh Jones, *There's No Sugar Coating It: This Was the Worst Year Ever for Lawyer Headcount*, NAT'L L.J., Nov. 9, 2009, at S–4, *available at* http://www.law.com/jsp/nlj/Pub ArticleNLJ.jsp?id=1202435251608 [hereinafter Jones, *2009 Worst Year*].

[23] Jones, *2009 Worst Year*, *supra* note 22. Between 1998 and 2004, the top decile of law firms by size increased in total number of lawyers from 10% to 18% of lawyers in private firms of 5 or more, while all other deciles remained roughly the same in headcount, indicating consolidation at the large end of the scale. George P. Baker & Rachel Parkin, *The Changing Structure of the Legal Services Industry and the Careers of Lawyers*, 84 N.C. L. REV. 1635, 1658–60 (2006) [hereinafter Baker & Parkin, *Changing Structure*].

[24] *See* Galanter & Henderson, *Elastic Tournament*, *supra* note 10, at 117; GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 47.

typically at a rate more rapid than the home office's.[25] By 2003, the average Am Law 200 law firm had nine branch offices.[26]

Increasing revenues and profitability. The legal profession as a whole grew rapidly, but large firms grew much faster than the Bar as a whole and became relatively more affluent than their peers in smaller firms, in-house, and in government.[27] Between 1960 and 1985, the portion of the gross national product and the portion of national income attributable to legal services both doubled.[28] But businesses rather than individuals spent a greater and greater portion of those sums, and thus the share of the market for legal services held by the largest firms doubled between 1972 and 1986.[29] That trend continued into the new century. Corporate legal costs increased 4 times faster than the average cost in the years after 2000, and by 2007 profits per

[25] *See, e.g.*, Galanter & Henderson, *Elastic Tournament*, *supra* note 10, at 123–24; Baker & Parkin, *Changing Structure*, *supra* note 23, at 1662–63; GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 47–48.

[26] William 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*].

[27] Sander & Williams, *So Many Lawyers*, *supra* note 17, at 435–40.

[28] GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 40. *See also* Sander, *supra* note 17, at 665 ("The United States [in 1992] spen[t] about $100 billion per year 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.*

[29] GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 40–41; Sander & Williams, *So Many Lawyers*, *supra* note 17, at 440–41. *See* Richard H. Sander & 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) ("[T]he receipts of the nation's 50 largest firms increased, in *real dollars*, an average of 10 percent per year from 1972 to 1987—more than double the rate of growth in the legal services field generally") [hereinafter Sander & Williams, *Theorizing*]. Between 1972 and 1986, total revenues for the twenty largest firms increased fourfold. Sander & Williams, *So Many Lawyers*, *supra* note 17, at 437.

equity partner ("PPP") at the 100 most profitable large firms *averaged* $1.3 million, 68% more than in 2000.[30]

The advent and expansion of lateral mobility. Lateral movement between elite firms, previously rare, increased dramatically for both partners and associates beginning in the 1970s. More sophisticated general counsel increasingly shopped for special expertise for particular projects rather than depending on a single outside firm to provide it to them.[31] An increasingly influential legal press

[30] Leigh Jones, *For Associates a Time of Thrills and Chills*, NAT'L L.J., Dec. 21, 2009, at 8, *available at* http://www.law.com/jsp/nlj/PubArticle NLJ.jsp?id=1202437225554 [hereinafter Jones, *Thrills & Chills*]; Jeff Jeffrey, *Alternate Billing Arrangements Putting Down Deep Roots, General Counsel Say*, THE BLOG OF LEGAL TIMES (Mar. 14, 2010, 1:54 PM), http:// legaltimes.typepad.com/blt/2010/05/alternate-billing-arrangements-puttin g-down-deep-roots-general-counsels-say.html. Significantly, the increase in profitability has not been uniform across the market. From 1975–1995, real income for equity partners in firms of 101–299 lawyers increased 44%, while real income for partners in firms of 2–100 lawyers fell. Galanter & Henderson, *Elastic Tournament*, *supra* note 10, at 105 n.11. From 1998 through 2007, average PPP for the top quartile of the most profitable firms increased over 95%, while the bottom quartile most profitable of the Am Law 200 increased 58%. *Id.* at 138. The ratio of average PPP to starting associate salary (the latter of which is highly uniform across the Am Law 200) is nearly fourteen at the ninety-fifth percentile of profitability, and only four at the twenty-fifth percentile. *Id.* at 139.

[31] A number of market forces contributed:

> 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.

Galanter & Henderson, *Elastic Tournament*, *supra* note 10, at 129 (footnotes omitted); *see id.* at 50. *See also* REGAN, *supra* note 15, at 33; Mark C. Suchman, *Working Without a Net: The Sociology of Legal Ethics* disseminated detailed information regarding law firms' profitability, creating more informed and robust competition among law firms for the partners whose expertise and services were most in demand, and fostering a market in which partners' "human capital" could be more easily valued and compared.[32] Swimming with the tide, lawyers began to move to the firms where they could maximize their returns on their human capital.

By 1988, over a quarter of the 500 largest U.S. firms had acquired more than half their new partners from outside the firm, and a quarter also reported hiring more than half their associates laterally.[33] From 2000 through 2005, the *American Lawyer* accumulated information on over 14,000 lateral moves, most of them at the partner level, and 97% of

---

in Corporate Litigation, 67 FORDHAM L. REV. 837, 856 (1998); Baker & Parkin, *Changing Structure*, *supra* note 23, at 1655–56; Emily Couric, *New Relationships, New Rules*, NAT'L L.J., Aug. 1, 1988, at S–2; Rita Henley Jensen, *Banking Clients More Willing to Shop for Firms*, NAT'L L.J., Jan. 18, 1988, at 1; Gilson & Mnookin, *Profit Sharing*, *supra* note 8, at 385; Francis Flaherty, *Comparison Shopping Hits the Law: Companies Cut Costs*, NAT'L L.J., Oct. 31, 1983, at 1. 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 L.J., Feb. 4, 1980, at 25.

[32] The *National Law Journal* began publishing statistics on the 250 largest firms, measured by lawyer headcount, in 1979. Galanter & Henderson, *Elastic Tournament*, *supra* note 10, at 118–19. The *American Lawyer* began gathering and publishing statistics on the fifty 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* GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 71–72 (the modern legal press enabled by the United States Supreme Court's decision in *Bates v. Arizona* disseminated information on law firm economics that facilitated a more competitive market for legal services and among firms for personnel); Galanter & Henderson, *Elastic Tournament*, *supra* note 10, at 130–32 (similar); *see also* Lawrence J. Fox, *The End of Partnership*, 33 FORDHAM URB. L.J. 245, 248 (2005) [hereinafter Fox, *End of Partnership*].

[33] GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 54–55. *See also* Galanter & Henderson, *Elastic Tournament*, *supra* note 10, at 111, 128–33.

which were into or out of Am Law 200 firms.[34] These numbers suggest that something approaching half of the partners in what had become known as "BigLaw" changed firms during this six-year period.[35]

Erosion of the availability, stability and value of partnership. Competition among firms for profitable partners fueled increasing competition within firms for money and power, backed by the threat of departure for greener pastures. Firms began to pay larger shares of their profits to lawyers with portable books of business.[36] As financial rewards became more concentrated within a given firm, non-financial rewards became less secure. Partnership tenure and benefits became increasingly precarious: firms imposed compensation reductions, "de-equitizations" and outright dismissals on those partners viewed as inadequately "productive," with productivity measured by the ability to leave the firm and have clients follow.[37]

---

[34] Galanter & Henderson, *Elastic Tournament*, *supra* note 10, at 133–34.

[35] *See* Jones, *2009 Worst Year*, *supra* note 22 (250 largest firms in 2004 employed 110,000 lawyers); Henderson, *Single vs. Two-Tier Partnerships*, *supra* note 26, at 1714 (average leverage at AmLaw 200 firms in 2003 was 3.5:1).

[36] *See* Henderson, *Single vs. Two-Tier Partnerships*, *supra* note 26, at 1697, 1741; Galanter & Henderson, *Elastic Tournament*, *supra* note 10, at 102–03, 107, 141–42; GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 52–53, 58, 67–68; *see generally* ROBERT NELSON, PARTNERS WITH POWER: THE SOCIAL TRANSFORMATION OF THE LARGE LAW FIRM 5 (1988) (arguing that the "organizational rationalization of the firm will be controlled by the partners with power," and power is "inextricably tied to 'control of clients'").

[37] Fox, *End of Partnership*, *supra* note 32, at 247 ("[E]levation to partnership no longer comes with any sense of tenure"). *See also* Galanter & Henderson, *Elastic Tournament*, *supra* note 10, at 111–13, 127 & n.88; Henderson, *Single vs. Two-Tier Partnerships*, *supra* note 26, at 1697; 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); *see also infra* note 78.

At the same time, associates' time to partnership rose and rates of promotion fell.[38] More firms relaxed the traditional "up or out" rule and 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 primarily by a fixed salary with a limited discretionary bonus—in short, they are "partners" in name only, and in some cases not even in name as classes of indefinite-term "senior associates," "counsel," and the like became common.[39] In 1988, half of the firms with more than

[38] GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 62–63 (noting that the evidence is somewhat equivocal, but that the shorter partnership tracks of five and a half to seven and a half years that were typical of the 1960s and 1970s lengthened to eight to nine years, with longer periods more typical in New York throughout). *See also id.* at 63–64, 75–76 (citing studies, which are not entirely consistent probably because of classification disparities, showing falling rates of promotion); Baker & Parkin, *Changing Structure*, *supra* note 23, at 1670–71 (documenting rising track length (to nearly ten years) and falling promotion rates (to around 5%) in the late 1990s and early 2000s, with variation among geographic markets).

[39] *See* Henderson, *Single vs. Two-Tier Partnerships*, *supra* note 26, at 1722–23, 1730 & n.146; GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 58–59; Baker & Parkin, *Changing Structure*, *supra* note 23, at 1673–75 (empirically analyzing apparent erosion of the "up or out" rule during late 1990s and early 2000s); Fox, *End of Partnership*, *supra* note 32, at 247 (stating that "fewer and fewer of those now called partners really occupy that status"); Gilson & Mnookin, *Profit Sharing*, *supra* note 8, 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 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

seventy-five lawyers had two tiers of partners.[40] By 2004, 79% of the 200 largest firms in America had 2 partnership tiers, and the number of nonequity partners at those firms was increasing far more rapidly than the number of equity partners.[41] The portion of the professional census comprising neither true partners nor associates grew steadily.[42]

With time to partner increasing, promotion rates decreasing, and greater and greater numbers of long-term nonpartner attorney employees, firms' leverage ramped up substantially.[43] From 1960 to the mid 1980s, leverage

---

with reduced pressure to become rainmakers themselves. Henderson, *Single vs. Two-Tier Partnerships*, *supra* note 26, at 1709–12.

[40] GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 58.

[41] Henderson, *Single vs. Two-Tier Partnerships*, *supra* note 26, at 1695, 1725. *See also* 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); Galanter & Henderson, *Elastic Tournament*, *supra* note 10, at 1892 (for fiscal year 2005, number of equity partners in the Am Law 200 up 148 vs. 1455 for nonequity partners). 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*, *supra* note 26, at 1714 (chart).

[42] The late 1980s marked the high-water mark of associates as a percentage of all lawyer-employees. From this point, associates continued to increase in number and remained the largest single category, but comprised a falling percentage of firms' lawyer-employees, with the principal percentage gains in the "other" (non-partner, non-associate) ranks. *See* Leigh Jones, *NLJ 250 Records a New Low Point for Legal Associates*, NAT'L L.J. (Nov. 10, 2010), http://www.law.com/jsp/nlj/legaltimes/PubArticleLT.jsp?id=1202474693179&NLJ__records_a_new_low_point_for_legal_associates (stating that associates were 60% of large-firm lawyers in 1987; 55% in 2001; 48% in 2010).

[43] Leverage 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* GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 61 n.152; Henderson, *Single vs. Two-Tier Partnerships*, *supra* note 26, at 1722–23 (noting that in a two-tier partnership, it is unclear how to classify nonequity partners); Leigh Jones, *Legal Heavyweights Lean on NALP to Track Nonequity Partners*, NAT'L L.J. (Apr. 7, 2010), http://www.lawjobs.com/newsandviews/LawArticle.jsp?id=1202447690872&slreturn=1&hbxlogin=1; Elie Mystal, *Vault Explains*

appears to have increased about 30%, to what has been variously calculated at between 1.47 and 2.25 associates per partner.[44] By 2003, mean leverage among the AmLaw 200 firms was over 3.5, with the 75th percentile boasting over four nonpartner attorneys per equity partner.[45]

Associate Recruiting and Compensation. 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.[46] But as the sheer number of new recruits necessary to support the pyramid increased, firms interviewed applicants at more and more law schools and reached further and further down into their graduating classes to fill their needs.[47]

Why It's Better Than NALP, ABOVE THE LAW (Feb. 25, 2010, 3:06 PM), http://abovethelaw.com/2010/02/vault-explains-why-its-better-than-nalp/ (describing firms' reticence to disclose equity vs. nonequity partner demographics).

[44] GALANTER & PALAY, TOURNAMENT, *supra* note 4, 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 partners that reporting firms outside New York added into their leverage denominator as if they were equity partners. *Id.* at 61 n.152.

[45] Henderson, *Single vs. Two-Tier Partnerships*, *supra* note 26, at 1714, 1728 tbl.6. *But see* Baker & Parkin, *Changing Structure*, *supra* note 23, at 1664–69 (suggesting increasing but significantly lower leverage at larger firms, apparently because they include both equity and nonequity partners in the leverage denominator).

[46] *See* GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 24; Galanter & Henderson, *Elastic Tournament*, *supra* note 10, at 104–05. *See also* Nick Brown, *Firms' 'Ego-Driven' Salary Structure Can't Last: Experts*, LAW360 (Oct. 2, 2009), http://www.law360.com/topnews/articles/125954/firms-ego-driven-salary-structure-can-t-last-experts (quoting a law firm consultant who stated, "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.").

[47] GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 55–57; Gilson & Mnookin, *Associate Careers*, *infra* note 108, at 589–92; Sander & Williams, *So Many Lawyers*, *supra* note 17, at 476–77. The degree to which this affected the overall quality (however measured) of the firms' associate corps is debatable. Increasing numbers of talented law-school applicants and increasing levels of law-school admissions selectivity have likely

Increasing demand pushed associate pay higher and higher. Beginning in the 1920s and continuing for over forty 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.[48] During the Vietnam era, as the draft and the youthful idealism of the time reduced the number of qualified applicants willing or able to pursue careers in elite 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.[49]

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 especially to strain supply.[50] 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.[51]

In 2000, amidst the unprecedented demand for associates created by the "tech bubble," starting salaries leapt again, from $95,000 to $125,000 (plus bonuses).[52] The economic

substantially increased the number of highly qualified graduates since the 1960s. *See, e.g.*, RICHARD ABEL, AMERICAN LAWYERS 253 tbl.4 (1989); Sander & Williams, *So Many Lawyers*, *supra* note 17, at 462–63, 476–77. However, some commentators (including the authors) believe that the variability of the quality within the associate corps has increased as large firms grew larger. *See, e.g.*, GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 110–11.

[48] GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 24, 55–56 (citing historical sources).

[49] *Id.* The "going rate" had risen $3,000 over the previous five years. *Id.* at 55–56.

[50] *See generally* Sander & Williams, *So Many Lawyers*, *supra* note 17, at 466, tbl.14.

[51] GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 56–57.

[52] Jones, *Thrills & Chills*, *supra* note 30. The dynamics of the jump in 2000 are particularly interesting. The first mover was Gunderson Dettmer Stough Villeneuve Franklin & Hachigian LLP, then a modest-sized firm of about seventy lawyers with a single office in Silicon Valley (the technology-centered region south of San Francisco), no litigation

downturn in the early 2000s slowed increases, but the upward trend in pay resumed as the economy recovered. Base associate salaries jumped in 2006 to $145,000 and once more in 2007 to $160,000.[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]

Billing Rates. To support the expense of rapidly increasing associate salaries in a heavily leveraged structure, law firms raised their rates, including partners'

---

practice, and a hard focus on business and transactions involving the many emerging technology companies germinating in its backyard. To address the associate exodus from law firms to in-house jobs offering potentially skyrocketing equity, at the peak of the tech bubble in early 2000 Gunderson shocked the legal community by announcing that it would increase entry-level associates' pay from $95,000 to $145,000 per year. *Id.* In what the legal press has called a "bicoastal frenzy," the largest and most elite firms in every major market promptly moved to match this tiny player. *Id.*

[53] *Id.* 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. The need for regional and local firms to remain competitive drew lagging labor markets higher. *Id.*; Bradford Hildebrandt, *Unprecedented Decade in the Legal Profession*, NAT'L L.J. (Dec. 28, 2009), http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=120243 7225077. The sudden jumps 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, 2:14 AM), http://www.elsblog.org/the_empirical _legal_studi/2008/07/how-the-cravath.html (noting how unusual and typically unstable such a distribution is in a labor market). By 2008, the spikes in the bimodal distribution centered around $40,000–$65,000 and $145,000–$160,000. *See* note 235, *infra,* and accompanying text.

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

rates, as precipitously as they raised associates' salaries.[55] Typical large-firm rates rose over 65% between 1998 and 2009.[56] A limited number of "marquee" partners breached the $1,000-per-hour threshold in 2007.[57] 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.[58] With increasing volume and urgency, clients began voicing their growing resistance to financing this practice structure and to "paying for associates' training."[59]

---

[55] Bradford Hildebrandt, *Unprecedented Decade in the Legal Profession*, NAT'L L.J. (Dec. 28, 2009), http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202437225077.

[56] *Offshoring Your Lawyer*, THE ECONOMIST, Dec. 16, 2010, *available at* http://www.economist.com/node/17733545.

[57] Leigh Jones, *Billing Goes Up*, NAT'L 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/PubArticleFriendlyCA.jsp?id=900005489968.

[58] *See A Nationwide Sample of Firm Billing Rates*, NAT'L L.J. (Dec. 7, 2009), http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202436055916 (2009 rates); *Firms Report Their Billing Rates*, NAT'L 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 L.J. (Dec. 10, 2007), http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1197021870294 (2007 rates); *2007 NLJ Associate Billing Rates Survey: Billing Rates by Associate Class*, NAT'L L.J. (Dec. 10, 2007), http://www.law.com/jsp/article.jsp?id=1197281081525 (2007 associate billing rates by class).

[59] By 2010, nearly half of the Am Law 200 had clients that refused to pay for the work of first- or second-year associates. Claire Zillman, *Law Firm Leaders Survey 2010: The New Normal*, AM. LAW., Dec. 1, 2010, 66, 68, *available at* http://www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202475032294 [hereinafter Zillman, *New Normal*]. Sharon Driscoll, *Law Firm Hiring: Time for a Change?*, STAN. LAW., Fall 2009, at 9, 11, *available at* http://stanfordlawyer.law.stanford.edu/2009/10/law-firm-hiring-; Shannon Henson, *Change May Be Coming To Law Firm Staffing Models*, LAW360 (Dec. 8, 2009), http://www.law360.com/articles/135593; Jones, *Thrills & Chills*, *supra* note 30; Zach Lowe, *This Isn't The End of Big-Law-Firm Associates*, AM. L. DAILY (Mar. 10, 2010, 4:15 PM), http://amlawdaily.typepad.com/amlawdaily/2010/03/clobiglawassociates.html (noting clients' refusal to pay for first-year, and in some cases second-year, associate time); Nate Raymond, *Clients Grow Cool To The Support Of Dwindling*

Nature and allocation of work. The more routine aspects of the broad, stable client relationships typical of the elite firms' "golden age" had been delegated, with appropriate supervision made possible by the firms' more modest leverage, to the firms' associates. This work served as a valuable training ground in which associates acquired not only skills and experience relevant to their professional interests, but also familiarity with clients' businesses, practices and procedures, records, and personnel that allowed the services to be provided more efficiently.[60]

As senior in-house legal staff became steadily more knowledgeable and sophisticated about acquiring legal services, they assigned recurring tasks and issues to permanent employees in-house who did not have to be paid high hourly rates to be trained. Beginning in the late 1970s, in-house law departments became significantly larger and began handling more of their companies' day-to-day contractual and regulatory issues, as well as many kinds of litigation.[61]

Summer Classes, N.Y.L.J. (June 8, 2010), http://www.law.com/jsp/nylj/PubArticleNY.jsp?id=1202461074366 (noting clients' refusal to pay for summer associate time); Debra Cassens Weiss, *Nixon Peabody Hiring Partner: Student Recruitment Model is 'Antiquated,'* A.B.A. J. (Oct. 5, 2009, 9:58 AM), http://www.abajournal.com/news/article/nixon_peabody_hiring_partner_student_recruitment_model_is_antiquated (Nixon Peabody hiring partner John Snellings: "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?").

[60] GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 33–34, 48–52; *see also* 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 made it difficult for a bank to switch); ELLEN JOAN POLLOCK, TURKS AND BRAHMINS: UPHEAVAL AT MILBANK, TWEED 13 (1990) (describing Milbank's historical performance of Chase's routine work as typical).

[61] *See* Rees Morrison, *How Many In-House Counsel Are in the World's 500 Largest Corporations?*, LAW DEP'T MGMT. BLOG (Feb. 9, 2010, 9:17 AM), 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-benchmarks.html (estimating "high tens of thousands"); Baker & Parkin, *Changing Structure*, *supra* note 23, at 1654–55 (discussing growth in size and scope of in-house law

As outside counsel's domain correspondingly shifted to work for which highly specialized expertise (and/or large teams of people) were required,[62] the nature of associates' workload and the availability of training and professional development deteriorated.

Widespread lateral recruitment and hiring of both partners and associates made "home-schooling" of younger lawyers less central to the prevailing model's self-perpetuation and success.[63] Meanwhile, partners were under pressure from every direction: greater numbers of associates per partner to oversee;[64] greater pressure to bill more, but bill only time and tasks that would survive in-house counsel's or a fee auditor's scrutiny;[65] greater misgivings from clients as associate rates soared to pay for anything

departments in the late 1990s and early 2000s); GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 49–50 and authorities cited (tracking growth of in-house law departments in the 1970s and 80s); POLLOCK, *supra* note 60, at 13, 123.

[62] *See* GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 51–52; Baker & Parkin, *Changing Structure*, *supra* note 23, at 1656; Galanter & Henderson, *Elastic Tournament*, *supra* note 10, at 129.

[63] *See* David B. Wilkins & 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*] (highlighting the 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).

[64] *See supra* notes 43–45 and accompanying text.

[65] Alix Stuart, *Legally Blind*, CFO (Aug. 20, 2009), http://www.cfo.com/article.cfm/14257550/ (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 growth in partner hours may be attributable to a greater number of nonequity partners, whose role is to bill more hours; or to increased competition for the billings necessary to accrue rewards or simply preserve partnership status. *See* Henderson, *Single vs. Two-Tier Partnerships*, *supra* note 26, at 1710–11.

resembling on-the-job training.[66] Associates saw less and less of the experienced practitioners and firm leaders who in past generations had taught by observable example, and, in many cases, by personal tutelage as well. With smaller, more routine transactions and cases more frequently reserved for the client's own less expensive in-house legal staff, junior associates at elite firms were more often forced to find their training (if they found it at all) as deeply subordinated members of crowded "teams" in large, complex matters.[67]

Ironically, as salaries and billing rates rose steeply, elite firms hired 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 performing monotonous and menial tasks organizing large quantities of information and documents.[68] Those tasks did not call for the special talents for which their employers said they had recruited them. Nor did they develop professional skills to prepare younger lawyers for more challenging and responsible work—or for partnership, which became increasingly unavailable as track length rose and promotion rates fell.[69] Yet these back-office

---

[66] *See supra* note 59 and accompanying text.

[67] It 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, 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)*, ABOVE THE LAW (Apr. 9, 2010, 6:08 PM), http://abovethelaw.com/2010/04/corporate-general-counsel-puts-fear-of-god-into-legal-educators-and-you-should-be-worried-too/; *see also infra* Parts II.C., VI.C.

[68] *See infra* Part V.B for a more detailed discussion of the source and nature of this class of work. *See also* William D. Henderson & David Zaring, *Young Associates in Trouble,* 105 MICH. L. REV. 1087, 1096–1104 (2007) [hereinafter Henderson & Zaring, *Young Associates*]; William H. Rehnquist, *The Legal Profession Today*, 62 IND. L.J. 151, 151–54 (1987) ("drudgery"); 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, 725–26 (1998) ("numbingly dull").

[69] *See supra* note 38 and accompanying text; Dan Slater, *At Law Firms, Reconsidering the Model for Associates' Pay*, N.Y. TIMES DEALBOOK

projects have often been the most leveraged, and thus the most profitable, that large outside firms can obtain. Indeed, a recent empirical study shows that greater amounts of work that associates consider more interesting is *negatively* correlated with firm profitability![70]

Incipient Segmentation of the Elite Sector of the Bar. As 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 distinguished principally by exceptionally high prestige. These firms are generally characterized by very high profits per partner, a single-tier partnership (true equity partners only), and somewhat harder-working associates. They also engage heavily in the most price-

(Mar. 31, 2010, 1:17 AM), http://dealbook.nytimes.com/2010/04/01/at-law-firms-reconsidering-the-model-for-associates-pay/ (quoting the managing partner of Howrey observing that under the current conventional recruitment model, associates are not hired to become partners, but rather to perform "rudimentary work" for a few years). 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 is still a part of some large-firm associates' workloads. 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. *See* Wilkins & Gulati, *Reconceiving the Tournament*, *supra* note 63, at 1609–11, 1643–50, 1651–57 (suggesting 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).

[70] Henderson & Zaring, *Young Associates*, *supra* note 68, at 1100–01 & tbl.4. This 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). *Id.* at 1102 & tbl.5. This appears to differ from what associates report induced them to hire on in the first place: "many students state that the high 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*, *supra* note 63, at 1637 & n.186.

insensitive work and concentrate in traditionally super-profitable areas: large-scale financial and capital markets transactions and litigation, high-end white-collar criminal defense, antitrust, and intellectual property.[71] 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 multi-tier partnerships, with a smaller equity tier in which most profit and power are concentrated.[72]

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 10,000 entry-level associates to begin in the fall of 2008.[73]

We all know what happened next: the housing bubble burst. Capital markets seized; numerous investment and commercial banks either failed, collapsed into a more solvent

---

[71] Henderson, *Single vs. Two-Tier Partnerships*, *supra* note 26, at 1696–98, 1742–43. *Cf.* Galanter & Henderson, *Elastic Tournament*, *supra* note 10, at 1899–1904 & tbls.2–4 (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, the super-elite firms tend to have leverage that, while significant, is on average lower than that of many firms in the other subgroup, owing principally to having no nonequity partners. Henderson, *Single vs. Two-Tier Partnerships*, *supra* note 26, at 1727 & tbl.5.

[72] *See e.g.*, Henderson, *Single vs. Two-Tier Partnerships*, *supra* note 26, at 1697–98, 1712, 1743–44 ("[A] two-tier firm will allocate a large percentage of its profits to powerful and mobile rainmaker partners and limit the class of new equity partners.").

[73] Aric Press, *Annual Survey Shows the New Reality of Associate Life*, AM. LAW., Aug. 2007, at 91, *available at* http://www.law.com/jsp/article.jsp?id=1185820712350 (noting that the figure of 10,000 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 the nation would graduate a total of only about 6500).

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 to reassess the cost and staffing of any work that was unavoidable.[74] Naturally these events had profound effects on the law firms that served these clients.

Reductions in Force. Large law firms shed personnel in unprecedented numbers. From January 1, 2008 through

---

[74] *See* Elie Mystal, *In-House Counsel Don't Intend to Give You Hours*, ABOVE THE LAW (June 1, 2010), http://abovethelaw.com/2010/06/in-house-counsel-dont-intend-to-give-you-hours/. Not only capital markets work and lending-dependent transactions dropped steeply. Venture capital investments dropped 37% from the prior year to a 12 year low. *VC Investing Hit 12-Year Low in 2009*, WALL ST. J. BLOG (Jan. 22, 2010, 5:57AM), http://blogs.wsj.com/venturecapital/2009/04/18/venture-capital-investing-hits-11-year-low/. 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 L.J. (Aug. 17, 2009), http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202433112312. *See also* Erin Marie Daly, *Weak Economy Slows Litigation Growth*, LAW360 (Jan. 4, 2010), http://www.law360.com/articles/141372 (stating that litigation filings in 2009 rose only 5%, compared with 9% the year before). Antitrust filings fell almost 39% in 2009, though this also reflected an upward spike in 2008. Jacqueline Bell, *Antitrust Litigation Recedes from Peak in 2009*, LAW360 (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 Dips*, LAW360 (Jan. 4, 2010), http://www.law360.com/ip/articles/141363/depressed-by-copyright-plunge-ip-litigation-dips. Environmental litigation filings also fell. Jesse Greenspan, *Environmental Litigation Drops in 2009*, LAW360 (Jan. 4, 2010), http://www.law360.com/environmental/articles/141496/environmental-litigation-drops-in-2009. Insurance-law filings in federal court dropped 9%. Christie Smythe, *Bucking Expectations, Insurance Suits Drop 9% in '09*, LAW360 (Jan. 4, 2010), http://www.law360.com/insurance/articles/141369/bucking-expectations-insurance-suits-drop-9-in-09. Finally, securities filings rose more slowly than anticipated, including a drop in class-action filings. *See* Evan Weinberger, *Securities Litigation Grows More Slowly Than Expected*, LAW360 (Jan. 4, 2010), http://www.law360.com/securities/articles/141366/securities-litigation-grows-more-slowly-than-expected.

January 31, 2010, the *Law Shucks* website documented 14,347 people laid off by "major" law firms. These layoffs included 5632 lawyers and 8715 staff (a category comprising staff attorneys and contract attorneys as well as nonlawyer staff), numbers that the site itself recognized were significantly understated.[75] The total number of attorneys in the *NLJ* 250 decreased 4.3% in 2009 compared with 2008, and another 1.1% in 2010, only the second period since the *National Law Journal* started compiling these statistics in 1979 that the total has decreased.[76]

---

[75] *See Layoff Tracker*, LAW SHUCKS, http://lawshucks.com/layoff-tracker/ (last visited Mar. 4, 2011). 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). For a discussion of *Law Shucks*'s methodology, see http://lawshucks.com/layoff-tracker/#methodology. It does not count the fallout from the dissolution of large firms such as Heller Ehrman (over 700 lawyers and over 1000 staff); Thelen (over 400 lawyers); Wolf Block Schorr & Solis-Cohen (about 300 lawyers) and Thacher Proffitt & Wood (about 200 lawyers). *Id.* It cannot account for "stealth" layoffs of associates and staff in the guise of performance reviews. *Id.* And it 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*, LAW360 (Jan. 1, 2010), http://www.law360.com/ip/articles/139219 [hereinafter Allison, *Cost-Cutting Strategies*]; Christine Caulfield, *Firms Quietly Show Partners the Door*, LAW360 (Sept. 9, 2009), http://www.law360.com/legalindustry/articles/117009/firms-quietly-show-partners-the-door; *infra* note 78.

[76] Leigh Jones, *Vanishing Act, Year II*, NAT'L L.J. (Nov, 8, 2010), http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202474471365 [hereinafter Jones, *Vanishing Act*]; Jones, *2009 Worst Year*, *supra* note 22. The last time attorney census fell (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 5% drop in the *NLJ* 250 is just the tip of the iceberg: over a dozen firms fell out of the biggest 250 by shrinking or disappearing altogether through dissolution or merger, and the downsizing appears to have extended in similar proportions across the hundreds of smaller large firms not in the *NLJ* 250. *See Chart of "Firms New to the List" and "Firms that Fell Off the List,"* NAT'L L.J., http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202435287840 (last visited Mar. 4, 2011); Brush, *supra* note 22. William Henderson's analysis of the *NLJ* figures shows losses disproportionately concentrated in firms headquartered in New York City,

The total number of associates in the 250 most populous firms fell about 10% over the 2-year period, most of that in 2009. "Other" attorneys (neither partners nor associates) fell nearly 10% in 2009 but recovered about two-thirds of that loss in 2010, while partners increased about 1.5% over the 2 years.[77] And while partner numbers were reportedly flat, growing numbers of partners have been demoted to nonequity status, with many firms anticipating partner dismissals.[78] Overall, at least 25 firms decreased 12% or

---

with percentage losses 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-bigl aw-contraction-patterns-of-winners-losers.html.

[77] Leigh Jones, *Jump in the Number of 'Other' Attorneys at NLJ 250 Firms*, NAT'L L.J. (Nov. 11, 2010), http://www.law.com/jsp/nlj/PubArticle NLJ.jsp?id=1202474763926; Jones, *Vanishing Act*, *supra* note 76. Needless to say, partnership promotion rates have fallen as well. THOMAS S. CLAY & ERIC A. SEEGER, 2010 LAW FIRMS IN TRANSITION 5, 11 (2010), *available at* http://www.altmanweil.com/dir_images/upload/docs/2010LFiT Survey.pdf [hereinafter CLAY & SEEGER, 2010 LAW FIRMS IN TRANSITION] (40% of firms with over 50 lawyers surveyed made fewer partnership offers in 2009, and 50% will or might do so in 2010); Shannon Henson, *Fewer Associates Promoted to Partner in Downturn*, LAW360 (Nov. 11, 2009), http://www.law360.com/legalindustry/articles/131439/fewer-associat es-promoted-to-partner-in-downturn; Carlyn Kolker, *Making Partner Less Likely As Big Law Firms Face Cash Crunch*, BUS. WK. (Feb. 17, 2010), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aHFoBM2Ts WRA&pos=13. The reductions in force have disproportionately affected minorities and women. AM. BAR ASS'N, DIVERSITY IN THE LEGAL PROFESSION: THE NEXT STEPS (Apr. 2010), http://www.americanbar.org/con tent/dam/aba/migrated/2011_build/diversity/next_steps.authcheckdam.pdf; *see also* Emily Barker, *Diversity Scorecard 2010: One Step Back*, AM. LAW. (Mar. 1, 2010), http://amlawdaily.typepad.com/amlawdaily/2010/03/oneste pback.html (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); *but see* Karen Sloan, *Decline in Law Firm Diversity Blamed on a Few 'Bad Actors,'* NAT'L L.J. (Nov. 8, 2010), http://www.law. com/jsp/nlj/PubArticleNLJ.jsp?id=1202474600719 (bad effects on diversity concentrated in only about 25% of larger firms).

[78] 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

more in attorney census. Just in 2009, 15 firms shed more than 100 lawyers, and 7 more than 200. Latham & Watkins alone jettisoned 444 lawyers, or 19%; Fried Frank dropped 168, over 26%.[79]

Associate Hiring Curtailed. In addition to laying off existing employees, firms also drastically cut new associate hiring.[80] In 2009 and 2010, numerous firms rescinded existing employment offers or "deferred" new hires' start dates 3 to 12 months or more.[81] Over 100 *NLJ* 250 firms reported deferring a total of nearly 2800 new associates, some 42% of their entering classes.[82] 60% of the Am Law

---

might in 2010. Firms with over 250 lawyers were twice as likely to de-equitize partners as smaller ones. CLAY & SEEGER, 2010 LAW FIRMS IN TRANSITION, *supra* note 77, at 5, 11. 70% of large firms expect to dismiss partners in 2011. Zillman, *New Normal*, *supra* note 59, at 68 (also noting that 31% plan to de-equitize more partners).

[79] Jones, *2009 Worst Year*, *supra* note 22.

[80] *See generally Perspectives on Fall 2009 Law Student Recruiting*, NAT'L ASS'N FOR LAW PLACEMENT (2010), http://www.nalp.org/perspectivesonfallrecruiting (gathering figures on reduced hiring); *Entry-Level Recruiting Volumes Plunge, Some Start Dates Deferred*, NAT'L ASS'N FOR LAW PLACEMENT (Mar. 2, 2010), http://www.nalp.org/2009perspectivesonfallrecruiting (press release summarizing NALP report). *See also* Elie Mystal, *Statistics About the Lost Generation*, ABOVE THE LAW (Mar. 3, 2010, 2:32 PM), http://abovethelaw.com/2010/03/statistics-about-the-lost-generation-/; Karen Sloan, *Summer Associate Offers Hit 17-Year Low, Says NALP*, NAT'L L.J. (Mar. 3, 2010), http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202445314748 (only 10 of 300 firms surveyed made any job offers to third-year law students).

[81] *See, e.g.*, Tina Peng, *Arent Fox Revokes Some Associate Offers*, LAW360 (Sept. 24, 2009), http://ip.law360.com/articles/124431.

[82] Jones, *2009 Worst Year*, *supra* note 22; *see also Career Center: First-Year Associate Survey Results*, ABOVE THE LAW (Nov. 18, 2010, 1:13 PM), http://abovethelaw.com/2010/11/career-center-first-year-associate-survey-results/ (44% of associates responding reported deferred start dates). Larger firms 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, 6:06 AM), 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*, ABOVE THE LAW (June 12,

200's responding managing partners reported deferring associates in 2009, and 43% expected to defer associates again in 2010, apparently including some who had already been deferred once.[83] Firms also reduced or cancelled on-campus interviewing, slashed or eliminated summer programs, and dramatically cut hiring goals.[84] 72% of Am

---

2009, 11:17 PM), http://abovethelaw.com/2009/06/cravath-offers-voluntary-deferral-to-class-of-2009-and-delays-class-of-2010-a-full-year/ ($80,000). 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?*, ABOVE THE LAW (Feb. 26, 2010, 12:30 PM), http://abovethelaw.com/2010/02/if-you-bail-on-biglaw-do-you-have-to-repay-your-deferral-stipend/; *see also* Lisa Faye Petak, *Young Lawyers Turn to Public Service*, N.Y. TIMES, Aug. 20, 2010, at A14, *available at* http://www.nytimes.com/2010/08/20/us/20defer.html.

[83] Combs, *Am Law 2009 Survey: Associates*, *supra* note 3. *See also* Liz McKenzie, *Contract Attys Sitting Pretty as Associates Deferred*, LAW360 (Feb. 9, 2010), http://www.law360.com/legalindustry/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*, N.Y. TIMES, Jan. 17, 2010, at ST–1, *available at* http://www.nytimes.com/2010/01/17/fashion/17lawyer.html; Debra Cassens Weiss, *Almost 1/3 of Law Students Expect to Graduate with $120K Debt*, A.B.A. J. (Jan. 6, 2010, 8:23 AM), http://www.abajournal.com/news/article/almost_1_3_of_law_students_expect_to_graduate_with_120k_in_debt/;. *see also* Lat & Mystal, *Cravath Offers Voluntary Deferral*, *supra* note 82.

[84] CLAY & SEEGER, 2010 LAW FIRMS IN TRANSITION, *supra* note 77, at 5 (64% of surveyed firms larger than 50 reduced their summer programs in 2009, and 54% will do so again in 2010); Gerry Shih, *Downturn Dims Prospects Even at Top Law Schools*, N.Y. TIMES, Aug. 26, 2009, at B1, *available at* http://www.nytimes.com/2009/08/26/business/26lawyers.html; Elie Mystal, *NALP 2010: NALP Executive Director James Leipold Talks to the 'Lost Generation,'* ABOVE THE LAW (May 3, 2010, 1:38PM), http://abovethelaw.com/2010/05/nalp-2010-nalp-executive-director-james-leipold-talks-to-the-lost-generation/; Debra Cassens Weiss, *A 'Lost Year' for 2Ls: About Half of BigLaw Jobs Are* Gone, A.B.A. J. (Aug. 26, 2009, 8:46 AM), http://www.abajournal.com/news/article/a_lost_year_for_2ls_about_half_of_biglaw_jobs_are_gone/. 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*,

Law 200 firms predicted an even smaller entering class in 2010 than they did in 2009 (which had already shrunk from 2008 levels), and 22% no larger;[85] 87% of those firms expect their entering classes to be no larger in 2011 than the downsized classes of 2010.[86]

Even if nothing fundamental about the market for lawyers and their services has changed (an assumption we question in the balance of this Article), law graduates in 2011 and beyond will face an extraordinary reduction in demand for large firms' services. A recovery may well take years. Law graduates' 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.[87]

Associate Compensation Reduced and Restructured, with Seniority Raises Conditioned or Reduced. Many large firms froze associate salaries in 2009, or reduced entering associates' salaries by 10–20% with similar reductions up the line in the more senior classes.[88] Firms

---

LAW360 (Dec. 8, 2009), http://www.law360.com/topnews/articles/135593/change-may-be-coming-to-firm-staffing-models.

[85] Combs, *Am Law 2009 Survey: Associates*, *supra* note 3. *See also* CLAY & SEEGER, 2010 LAW FIRMS IN TRANSITION, *supra* note 77, at 5 (2010 Altman Weil survey of firms larger than 50 attorneys found that more than half discontinued or reduced first-year hiring in 2009, and 38% will do so again in 2010).

[86] Zillman, *New Normal*, *supra* note 59, at 66.

[87] *See supra* notes 82–83 and accompanying text.

[88] The *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. Combs, *Am Law 2009 Survey: Associates*, *supra* note 3. *See also, e.g.*, Julie Triedman, *Associate Pay Cuts Here to Stay, Say Firms, Analysts*, AM. LAW. DAILY (Dec. 14, 2009), http://www.law.com/jsp/article.jsp?id=1202436246170 [hereinafter Triedman, *Associate Pay Cuts*]; Julie Zeveloff, *Mayer Brown, Pillsbury Disclose 2010 Pay Scales*, LAW360 (Feb 3, 2010), http://www.law360.com/articles/147454. At least two large firms have required their nonequity partners to purchase equity stakes in the firm, effectively by reducing

also eliminated or reduced associate bonuses, which can be a substantial part of senior associates' 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 as one third compared with 2007.[89]

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.[90] 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

their salaries and devoting it to the "investment." Steven R. Stahler, *DLA Piper Makes Seismic Shift in Structure*, CHICAGO BUS. (Nov. 19, 2008), http://www.chicagobusiness.com/cgi-bin/news.pl?id=31887 (275 nonequity partners asked to contribute capital of $150,000 each); Debra Cassens Weiss, *Reed Smith Will Ask Nonequity Partners to Pony Up Possibly 15% of* Pay, A.B.A. J. (Nov. 16, 2009), http://www.abajournal.com/mobile/reed_smith_will_ask_nonequity_partners_to_pony_up_possibly_15_of_pay/.

[89] David Lat & Elie Mystal, *Cravath Bonuses are Out: The 2010 Bonus Season is Underway!*, ABOVE THE LAW (Nov. 22, 2010, 2:51 PM), http://abovethelaw.com/2010/11/associate-bonus-watch-the-2010-bonus-season-is-under-way/#more-44097 (showing falling bonuses had effectively reduced first-year compensation 20% between 2007 and 2010 at salary market-leader Cravath, whose pay and bonus scales many large firms have mimicked). As time goes on, compensation cuts are concentrating in bonuses: some firms have begun to "unfreeze" salary and relax strictures on associate bonuses, but generally total compensation remains well below pre-recession levels. *See, e.g.*, *id.*; Amanda Royal, *Latham: We're Gonna Pay You Like 2009 Never Happened*, LEGAL PAD (Jan. 4, 2010), http://legalpad.typepad.com/my_weblog/2010/01/latham-were-going-pay-you-like-2009-never-happened.html; Julie Zeveloff, *MoFo to Pay 1st-Years $160K Across the Board*, LAW360 (Feb. 17, 2010), http://www.law360.com/ip/articles/150371. Others are not. *See, e.g.*, Elie Mystal, *Morgan Lewis: Not Enough Pie for Everybody*, ABOVE THE LAW (Feb. 11, 2010, 1:49 PM), http://abovethelaw.com/2010/02/morgan-lewis-not-enough-pie-for-everybody/ (quoting an anonymous associate: "[s]omething is nauseatingly wrong . . . [w]hen third years billing over 2200 hours [per year] are being paid $5,000 more than first years").

[90] Allison, *Cost-Cutting Strategies*, *supra* note 75. During the high-demand period of the "tech bubble," many firms paid tiered bonuses based on excess billable hours, a tactic that largely disappeared during the recession.

inchoately) "merit."[91] 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 those who may not be. A "merit" system

[91] A 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.) Combs, *Am Law 2009 Survey: Associates*, *supra* note 3. *See also* Amanda Becker, *Howrey Firm Shifts Pay, Development of Entry-level Associates*, WASH. POST, Apr. 26, 2010, at 15, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2010/04/23/AR2010042303429.html; Dan Slater, *At Law Firms, Reconsidering the Model for Associates' Pay*, N.Y. TIMES, Mar. 31, 2010, at SPG10, *available at* http://www.nytimes.com/2010/04/01/business/01LEGAL.html; Allison, *Cost-Cutting Strategies*, *supra* note 75; Erin Fuchs, *Life Post-Lockstep: Moving to Merit Pay Without a Map*, LAW360 (Jan. 25, 2010), http://www.law360.com/topnews/articles/145121/life-post-lockstep-moving-to-merit-pay-without-a-map; Jones, *Thrills & Chills*, *supra* note 30; Elie Mystal, *Associate Bonus Watch: Orrick, A Case Study in Merit-Based Bonus Payments*, ABOVE THE LAW (Feb. 10, 2010, 2:05 PM), http://abovethelaw.com/2010/02/associate-bonus-watch-orrick-a-case-study-in-merit-based-bonus-payments/ (including a copy of Orrick management's memorandum to associates with detailed charts on the amount and distribution of bonus awards); Triedman, *Associate Pay Cuts*, *supra* note 88; Debra Cassens Weiss, *Five Questions for Law Firms Abandoning Lockstep Compensation*, A.B.A. J. (Nov. 17, 2009), http://www.abajournal.com/news/article/five_questions_for_law_firms_abandoning_lockstep_compensation; Rachel M. Zahorsky, *Law School Rank and Class Take Back Seat to Practical Skills in 2010*, A.B.A. J. (Jan. 7, 2010), http://www.abajournal.com/news/article/law_school_rank_and_class_year_take_back_seat_to_practical_skills_in_2010; Julie Zeveloff, *Morgan Lewis Reveals Details on New Pay System*, LAW360 (Jan. 20, 2010), http://www.law360.com/topnews/articles/144550. It remains unclear how many firms may retain the change. *See* Nick Brown, *Law Firms Fall Back In Step With Lockstep*, LAW360 (July 15, 2010), http://www.law360.com/print_article/181193?section=topnews.

could also quietly implement modest to significant pay reductions for many associates.[92]

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.[93] In addition, "creative" billing arrangements, such

[92] David Lat, *A Peek Inside the Winston & Strawn Black Box and Additional Info on Stealth Layoffs*, ABOVE THE LAW (Apr. 23, 2010, 3:42 PM), 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"); Allison, *Cost-Cutting Strategies*, *supra* note 75; Triedman, *Associate Pay Cuts*, *supra* note 88. Again, we express no judgment about whether this will ultimately prove to be a "good" or a "bad" development for associates or 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*, LAW360 (Jan. 8, 2010), http://www.law360.com/topnews/articles/142513/shift-from-lockstep-pay-rife-with-perils-experts-say; Steven Harper, *Bonuses Cast Spotlight on Merit-Based vs. Lockstep Divide*, AMLAW DAILY (Dec. 22, 2010, 2:38 PM), http://amlawdaily.typepad.com/amlawdaily/2010/12/harperbonuses1222.html. We simply observe that experimentation is underway, and has a number of potentially important causes and significant effects.

[93] *See* Dan DiPietro & Gretta Rusanow, *Cost Reduction is Good, Cost Certainty is Better*, AMLAW DAILY (Dec. 10, 2010, 6:00 AM), http://amlawdaily.typepad.com/amlawdaily/2010/12/citi3quarterparttwo.html. Rate increases at large firms in 2009 and 2010 were small or nonexistent, on average about 2.5%. *See 2010 Law Firm Billing Survey*, NAT'L L.J. (Dec. 6, 2010), http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202475713526; Karen Sloan, *Reality Dawns on Hourly Rates*, NAT'L L.J. (Dec. 7, 2009), http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202436065834. On discounting, *see* Debra Cassens Weiss, *Why Law Firms Are Like Hotels: 'Rack Rates' Are Negotiable, Real Rates Vary by Client*, A.B.A. J. (May 26, 2010, 7:08 AM), http://www.abajournal.com/news/article/client_beware_law_firm_rack_rates_are_negotiable_and_real_rates_vary_even_f; Zillman, *New Normal*, *supra* note 59, at 69 (noting that 85% of clients requested discounts in 2010, down from 92% in 2009). London's "Magic Circle" firms have reportedly reduced their partner rates to levels

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.[94] Values like predictability and shared risk are often proffered to support such arrangements, but clients are, if anything, more vigilant and less tolerant than ever about paying premium fees for routine work.[95] Indeed, one feature of the current unrest among pricing models is strong

last seen five years ago. Tina Peng, *Partner Rates Plummet at Top London Firms: Report*, LAW360 (Sept. 22, 2009), http://www.law360.com/articles/123691.

[94] A survey of chief legal officers that law firm consultants Altman Weil conducted in the summer of 2009 found that nearly 40% 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*, LAW360 (Nov. 6, 2009), http://www.law360.com/topnews/articles/122992/general-counsel-keep-billable-hour-hanging-on- [hereinafter Urda, *General Counsel Keep Billable Hour*] (but also suggesting that alternative fees currently consume no more that 2% of corporate legal spending). *See* Jerry Kowalski, *Alternative Fee and Billing Arrangements: A Primer*, LAW360 (Apr. 1, 2010), http://www.law360.com/ip/articles/155660; *Firms Report Using Alternatives to the Billable Hour*, NAT'L L.J., www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202436026951 (last visited Mar. 4, 2011) (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, however. *See* Sharon Green, *The ACC/TAL Survey: General Counsel, in Their Own Words*, CORP. COUNS. (Dec. 3, 2010), http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202475648751; Lee Stephen MacPhee, *NOT Dead (Just Beaten Up)*, CORP. COUNS. (Apr. 2, 2010), http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202447313892; Urda, *General Counsel Keep Billable Hour*, *supra*; Zillman, *New Normal*, *supra* note 59, at 68 (noting that half of corporate clients with revenues over $1 billion will pay for 95% of their outside legal work by the hour).

[95] A 2008 Altman Weil survey of general counsel found 75% had had their 2009 budgets cut, and they also 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*, LAW360 (Dec. 9, 2008), http://www.law360.com/web/articles/79627. *See also* Emily Heller, *General Counsel Pressuring Firms Amid Recession*, NAT'L L.J. (March 30, 2009), http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202429666843.

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.[96]

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.[97] From October 2008 through

---

[96] *See* DiPietro & Rusanow, *supra* note 93 ("[F]or many firms, their experience has been that clients are using [alternative fee arrangements] as code for seeking a deeper discount to the hourly rate . . . ."); *Q&A with FMC Technologies GC Jeffrey Carr*, LAW360 (Mar. 30, 2010), http://www.law360.com/legalindustry/articles/157416/q-a-with-fmc-technologies-gc-jeffrey-carr ("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."). *See also* Karen Sloan, *Firms' Billing Rates Inched Up During 2009, NLJ Survey Shows*, NAT'L L.J. (Dec. 7, 2009), http://www.law.com/jsp/article.jsp?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, *General Counsel Keep Billable Hour*, *supra* note 94; Debra Cassens Weiss, *64% of Law Departments Have or Will Implement Rate Freezes, Survey Says*, A.B.A. J. (Nov. 20, 2009, 9:30 AM), http://www.abajournal.com/weekly/article/law_departments_cut_costs_by_squeezing_law_firms_freezing_staff_salaries.

[97] *See* Zillman, *supra* note 1 (full disclosure: one of the authors is Of Counsel to one of the firms profiled in the Zillman article). *See also* Erin Coe, *Rash of IP Boutiques Look to Cash In Post-Recession*, LAW360 (Feb. 2, 2010), http://www.law360.com/articles/143421; Shannon Henson, *Recession Offers Attorneys Chance to Branch Out*, LAW360 (Oct. 28, 2009), http://www.law360.com/ip/articles/128352; David Lat, *A Hot New Trend: Leaving BigLaw to Start Your Own Firm*, ABOVE THE LAW (Aug. 20, 2010, 11:14 AM), 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*, LEGAL INTELLIGENCER (Apr. 14, 2010), http://www.law.com/jsp/law/sfb/lawArticleSFB.jsp?id=1202448019303; 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*, LAW360 (Apr. 23, 2009), http://www.law360.com/ip/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

September 2009, 114 Am Law 200 partners left their firms to start or join small practices, up from 70 the year before.[98]

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.[99] The recessions of the early 1980s,

---

Bell, *Boutique Biz Model Puts Associates in Driver's Seat*, LAW360 (Dec. 10, 2009), http://www.law360.com/web/articles/131608.

[98] Zillman, *supra* note 1. More generally, mid-market and mid-sized firms with the benefit of lower overhead and lower pricing also enjoyed more market attention. Nick Brown, *Midsize Firms Make Big Splash in BTI Top 30*, LAW360 (Nov. 13, 2009), http://www.law360.com/ip/articles/134065 (referring to particular firms of 200–300 lawyers as "midsize"); Heller, *supra* note 95 (noting that general counsel are replacing large national firms with "smaller regional firms" that charge significantly lower hourly rates).

[99] Overall, in 2009 Am Law 200 firms saw modest declines in gross revenue, but flat or even slightly increased profits per partner. Drew Combs, *No Place to Hide*, AM. LAW. (June 1, 2010), http://www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202458447280; Aric Press & Greg Mulligan, *Lessons of the Am Law 100*, AM. LAW. (Apr. 29, 2010), http://www.law.com/jsp/article.jsp?id=1202454891802. *See also Summary 2009 Financial Results of 67 Top Firms Reporting as of March 1, 2010*, ZEUGHAUSER GROUP (March 2010), http://www.zeughausergroup.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' results varied, of course. *See, e.g.*, Drew Combs, *THE AM LAW 100: Profits, Revenue Rise at Gibson, Dunn*, AMLAW DAILY (Feb. 16, 2010, 4:52 PM), http://amlawdaily.typepad.com/amlawdaily/2010/02/al100gibson.html (revenue up 4%; PPP up 1.6% to $1.9 million); Michael D. Goldhaber, *THE AM LAW 100: Profits Up, Revenue Down at Shearman & Sterling*, AMLAW DAILY (Feb. 16, 2010, 6:00 AM), http://amlawdaily.typepad.com/amlawdaily/2010/02/al100shearman.html (revenue down 8.6%; PPP up 4.2% to over $1.7 million); Richard Lloyd, *THE AM LAW 100: Latham's Profits Bounce Back*, AMLAW DAILY (Feb. 17, 2010, 11:01 AM), http://amlawdaily.typepad.com/amlawdaily/2010/02/al100latham.html (revenues down 5%; PPP up 5% to $1.9 million); Elie Mystal, *Boston Legal Enjoys Record Profits Per Partner*, ABOVE THE LAW (Feb. 5, 2010, 11:05 AM), http://abovethelaw.com/2010/02/boston-legal-enjoys-record-profits-per-partner. Paul Weiss's managing partner publicly claimed record 2009 profits

early 1990s, and early years of the new century each produced temporary dips 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.[100] 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 setbacks merely temporary deviations in trends that, as previously, will be pulled by familiar market forces back onto the path they have followed assiduously for the last forty 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 in the perceptions of those at the crossroads. 58% of those responding believed that the "economic downturn [had] produced a fundamental shift in the legal marketplace."[101] However, 70% of the same managing partners said that the recession had *not* "produced a fundamental shift in [their firm's] business model."[102] Similarly, an Altman Weil survey conducted in the spring of 2009 explored whether U.S. firms larger than 50 lawyers were reconsidering their basic

---

of $2.69 million per partner "without resorting to layoffs," despite reported 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?*, ABOVE THE LAW (Feb. 1, 2010, 4:23 PM), http://abovethelaw.com/2010/02/what-did-paul-weiss-just-say. Other firms were less successful. *See, e.g.*, Dimitra Kessenides, *THE AM LAW 100: Howrey's PPP Plunges 35 Percent*, AMLAW DAILY (Feb. 22, 2010, 4:20 PM), 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*, AMLAW DAILY (Feb. 26, 2010, 6:00 AM), http://amlawdaily.typepad.com/amlawdaily/2010/02/al100debevoise.html (revenue down 12%; PPP down 16% to $1.9 million).

[100] *See generally supra* Part II.B.

[101] Combs, *Am Law 2009 Survey: Associates*, *supra* note 3.

[102] *Id.*

paradigm, and found little evidence of intent to implement fundamental change.[103]

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 twenty-five years, and test their predictions against the facts we know to date.

III. 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.[104] These models 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; 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

---

[103] Brush, *supra* note 22 (quoting Altman Weil principal that survey showed little evidence that "all the noise in the marketplace about a new law firm business model was translating into real change"). The survey asked 687 U.S. firms with 50 or more lawyers which changes in the economic environment they perceived as temporary, and which permanent. The top four areas of permanent change respondents 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. Significantly, the largest law firms (over 500 lawyers) differed from the overall group on leverage, with about 40% of those firms perceiving leverage reductions as a permanent change in the landscape. *Id.*

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

explanations offered to date, but have not produced any definitive answers.[105]

However this story is told, client demand comprises an essential part of any plausible explanation. Certain cost reductions might cause firms to get bigger even if demand held constant, but we think a significant part of the explanation for firm growth is simply that, in both the United States and other countries, big-firm clients have become wealthier over the past forty years, and much of the increase involves intangibles (such as intellectual property rights, and the property interests represented by securities), the regulation of which has created steadily increasing demand for complex, specialized, high-margin legal services. In addition, 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.[106]

---

[105] One explanation that merits consideration, at least in passing, is blind faddishness on the part of firm managers—that is, the possibility that many firms got bigger simply because their peers were doing the same, and naturally competitive firm leaders insisted on keeping up (as it were) with the Jones Days. Increases in demand for high-end legal services kept everyone busy during this period, and the increases in price that accompanied the increases in demand easily bolstered partner profits without forcing careful consideration of whether other sizing or staffing strategies might have yielded greater efficiency or profitability. *See generally supra* Part II.B. While our desire to treat this paper as more than wasted effort urges respect for market forces' tendencies to guide players toward optimal strategies, the twentieth century offers other examples of business vogues substituting for considered financial judgment. *See, e.g.*, LINCOLN CAPLAN, SKADDEN: POWER, MONEY, AND THE RISE OF A LEGAL EMPIRE 207–27 (1993) (describing waves of conglomerate mergers in the 1960s and leveraged buyouts in the 1980s that studies show provided little lasting financial benefit). For purposes of argument we will assume that, whatever other influences may have been at play, *some* economic forces have also materially driven trends in the legal marketplace. As we show in the pages that follow, however, the failure to date of numerous thoughtful investigators to identify those forces is sobering.

[106] *See* GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 50–52; JOHN P. HEINZ ET AL., URBAN LAWYERS: THE NEW STRUCTURE OF THE BAR 287

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. Elite firms may achieve economies of scale, but these economies appear to exhaust themselves at sizes that are relatively modest, and almost certainly smaller than most firms in this practice sector today (or, for that matter, a generation ago).[107] Nor will overall demand alone tell us how firms allocate authority, share profits, or hire or promote new lawyers.

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.

(2005); John P. Heinz, Robert L. Nelson & Edward O. Laumann, *The Scale of Justice: Observations on the Transformation of Urban Law Practice*, 27 ANN. REV. SOC. 337, 342 (2001); Nelson, *Explaining Growth*, *supra* note 17, at 747–49; Randall S. Thomas, Stewart J. Schwab & Robert G. Hansen, *Megafirms*, 80 N.C. L. REV. 115, 136–52 (2001). Galanter and Palay acknowledge that "changing scale and complexity" of large-firm legal work is a "plausible" explanation for law firm growth (in 1991) but they discount this explanation as "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, *supra* note 4, at 113. Thomas, Schwab, and Hansen quantify in the mergers and acquisitions context something inescapable to any casual observer: lawsuits and deals keep getting bigger and more numerous over time. In Part V.B, *infra*, we suggest that one reason for the increase in the legal costs associated with these growing engagements is the increasingly larger body of durable information relevant to most disputes and transactions that has been created by the digital revolution.

[107] *See* Sander & Williams, *Theorizing*, *supra* note 29, at 393–94 (surveying commentary). There are also well-recognized *dis*-economies of scale, such as conflicts of interest and the costs and frictions of management, which increase in number and complexity as a firm expands. These tend to slow or discourage growth beyond a scale that most elite firms exceeded long ago.

A. Diversification of "Human Capital" (Gilson & Mnookin)

The touchstone economic analysis of the professional firm is Ronald Gilson and Robert Mnookin's 1985 exploration of "Sharing Among the Human Capitalists," and their follow-on work on associate career patterns in large law firms.[108] Gilson and Mnookin begin with the important question why law firms exist at all. To answer that question, they treat lawyers' skills as human capital and lawyers' income as returns on investments in that capital.[109] They posit that a principal purpose of a firm is to maximize returns to the joint investments of the lawyers in the firm.[110] This framework leads them to ask how practice in a firm can generate greater returns per practitioner than individual practice.

Diversification of a firm's portfolio of human capital is the key to Gilson and Mnookin's answer. They observe that it is hard for one lawyer to diversify risks relevant to his or her practice, such as a personal illness or decline in the business of a core client or market segment. Firms allow such risks to be diversified across many lawyers and many client markets, thus optimizing returns on the group's human capital as a

---

[108] Gilson & Mnookin, *Profit Sharing*, *supra* note 8; 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 (1988) [hereinafter Gilson & Mnookin, *Associate Careers*]. Gilson and Mnookin were the first to recognize the economics of elite law firms as a subject worthy of study; the first to apply rigorous economic scrutiny to the industry; the first to try and isolate relevant variables and examine them in a context in which analysis could 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.

[109] Gilson & Mnookin, *Profit Sharing*, *supra* note 8, at 324.

[110] This model focuses almost entirely on the interactions among lawyers—specifically, relations among owners (partners), and relations between partners and associates. Non-attorney 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 infra* Part V.C.1.

whole.[111] On this account, diversification binds lawyers to a firm and provides the organizing principle for the firm's production of legal services.[112]

As Gilson and Mnookin point out, attaining the benefits of full diversification requires lawyers to divide the collective returns on their human capital in equal shares.[113] To the extent they do not, diversification is imperfect: the "winners" and "losers" in any given year do not balance out the risks and benefits they agreed to share *ex ante*. Too little sharing would reduce the firm to a group of undiversified solo practitioners sharing certain expenses but each still bearing, at the very least, a large fraction of the specific risks of their own individual lives and practices.[114]

Gilson and Mnookin recognized that the sharing necessary to achieve adequate diversification creates risks of opportunistic behaviors. These behaviors include partners not doing their fair share of the work while still receiving an equal share of the profits ("shirking"); subverting equal sharing by demanding greater-than-equal shares of the profits on the basis of their greater immediate contribution

[111] Gilson & Mnookin, *Profit Sharing*, *supra* note 8, at 324–29.

[112] In particular, they point out that portfolio 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.

[113] To 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 *supra* note 90 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.

[114] *Id.* at 331.

or value ("grabbing"); or 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").[115] They believed that many structural features common among large law firms are therefore "organizational forms that provide self-enforcement of the sharing bargain" necessary to achieve the benefits of diversification.[116]

According to Gilson and Mnookin, the "most significant constraint" on "grabbing" and "leaving" is "firm-specific capital"—human capital that is more valuable deployed within the firm than it would be elsewhere.[117] Grabbing and leaving work only if opportunistic partners can withdraw their human capital from the firm and make more money on it elsewhere.[118] If they cannot, leaving would be self-defeating and threats to leave in an effort to grab would not be credible.[119] 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

[115] *Id.* at 336–38.

[116] *Id.* at 339.

[117] *Id.* at 354.

[118] *Id.* at 355. Applying ordinary market valuation principles, Gilson and Mnookin 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.* at 354.

[119] *Id.* 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 does not pretend to be more than an *economic* model, and in a for-profit firm economics obviously matter. Gilson and Mnookin recognize that 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. *See id.* at 376.

them to another firm);[120] "client-specific information" regarding the client's business and service preferences that would be costly to duplicate elsewhere;[121] and the firm's general brand name reputation for quality.[122]

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.[123] Gilson and Mnookin presciently predicted in 1985 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."[124]

1. Experience Shows Full Diversification Is Rare and Not Correlated with Superior Profits

The available historical and empirical evidence suggests that few (if any) firms are diversified in the portfolio theory sense or enjoy the financial benefits they assumed diversification could provide. While law firms may diversify across clients in select lines of business, there is little evidence that firms diversify significantly across lines of business. If returns to diversification were high, one would expect to see widespread use of lockstep compensation, which most fully diversifies risk and thus should make the financial benefits of diversification most available. But neither historically nor currently have firms widely implemented lockstep compensation. Gilson and Mnookin simply assumed in 1985 that lockstep compensation was

---

[120] *Id.* at 354–55.

[121] *Id.* at 358–59.

[122] *Id.* at 360–63. 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 369. It also depends on the difficulty of determining quality both before and after the delivery of the services, and the costs of refining that uncertainty (which in turn depends on the sophistication of the buyer-client). *Id.* at 360–63.

[123] *Id.* at 381.

[124] *Id.* *See also id.* at 384–86 (discussing approaches that clients can take to reduce their dependence on a single law firm).

then, or until recently had been, pervasive among elite law firms, particularly the most successful ones.[125] Yet sociological and historical studies indicate that if lockstep partner compensation had ever been widespread, by 1960 it was more typical for partners in elite firms to divide profits based in significant part on recent individual contribution, a practice the literature generally refers to as "marginal product" compensation.[126] A 1995 *American Lawyer* survey

[125] *See id.* at 315 (positing a "[t]radition[]" of "seniority-based divisions of partnership income" without citation); *id.* at 353 n.63 (criticizing another article for assuming a productivity-based profit division formula at most firms "because no underlying data are disclosed," and 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"); *id.* at 319 (noting the general assumption that "well-established firms . . . divide the pie by some sort of seniority-based system"); *id. at* 341 (listing several large firms "committed" to lockstep compensation systems). *See also* Gilson & Mnookin, *Associate Careers*, *supra* note 108, at 571–72 (citing only their *Profit Sharing* article (which contains no empirical data) to support the proposition that "[u]ntil recently, [profit division] in many firms took the form of what we have called a sharing model in which profits were divided based on a lock-step seniority system without regard to the actual productivity of any particular partner"); *id.* at 567 (noting the "long-standing reliance on seniority that emphasizes risk-sharing").

[126] GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 30–32. *See also* the authorities cited therein, including MARTIN MAYER, THE LAWYERS 336 (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); 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"). The available evidence is concededly limited. *Bates v. Arizona* ushered in the specialty legal press in the late 1970s. *See supra* note 32. Prior to that time, 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 amounted to prohibited lawyer advertising. GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 20–21, 30–31, 69–70; SMIGEL, *supra* note 10, at 18 (compensation a "taboo topic"); *id.* at 92 ("The subject of

of the 100 largest U.S. law firms by revenue showed that only 4 of 70 respondents characterized their partner compensation systems as lockstep.[127] Thus, although a small number of successful firms still employ lockstep today, the overwhelming majority do not, and probably did not even in 1985.[128]

In addition, there is no evidence that well-diversified law firms are more profitable than less-diversified firms as Gilson & Mnookin predict.[129] A leading sociologist of elite law firm culture found no evidence that portfolio-style diversification was a management objective in such firms.[130] Nor has any empirical evidence emerged that any particular diversification strategy consistently produces recognizable

percentages and salaries is particularly 'hush, hush.'"); Hoffman, *supra* note 60, 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, *supra* note 4, at 31 n.86.

[127] Partnership Retreat Notebook, *Part I: The Meaning of Partnership in 1996*, AM. LAW., Supp. June 1996, at 8.

[128] The advantages of diversification can be achieved only if the opportunistic behaviors that may attend lockstep compensation are overcome with appropriate organizational protections. *See* Gilson & Mnookin, *Profit Sharing*, *supra* note 8, 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 limited 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 infra* Part III.A.2.

[129] The 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 that the example "while theoretically helpful, may in reality be inaccurate." Gilson & Mnookin, *Profit Sharing*, *supra* note 8, at 328 n.27.

[130] NELSON, *supra* note 36, at 64–66 (noting that extensive interviews with many partners at four large Chicago firms showed no significant interest in diversification as a goal of growth).

financial advantages.[131] To the contrary, more profitable large firms have tended to concentrate their practices on high-margin work for which prices are relatively inelastic, and which is often found in related practice areas.[132] A recent empirical study of partner mobility found that "upstream" lateral movement—that is, movement from a less

[131] For 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.L. ECON. & ORG. 339 (2009). Garicano and Hubbard do find support for an information-sharing explanation of firm boundaries, which is consistent with the referral network explanation we suggest in Part IV, *infra*. Similarly, number 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. *See* Henderson, *Single vs. Two-Tier Partnerships*, *supra* note 26, at 1735 n.164. 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, or a nationwide set of related issues (such as employment or distribution practices). *See* Galanter & Henderson, *Elastic Tournament*, *supra* note 10, at 117, 122 (suggesting various motivations for geographic expansion).

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. *See* Henderson, *Single vs. Two-Tier Partnerships*, *supra* note 26, at 1735 n.164. Studies from the 1990s were mixed on the correlation between firm size and profitability. *See* Kyle Chadwick & Ramsey Hanna, *Predicting Profitability*, AM. LAW., Supp., July–Aug. 1994 at 63 (size correlated with profits); David. H. Maister, *Where Profits Come From*, AM. LAW., Sept. 1993, at 39 (arguing that size is a "zero factor" in profits); S.S. Samuelson & L.J. Jaffe, *A Statistical Analysis of Law Firm Profitability*, 70 B.U. L. REV. 185, 204–06 (1990) (size correlated). However, the two studies finding size correlated with profitability did not control for prestige, which Henderson's study shows is a "highly significant predictor" of profitability. Henderson, *Single vs. Two-Tier Partnerships*, *supra* note 26, at 1696 & n.24.

[132] *See supra* notes 71–72 and accompanying text.

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 these practice areas were focused around securities, finance, and capital markets (securities, M&A, private equity, high-end white-collar criminal defense, antitrust, or intellectual property). By contrast, partners concentrating in less profitable practices (real estate, trusts and estates, labor and employment) tended to lateral "downstream" to less profitable firms.[133]

Finally, contrary to Gilson and Mnookin's predictions, lower fees from more diversified firms have not priced out of business "boutique" firms specializing in a single or limited number of areas.[134] Instead, boutique firms in a range of specialties have survived and thrived, and have enjoyed a new resurgence during the current recession.[135] And by and large their success has been predicated on their ability to provide quality services, less encumbered by multiple offices

---

[133] Galanter & Henderson, *Elastic Tournament*, *supra* note 10, at 135–38 and accompanying notes. 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 economic downturns, when reductions in force, pay, and benefits create more issues and disputes than in good times. But employment (characteristically a lower-margin practice area comprising more spot counseling and smaller disputes) is a practice whose specialists have tended to lateral "downstream" to less profitable firms since 2000. *Id.* at 137. 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 supra* note 128), 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 their excess income elsewhere rather than manipulating their law firms' staffing structure or practice mix.

[134] Gilson & Mnookin, *Profit Sharing*, *supra* note 8, at 335 n.36.

[135] *See supra* notes 97–98 and accompanying text; Sander & Williams, *Theorizing*, *supra* note 29, at 396 (noting the continuing viability of boutique firms in 1992).

and other big-ticket infrastructure, at a *lower* price than the large general-practice firms, rather than the converse as diversification enthusiasts theorized.[136]

2. 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 explain law firm growth or structure, weaker notions of diversification may have some relevance. As Gilson and Mnookin themselves point out, true 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 shares some risks and benefits more generally among the partners.

For example, some degree of scale within firms should help lessen dependence on particular clients and "diversify" the firm's revenues among companies even if not among market segments in 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 forty years. This strategy's ability to explain observed law firm growth or structure thus is very limited.

Similarly, although elite firms in general are much closer to strict marginal-product compensation than to strict diversification, compensation systems are not one-round

[136] Sander & Williams, *Theorizing*, *supra* note 29, at 396. 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. Furthermore, as discussed above, the available empirical evidence suggests that the most successful partners are moving "upstream" to *less* diversified firms.

games. They work (or fail) over time. Our anecdotal understanding is that most marginal product systems lag actual performance and thus to some degree diversify revenue over time.[137] 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 "stickiness" or smoothing effect will tend to distribute over the entire partnership some of the unusual losses or gains that might otherwise disproportionately affect individual partners in particular years.[138]

"Stickiness" 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. Moderate marginal-product smoothing, like limited diversification within high-margin practice areas, may be valuable to the lawyers participating in the system, and certainly requires some degree of scale to work. But neither practice explains the size and structure of modern elite firms.[139]

---

[137] William Perlstein, managing partner of WilmerHale LLP, Remarks at the Georgetown Law Center for the Study of the Legal Profession Conference on Law Firm Evolution (Mar. 22, 2010).

[138] This smoothing can be achieved by (among other strategies) averaging 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. These measures 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 does not matter for these purposes; any such device will have the limited diversification-capturing effect described in the text to varying degrees.

[139] In fact, the strategy ought to work particularly well as part of a referral network, which we advance in Part IV below as an explanation of firm growth and cohesion. As discussed below, an internal referral network implies firms composed of lawyers with complementary, related

B. The Role of Human Capital in the Economic Relations Between Partners and Associates

1. Mutual Uncertainty and the "Up or Out" Rule

In a subsequent work, Gilson and Mnookin asked 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.[140] They pointed 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 associates, as well as the value of any firm-specific capital.[141] Similarly, 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.[142]

Gilson and Mnookin theorized that the forced "up or out" decision constrained partner opportunism by communicating credibly to associates that the firm was worth investing their time in. Such a measure might be needed because partners have an incentive not to dilute their own compensation, and thus to pay successful senior associates a wage high by associate standards but less than a partner's share. And if senior associates have acquired some firm-specific capital over time, a firm could probably offer them a wage higher than the non-partner wage at other firms in order to keep the added value of the associates' firm-specific capital at the firm. If associates knew partners had that incentive to engage in opportunistic behavior, then associates would be

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 supra* notes 131–32 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.

[140] Gilson & Mnookin, *Associate Careers*, *supra* note 108, at 567–68.

[141] *Id.* at 572–75.

[142] *Id.* at 575.

reluctant to join the firm and spend years toiling for a chance to be a partner. This risk of *ex post* opportunism thus could impair the firm's *ex ante* hiring chances.[143] Gilson and Mnookin thus saw 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 treat them fairly at the time they are considered for partnership" by promising in advance to forgo the value of any firm-specific capital created by an associate not promoted to partner.[144]

Because the "up or out" rule constrains opportunism regarding the firm-specific capital associates may acquire during their apprenticeships, Gilson and Mnookin predicted that the less such capital is available, the less firms will need to rely on "up or out" policies to "bond" it. Here it appears they called it right: by their 1989 publication date, increased client sophistication in selecting counsel had resulted in greatly decreased stability and exclusivity in the relationships between clients and their outside counsel, both factors tending to limit firm-specific capital.[145] At the same time, "up or out" was on the wane as nonequity partnerships and similar indefinite-term nonpartnership positions filled more offices at more firms.[146] Both trends have continued since.

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: rather than relying on an up-or-out policy as the principal mechanism bonding the firm's good faith in its

[143] *Id.* at 576–78.

[144] *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, they suggest that firms may adjust the associate risk calculus by making more partners. *Id.* at 584–86.

[145] *See supra* notes 60–62 and accompanying text; Gilson & Mnookin, *Profit Sharing*, *supra* note 8, at 360–68.

[146] *See supra* notes 38–42 and accompanying text.

promotion decisions, Galanter and Palay conclude that a firm shows its good faith to associates by conducting a rank-order promotion-to-partner "tournament." That is, it consistently promotes the same *percentage* of an associate class at the conclusion of a fixed-term apprenticeship, choosing them in rank order of quality relative to one another rather than some absolute standard.[147] 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 previous candidates and the difficulty of discerning the intangible qualities essential to a partner's success.[148]

Galanter and Palay reason that, for this bonding strategy to work, firms had to maintain the show of good faith the tournament represented year after year.[149] 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.[150]

The tournament theory is provocative, and much subsequent scholarship has engaged with it. However, we do

---

[147] GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 100–108.

[148] *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."

[149] Gilson and 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. The firm may opportunistically misrepresent these predictions, 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*, *supra* note 108, at 580 n.38.

[150] GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 88–89, 100–08.

not find it an adequate explanation for what we see. Most fundamentally, the tournament idea seems detached from client demand and the competition to satisfy that demand, and thus from the concerns that occupy most BigLaw partners' waking moments. The tournament model 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 enter despite long odds of winning.

We think it facially implausible that law firm managers would hire exponentially increasing numbers of associates simply to maintain the credibility that allowed them to hire more associates. At a minimum (and as rounds of layoffs in hard times before the most recent downturn confirm), firms hire only if they believe they have enough paying work for new lawyers to do. If they do not, acquiring the fixed costs of new associates just depresses profitability, which makes hiring harder as well.[151] 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 precipitously.[152] Moreover, the fact that the price of those services—hourly rates—increased steadily, steeply, and more quickly than inflation implies strong and relatively

[151] *See* Nelson, *Explaining Growth*, *supra* note 17, 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 rapid growth of firms and the distinct upward "kink" in their growth rates after 1970. GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 112–16.

[152] Henderson, *Single vs. Two-Tier Partnerships*, *supra* note 26, at 1710 (average annual associate hours across the Am Law 200 stayed steady at around 1850 from 1985–2003); *but see* Bruce A. Green, *Professional Challenges in Large Firm Practices*, 33 FORDHAM URB. L.J. 7, 8 (2005) (citing sources suggesting the number is considerably higher).

price-insensitive demand over that period.[153] In other words, it was not supply for its own sake but demand that drove prices up and increased firm hiring.

Relatedly, nothing in the tournament 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 associates' rates rose to levels previously commanded by accomplished and experienced practitioners.[154] Yet these developments are widely considered of great importance to the changes in the profession over the last thirty years. Nor does the theory take any meaningful account of costs. Advances in technology or know-how 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 V.B below—also cannot be accounted for by a self-perpetuating growth cycle divorced from these concerns.

Most importantly, tournament theory is not well supported by the empirical evidence. Sociological inquiry has uncovered no evidence that partners or firm managers feel bound to a fixed growth rate.[155] And the empirical data on which Galanter and Palay relied to support their tournament hypothesis are, as they 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).[156] Even considered as a

---

[153] *See supra* notes 55–58 and accompanying text; GALANTER & PALAY, TOURNAMENT, *supra* note 4, 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).

[154] *See supra* note 59.

[155] *See* Sander & Williams, *Theorizing*, *supra* note 29, at 402 & n.33, 403.

[156] GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 79–84 figs.5 & 6, 156–69. For a thoughtful exposition of the alternative interpretations of the data, see Nelson, *Explaining Growth*, *supra* note 17, at 739–43. Moreover, Galanter and 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

geometric growth curve, the data are not consistent with the fixed-rate curve that a tournament implies, and are more consistent with other common patterns of population growth.[157] 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 increased demand or the practical ability of existing firm structures to accommodate such demand.[158]

Finally, the tournament model fails to explain the significant changes in typical large-firm structure over the last twenty years. In their empirical study published in 2008 just as the Great Recession was beginning, Marc Galanter and William Henderson thoroughly chronicle how erosion of the stability of partnership status has reshaped the typical large law firm into a "core and mantle" configuration.[159] In this system, 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

future hires at that firm. Individual firm promotion rates do not appear to be as stable as a tournament would dictate. Sander & Williams, *Theorizing*, *supra* note 29, at 408–10.

[157] *See* Sander & Williams, *Theorizing*, *supra* note 29, at 404–07.

[158] *See* GALANTER & PALAY, TOURNAMENT, *supra* note 4, 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 partnerships of the largest firms in America (which in the aggregate had increased in size at a surprisingly steady rate for many years) increased no more than 1.5% in 2009–2010. *See supra* note 77; Gilson & Mnookin, *Associate Careers*, *supra* note 108, at 580 n.38 (noting that 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. *See supra* note 78.

[159] Galanter & Henderson, *Elastic Tournament*, *supra* note 10, at 1906. *See also* Henderson, *Single vs. Two-Tier Partnerships*, *supra* note 26, at 1691, 1709–13.

management and profits, surrounded by a "mantle" of long-term nonpartner attorneys with service roles, such as nonequity partners and permanent associates.[160] 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."[161] This career-long battle of all against all may share the tumult and drama of a metaphorical tournament, but it is not a "tournament" in the original theoretical sense at all. And while it admirably describes the changing configuration of elite law firms in more recent times, it provides little explanation for the change, and thus little with which to predict future trends.[162]

---

[160] Galanter & Henderson, *Elastic Tournament*, *supra* note 10, at 1877–80, 1906.

[161] *Id.* at 1877. 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 1906.

[162] *See* Wilkins & Gulati, *Reconceiving the Tournament*, *supra* note 63, at 1587 (noting that 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"). The typical large-firm structure Galanter and 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," (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), and (3) the falling prevalence of firm-specific capital acquired by associates in favor of

C. "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."[163] 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 pessimism, in part because we believe his insights support a certain degree of growth and cohesion among the individual lawyers within a firm rather than the firm as a whole, and in part because other forces that Ribstein and others fail to take into account (such as those discussed in Part IV below) foster growth and cohesion in large firms.[164]

In Ribstein's model, several elements combine to create a firm's reputation for quality and faithfulness that clients value. The firm invests in its reputation and effectively posts that reputation as a "bond" (guarantee) when it undertakes a representation. Young lawyers can piggyback on the firm's reputation until they develop their own, and the firm protects its reputation by training and monitoring its 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 create liability for the firm. This mutual interest also creates a certain institutional "bond" (in the sense of ties that bind) 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"—that selects high-

more easily transferable technical knowledge and skills. Gilson & Mnookin, *Associate Careers*, *supra* note 108, at 587–93. 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.

[163] Ribstein, *Death of BigLaw*, *supra* note 2, at 753–54.

[164] *See infra* Part IV.

quality lawyers for partnership and instills firm cultural values on the way up.[165]

Ribstein's reputational bonding model suggests some reasons why large firms grew over the past forty years, but ultimately cannot explain the speed or extent of the growth, or the large amount of lateral movement among certain types of firms. 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.[166]

As Ribstein candidly acknowledges, however, there are problems with this model, too. Keeping enough bodies around to handle peak-load problems creates excess costs if such problems become less common or less demanding. Firms 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 does not leave the firm as well equipped for the next client crisis (though it does fit observations from the most recent recession).[167]

More fundamentally, Ribstein points out that leveraging reputation implies an increase in scale and scope that makes monitoring progressively 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 could achieve effective

---

[165] Ribstein, *Death of BigLaw*, *supra* note 2, at 756. 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 758–59.

[166] *See id.* at 758.

[167] *See id.*

monitoring at the level of the firm as a whole. And as leverage increases, monitoring even at the level of a practice-group or supervising partner on a particular matter becomes increasingly diffuse.[168]

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. It is a tremendously powerful competitive force and remains a primary concern of most lawyers. But its force and nature have changed. In an era in which clients hire lawyers, not law firms, and in which firms reward partners for the revenues attributable to their personal contributions and successes, Ribstein is concerned that partners 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 then may become just a collection of individuals sharing expenses and revenues that has little or no value as a distinct entity."[169] This observation leads him to the grim conclusion mentioned earlier—that the large law firms are dead and just 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 for two generations 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 of firms. When applied at that level, factors he identifies, along with other forces, help explain the large firms' continued growth and cohesion.

---

[168] *See id.* at 754–55.

[169] *Id.* at 754.

IV. PERSONAL RELATIONAL CAPITAL'S ROLE IN MAKING A PROFESSIONAL PARTNERSHIP'S INTERNAL REFERRAL NETWORK A BINDING AND GROWTH-STIMULATING MECHANISM

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, partnership structure, leverage, or location.[170] The point is provocative: 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 and connections in building an internal referral network within a professional service partnership, and that internal network's binding and growth-stimulating force.

---

[170] Henderson, *Single vs. Two-Tier Partnerships*, *supra* note 26, at 1691, 1696, 1716–17, 1729. The prestige rankings on which the study relied were based on the surveys 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. If this were the case, the correlation would be a mere tautology, and unreliable evidence that prestige can drive profits. Vault, 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*, *supra* note 68, at 1093 n.20).

A. The Shift in Primacy from a Firm's Institutional Reputation and Connections to Those of Its Individual Principals

In the "golden age" of the elite firm, client relations were broad and stable at the firm level. A client typically gave a single firm all of its outside work, and depended on the firm's overall brand for quality and responsiveness to bring it the right personnel when a need arose. The firm subordinated individual partners' status and notoriety to the firm brand, for example by putting the firm name on work product rather than the name of individual partners.[171]

In twenty-first century markets, however, clients typically divide their work among many lawyers and many firms. Since the 1980s, it is both a mantra and largely true that clients hire lawyers, not firms.[172] More recently, clients have become willing to unbundle their buying even further, and outsource commodity work to third parties 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).[173]

This is not to say that a firm's overall brand has become irrelevant. We suspect that it is relevant for all firms, although for most it is no more than a relatively weak asset that signals the quality of the firm's control of internal agency costs. For example, firm reputation apparently matters to the extent that in-house counsel do not 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-

[171] *See* GALANTER & PALAY, TOURNAMENT, *supra* note 4, 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.

[172] Gilson and Mnookin noted the growing prevalence of this buying model in 1985. *Profit Sharing*, *supra* note 108, at 385; *see also* Baker & Parkin, *Changing Structure*, *supra* note 23, at 1655.

[173] *See infra* Part V.B.

house lawyer for hiring, say, Skadden on a matter of consequence.

That same in-house lawyer, however will also have selected a particular partner or partners at Skadden to lead the engagement, and will have done so by exploring their personal qualifications and experience relevant to the task. In 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?" Similarly, referrals no longer come in a generalized inquiry from the client to its outside firm, but rather to a particular partner whose reputation, experience, or prior proof of reliability has attracted the call. This is true even when the call concerns work that the caller has no reason to believe the partner would do herself. In short, the individual partner's *personal relational capital*—her personal reputation and connections—has become far more important in attracting demand to her firm than the overall reputation and connections of the firm as an entity.

B. The Organizational Implications of Personal Relational Capital's Primacy for the Firm as a Whole

As discussed above, other commentators have despaired of finding any durable forces fostering overall quality, professionalism, and cohesion in an environment in which individual experience and reputation has become primary in attracting demand. But each partner's focus on his or her own relational capital may also create incentives that benefit the firm as a whole in these same respects.

Even where clients hire particular lawyers rather than firms, 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 and search cost saving functions for the client. This results from the fact that very few large-firm engagements involve the efforts of single professional working alone. A client choosing the lead partner for a particular matter typically 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, and know how to choose and deploy, the colleagues and subordinates (conceivably dozens of them on a sufficiently large or complicated matter) with the knowledge, 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. Thus, individual partners' interests in their own reputations should induce them to engage in monitoring, selection, and training similar to those that prior scholarship predicts will result from the need for reputational bonding at the firm level.[174]

Similarly, a preoccupation with personal relational capital will affect the overall structure and demographics of the firm. In any compensation system that measures and rewards an individual's role in generating business, partners with relational capital will have financial incentives to surround themselves with two kinds of people. First is an

[174] *See supra* note 163 and accompanying text discussing Ribstein, *Death of BigLaw*, *supra* note 2, at 753–54. In fact, the same reasoning suggests that as firms grew too large to monitor each of their own people, client skepticism of reputational bonding pushed reputational scrutiny down to the level of the supervising partner. Individual partners 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.

array of competent service-providers and technical specialists proficient in matters that support the rates the firm customarily charges.[175] Such service-providers allow partners to profit from their connections by staffing the matters within their expertise, and addressing matters outside their expertise, while keeping the work within the firm, and thus sharing in the bounty they helped create. Second, partners will want to surround themselves with other partners who are at least as highly regarded and well-connected as they are. This is so that they may be in a position to benefit when a colleague has the opportunity to refer a matter calling for additional or different skills within the partner's expertise.[176]

More broadly, this implies that an individual partner with excess human capital—that is, the ability to attract and control more legal work than she can do herself—has incentives to affiliate with as many other partners with as much excess human capital of their own as possible.[177] One rainmaker will want to affiliate with as many other rainmakers as possible, each with the greatest complementary connections and reputation possible, because her chances of profiting from her own skill and connections increase with the number of internal referrals she can make and receive. And the greater the number of rainmaking

---

[175] 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.

[176] As 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: Meaning,* 4 J.L. ECON. & ORG. 19, 28 (1988), reprinted in THE NATURE OF THE FIRM: ORIGINS, EVOLUTION, AND DEVELOPMENT 55 (Oliver E. Williamson & Sidney G. Winter eds., 1991).

[177] This observation is consistent with 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. *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 discuss here, see Luis Garicano & Tano Santos, *Referrals,* 94 AM. ECON. REV. 499 (2004).

partners in a firm, each supporting a leveraged practice of their own, the larger the firm will be overall.[178]

Out of this web of incentives emerges a model of a professional partnership as an internal referral network, with both the partnership and the firm structured to maximize the value of each individual partner's relational and other human capital. Significantly, this explanation of firm structure envisions a very different kind of firm than that implied by a financial diversification theory. Diversification suggests that firms will develop disparate capabilities that are largely unrelated to each other.[179] A referral network theory, by contrast, suggests that firms will 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.[180] Significantly,

[178] This structure will also create incentives to acquire and maintain a stable of narrow technical specialists who, while not leveraged rainmakers in their own right, will be available when needed to support the complex or unusual matters that often command the highest margins. These specialists will make economic sense when the overall demand for their expertise within the firm is sufficient to make them profitable. They will probably occupy salaried nonpartner positions, but will collectively contribute to firm size and growth overall. 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.

[179] *See supra* note 111.

[180] *See* Garicano & Santos, *supra* note 177. To be sure, the usual opportunism and agency problems still exist, and may frustrate the benefits otherwise available. Partners may game the imperfections in the design or execution of their compensation system or management structure by hoarding or empire-building. Similarly, any referral opportunity may introduce the temptation to betray the referral source's trust by suggesting a less efficient or effective resource within the firm than the contact partner knows to be available outside. The risk that the proffered 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 better choice at a competing firm. If the internal expert-for-a-day produces substandard work (or overbills to acquire expertise that she was touted as possessing already), the lawyers have behaved badly and the client was ill-served. But these

the empirical evidence discussed above appears to indicate that complementarity of skills within firms is common, while the differentiation implied by diversification is not.[181]

C. The Internal Referral Network's Ability to Create Value, Stimulate Growth, and Bind the Firm Together (Loosely) as It Grows

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. 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," and such a firm thus should enjoy no financial returns in growing larger.[182] In fact, an aggregation that is so loosely bound together should prove to be *less* than the sum of its parts: diseconomies of scale—such as multiplying conflicts of interest and the friction inherent in management, coordination, and splitting the pie according to each individual's marginal contribution among increasingly unfamiliar colleagues—should 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 beyond its value in

---

incentives for misconduct exist in any referral situation, and are not unique to the contemporary "eat what you kill" partnership.

[181] *See supra* notes 131–32 and accompanying text.

[182] Ribstein, *Death of BigLaw*, *supra* note 2, at 754, 777. *See also* Gilson & Mnookin, *Profit Sharing*, *supra* note 8, at 346–52.

isolation from the partnership by giving each partner more and better chances to exploit that capital than they would have as a sole practitioner or in a smaller or differently constituted 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 (or one of only a few) 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, because keeping the referral in-house allows the referring partner to share in the proceeds. 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.[183] And the more

[183] One feature of the professional environment that reinforces these incentives is the tight constraints in most jurisdictions on paying a lawyer outside your own firm for a referral. *See, e.g.*, ABA MODEL RULES OF PROF. CONDUCT R. 1.5(e) (1983) (lawyers may share a fee with lawyers outside their firm only if the sharing is proportional to the services each provides or each assumes full responsibility for the engagement, the arrangement is disclosed and the client consents, and the overall fee is reasonable). These constraints make it difficult to profit from referring legal work outside the referring firm. In some jurisdictions, such constraints are more relaxed. *See, e.g.*, CAL. R. PROF. CONDUCT 2-200(A) (lawyers may share a fee with lawyers outside their firm if the division is disclosed to and consented to by the client in writing and does not increase the fee overall). But even under these more relaxed constraints, referrals outside a firm may be riskier for the referring lawyer than referrals within her own firm. *See, e.g.*, *Olsen v. Harbison*, 191 Cal. App. 4th 325 (2010) (referring lawyer limited to *quantum meruit* recovery from client where the lawyer complied with client consent provisions for referral and the lawyer receiving the referral allegedly induced the client to fire the referring lawyer). Repeat play on referrals between lawyers might limit the risk of opportunism of the kind alleged in *Olsen*, but that is just to say that to some extent firm structures may be mimicked in markets. That point does not contradict our analysis of firms, though it might show that in some subset of cases (which we believe to be comparatively small) the forces we identify are not unique to larger firms. Nevertheless, and to the extent our theory has force, the financial incentives to refer internally should be correspondingly diminished in jurisdictions allowing more liberal sharing of fees outside

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 and clients for doing high-end work. Partners' prestige likely will reflect on one another, and the internal referral network will enhance the reputations of both the referring and the receiving partners, as well as their ability to profit from that reputation.[184]

In short, the relational human capital of individual elite law firm partners should be more valuable when they are surrounded by others with similar characteristics. And the greater the surrounding partners' reputational and relational capital (whether per capita or distributed among greater absolute numbers), the more valuable each individual partner's own reputational and relational capital is likely to become. Thus, the human capital-enhancing power of the firm's internal referral network should create financial incentives for firms to get bigger by adding more connected and successful partners to the network, which should also result in the firm's ability to maintain greater numbers of skilled and specialized service-providers generally available to support the principals. 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

the firm. This raises the question of why firms in such jurisdictions do not appear to be growing more slowly than those in more tightly regulated states. The answer may relate to the increasingly national scope of larger American firms and their practice, the greater ease of and reliability of the rewards for internal referral, or other factors. But the question may deserve further scrutiny.

[184] Individual 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 the value of an individual marquee name. This varies, of course: in every firm, some partners are more eminent than others, and serve a more prominent role in enhancing the firm brand. Similarly, associates on the track to partnership are working to accrue the experience and relational capital that will qualify them for an invitation into the network.

than the sum of its parts. It also helps explain how large firms can create positive financial returns to growth after economies of scale are exhausted and despite the diseconomies of increasing 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—that these firms got so big, and kept getting bigger, while at the same time they became increasingly fragile, or perhaps more accurately brittle, in the sense that partners splintered off and moved laterally even as the firms they left continued to grow. If there can be positive returns to the size of an internal referral network, then firms should grow in order to obtain them. At the same time, however, nothing in the partners' personal relational capital that powers a firm's internal referral network is highly firm-specific: an individual partner's relational capital should lose little value if the partner withdraws it to move to another partnership whose members have personal capital that is similar, greater, or "better" (*e.g.*, more complementary or less prone to creating conflicts of interest) than the partners in the old firm.[185] This lack of asset specificity in the very assets that stimulate large firms' continuing growth helps explain the brittleness that has accompanied that growth.

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, for example, that a lawyer at Bingham McCutchen is probably about as good as a comparable lawyer at Orrick. But nothing more is needed

[185] One firm-specific feature is the effort necessary for the rainmaker to familiarize herself with the referral network with which she is affiliating. This may lessen the value of a transitioning partner's relational capital somewhat, but any impact is mitigated by 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 to be proffered from many sources within the new firm on the features of her new internal network.

for a partner with many outside referral sources to keep them when moving from Bingham 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.[186] We also recognize that there are many countervailing forces, and many pitfalls of design or management, that can frustrate the internal referral process and reduce its benefits. In addition to inadequate complementarity of practice areas and referral sources in the

[186] We also recognize that it is not difficult to find individual examples apparently 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 and quality 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. However, this test would not take into account our suggestion that the *quality* (relational capital per capita, so to speak, as well as the degree to which individual partners' relational capital complemented one another, both of which would appear difficult to measure, especially from outside the firm) as well as the *quantity* of network members matters. (Significantly, Wachtell Lipton and Cravath are both known as firms that have exceptionally high-quality partners that are focused in closely complementary practice areas across the board, unlike other, larger firms where partner quality and complementarity may vary more.) Moreover, currently available data are not adequate to even this limited 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 supra* note 131. The test we have in mind examines the correlation between the size, and the quality, of a firm's *internal referral network* and its profitability. Network size should be at least loosely measurable by the number of equity partners—in the twenty-first century "elastic tournament" environment, these generally are the individuals selected for their ability to attract and control (and therefore internally refer) legal work. But partnership data currently available do not reliably include only equity partners, and measures of the extent and complementarity of partners' relational capital have not yet been devised. We look forward to future inquiry on the question.

partnership, the simplest may be ordinary diseconomies of scale on a number of axes. For example, internal referral networks work only if partners with more business than they can personally handle can trust that (1) the lawyers to whom they refer matters will handle them competently enough to preserve the referring partner's reputation with the referral source; and (2) they will be appropriately rewarded 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.[187] 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.[188] 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 produce) also add to the unavoidable inefficiencies.

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. These insights also provide a context for the empirical observation that partners

[187] These 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*, *supra* note 26, at 1735 n.164.

[188] *See* Gilson & Mnookin, *Profit Sharing*, *supra* note 8, at 346–52.

with the most leveraged and high-margin practices tended to move "upstream" to firms with similarly profitable partners in related practices.[189] 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.

V. COST-BASED FACTORS AFFECTING LAW FIRM GROWTH AND STRUCTURE

A. How Transaction Costs and Technological Change Can Affect the Size and Shape of Professional Firms

Transaction costs and technological innovation are important in understanding how elite firms have evolved and how they might change in the future. Ronald Coase famously argued that firms[190] form to economize on transaction costs, meaning that the boundaries of the firm are set by the relative costs of internal coordination versus market transactions.[191] Thus, for each product or service a

[189] *See* Henderson, *Single vs. Two-Tier Partnerships*, *supra* note 26, at 1696–98, 1742–43, and the text accompanying note 71, *supra*. To elaborate, because each rainmaker's reputational and relational capital is more valuable in proximity to others with similar 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 the more profitable firms "upstream" should generally accept only lateral partners whose relational and reputational capital 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'.

[190] We speak here not just of law firms, but of any business organization.

[191] Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937), *reprinted in* THE NATURE OF THE FIRM: ORIGINS, EVOLUTION, AND

firm requires, the firm decides on the 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.[192]

Matters worth sending to an elite firm require a variety of inputs. Documents are reviewed in litigation or transactional due diligence; laws are researched; briefs and deal documents are written, proofread, organized, and filed; arguments are made; and so on. Law firms historically offered these inputs together as a bundle. From a Coasean perspective, such bundling saved clients the transaction costs of buying the inputs separately, and the ability to provide such savings supplies one part of the explanation for why elite firms became as big as they did.[193]

DEVELOPMENT 18 (Oliver E. Williamson & Sidney G. Winter eds., 1991). 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 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*, THE NATURE OF THE FIRM: ORIGINS, EVOLUTION, AND DEVELOPMENT, *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.

[192] Coase, *supra* note 191, at 48. Few scholars have focused on Coase's *Theory of the Firm* in this context. Larry Ribstein and a recent paper by Milton Regan and Palmer Heenan are notable exceptions. *See* Milton C. Regan, Jr. & Palmer T. Heenan, *Supply Chains and Porous Boundaries: The Disaggregation of Legal Services*, 78 FORDHAM L. REV. 2137 (2010) [hereinafter Regan & Heenan, *Supply Chains*].

[193] Basic 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 services from one or more different providers (factor costs), plus (2) the cost of finding the cheaper providers (search costs), plus (3) the cost of coordinating use of the cheaper providers 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 ones the client decides to carve out and hand to someone else.

But the ability to avoid a cost is worth no more than the cost avoided. As clients became more adept at unbundling work, the value of one-stop legal shopping declined accordingly. Increasing client sophistication helps explain why clients became better able to manage their own costs. 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 how to buy legal services, so they handed over whole tranches of legal work to outside counsel, thus buying peace of mind and freedom from search costs and the other hassles of unbundled contracting.[194]

Over time, however, in-house counsel became more knowledgeable and sophisticated buyers. More and more of them had served in elite law firms themselves, and thus knew what they needed, how to find it, and where inefficiencies might lurk when others provided it. As legal services became a more significant input in many financial and industrial companies' businesses, the price of outside counsel continued to rise. Management began to put pressure on general counsel to manage those costs and refocus investment on efficient in-house infrastructure.[195]

As a result, general counsel began to consider which legal services could be produced more efficiently in-house ("made" rather than bought). Much routine work, especially work requiring knowledge about the particular company's business or practices, was brought in-house rather than bought at elite firms. The size and scope of in-house law departments increased accordingly.[196] Eventually clients began to pressure firms to control prices on routine work not

---

[194] *See supra* notes 8 and 60 and accompanying text.

[195] *See generally supra* Part II.B.

[196] *See supra* note 61 and accompanying text. *See also Q&A with FMC Technologies GC Jeffrey Carr*, LAW360 (Mar. 30, 2010), http://www.law360.com/web/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.").

brought in-house, lowering the margins on such work and altering the composition of elite firms from full-service to more focused models.

Similarly, for less routine and more substantial matters requiring special (but not firm-specific) expertise, clients began to shop around rather than passively accept an internal referral from a single outside firm. 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 the outside counsel's internal search function. The value of that function is further reduced by agency issues—the client may be (justifiably) concerned 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. Searching today is also less costly, particularly as to projects for which firms are willing to front substantial information in the form of an elaborate pitch.[197] Moreover, social networks are strong and getting both broader and (strikingly) stronger as technology both expands the universe of people you may learn about, and allows you to learn a greater number of things about them more quickly and less expensively.[198]

As the search-cost-saving value of big firms diminishes, one would expect buyers to further dissect the services they purchase, and big firms to offer fewer functions themselves if clients could obtain them more cheaply elsewhere without incurring prohibitive search costs. If and to the extent

[197] Anecdotally, we believe it is quite common for firms to devote $50,000 or more worth of time pitching large cases or deals. Many pitch packages are heavily researched and produced, and include extensive thoughts on strategy. This is all free advice to the client being pitched, driving down client search costs in part because firms competing for business are bearing some of the information costs themselves.

[198] *See* Rees Morrison, *Goodbye legal guides and directories of lawyers; hello online searches and social networks*, LAW DEP'T MGMT. BLOG (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.

transaction cost economization represented a significant fraction of what elite firms traditionally sold, 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. We believe that this is a fair description of one set of trends in the market today.

Technological change is also crucial because it is perhaps the greatest influence on the relevant costs, particularly of information management. Therefore, it potentially affects the shape of all firms, and the very existence of some.[199] Lawyers create and manage information, and 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 information in a durable form. In particular, electronic recordkeeping has become progressively less cumbersome, less expensive, and more widely available. Even more importantly, the widespread accessibility of networked computers created a new, universal communication medium—email and related technologies—that has made durable communication instantaneous, simple, and cheap. Lower costs of generating and storing data such as documents and e-mail have led to increasing amounts of such data, and correspondingly increasing burdens on clients and firms to search and organize the data when needed for some legal purpose.[200] In

[199] This point is as famously associated with Joseph Schumpeter as transaction-cost economics is with Coase. Schumpeter focused on the contingencies that struck at the foundation of existing ways of doing things rather than minor modifications having marginal effects. He 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." *See, e.g.*, JOSEPH A. SCHUMPETER, BUSINESS CYCLES 87–88 (1939).

[200] 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. *See* FED. R. CIV. P. 16(b), 26(a)(1), 33, 34, 37, 45

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.

Technology has also altered what needs to be done in many cases and who is best suited to do it. As technology has brought instantaneous transmission and storage of electronic documents and communications, it has also brought software and know-how that facilitates large-scale storage, retrieval, compilation, and manipulation of electronic databases, as well as widely distributed document and information processing.[201] Technical sophistication is now at least as important as legal acumen for electronic discovery, and electronic discovery vendors do a robust business performing tasks lawyers performed thirty years ago. These developments have resulted in the routinization of many services, leading to markets that disaggregate services previously bundled into the package of services elite firms ordinarily offered.[202] These services may comprise a

(amendments adopted 2007); FED. R. EVID. 502 (adopted Sept. 19, 2008). 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 forms of regulatory scrutiny in mergers and acquisitions. *See, e.g.*, Gabe Acevedo, *Could Legal Technology Take the Cravath System Back to the Future?*, ABOVE THE LAW (Feb. 25, 2010, 12:08 PM), http://abovethelaw.com/2010/02/could-legal-technology-take-the-cravath-system-back-to-the-future/ (the SBC–AT&T merger in 2005 spawned the largest "second request" in history, involving over 700 attorneys and 25 million documents).

[201] *See, e.g.*, *Review Platforms*, GABE'S GUIDE TO E-DISCOVERY AND OTHER STUFF, http://gabesguide.com/e-discovery-vendors/ (last visited Mar. 4, 2011) (listing over 40 document review "platforms").

[202] *See, e.g.*, Montgomery Kosma, *As M&A Heats Up, Expect Antitrust Reviews*, THE RECORDER (Feb. 5, 2010), http://www.law.com/jsp/PubArticle.jsp?id=1202442014957 ("One way that 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.").

large fraction of the work performed in a particular matter.[203] Even when lawyers have to get involved, as in substantive document review, technology makes it easier for a bank of lawyers working in a low-overhead location, such as West Virginia or Ohio, to do the work for cases around the country. And the technology does not stop at national borders, driving outsourcing to even lower-cost production sources, such as India.[204]

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 or nonlawyers for elite lawyers in providing these services. We call this "downsourcing"—that is, producing work less with 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 to a flexibly available corps of contract lawyers and staff who either deal directly with the firm or are supplied by temp agencies on a per-project basis.[205] Relatedly, client companies that find

---

[203] *See id.* ("[D]ocument review can account for more than 75 percent of the cost in a merger investigation . . . .").

[204] *See infra* note 207 and accompanying text.

[205] *See* Regan & Heenan, *Supply Chains*, *supra* note 192, at 2142–44; Liz McKenzie, *Contract Attys Sitting Pretty as Associates Deferred*, LAW360 (Feb. 9, 2010), http://www.law360.com/web/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 . . . . More 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*, LAW360 (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*, LAW360 (June 12, 2009), http://www.law360.com/web/articles/101669 ("[A]n overall increase in the demand for temporary attorneys [has been seen] 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."). 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

themselves regularly required to undertake these kinds 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 procedures such as document "hold" and gathering protocols instead of paying outside counsel to reinvent these wheels in every new case or transaction.[206]

Clients have also begun to insist that outside counsel employ specialty companies that supply these services, and to rely on the resulting savings. The practice has become widespread enough to have acquired its own acronym—"LPO," for legal process outsourcing. These companies have developed expertise in using 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.[207]

---

the face of uncertain demand than do permanent associates or staff attorneys.

[206] *See* Regan & Heenan, *Supply Chains*, *supra* note 192, at 2142–44. 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 that a client would likely seek to control to reduce agency costs.

[207] As 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*, TIMES (London) (Jan. 15. 2010), http://business.timesonline.co.uk/tol/business/industry_sectors/support_services/article6988773.ece (paragraph breaks omitted) ("Whereas 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 volume of offshore work and its market penetration are increasing. *See Offshoring Your Lawyer, supra* note 56; Regan & Heenan, *Supply Chains, supra* note 192, at 2166–67; *see also* Anthony Lin, *Law Firm Inks $852 Million Outsourcing Deal*, AM. LAW. (May 19, 2010), http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202458488111 ($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*, LEGALLY INDIA (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 WK. (Feb. 23, 2010), http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202444082821 ("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). And in an ironic turn on globalization, American lawyers are beginning to move overseas to accept management positions in outsourcing firms abroad. *See* 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. And at the same time, Indian outsourcer Pangea3 is being acquired by Thomson Reuters, and is setting up new legal process operations in Texas and Michigan. Rachel Zahorsky, *Thomson Reuters Hiring Attorneys for New LPO Outfits in Michigan, Texas*, A.B.A. J. (Jan. 27, 2011), http://www.abajournal.com/news/article/thomson_reuters_hiring_attorneys_for_new_lpo_outfit_in_michigan/.

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, highly 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. These low-cost providers are not only familiar with the technology, the process, and the types of documents and information once again arrayed on their computer screens; they also understand that this is the job they were hired to do and willingly took it.[208]

Technology-based cost reductions can also have two countervailing effects on firm size. On the one hand, technology lowers the costs of communication and coordination within a firm. (Imagine running a manual conflicts check for a 1000 lawyer firm.) To whatever extent firm size may have been limited by diseconomies of scope or scale in the past, technology allows firms to operate efficiently at larger scopes and scales than before.

On the other hand, cost shifts that correlate with disaggregation also allow smaller groups of lawyers to enjoy

[208] Moreover, 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 do not possess, and may not be interested in acquiring. The accumulated management know-how 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*, *supra* note 192.

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. 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 justify the cost. 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.

Moreover, 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 or transaction, allow a small firm to compete more effectively with much larger firms for some kinds of large or complex matters 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 1000? 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 and coordination costs fall it may not matter to the client.

In fact, clients may come to prefer boutiques for their ability to limit agency costs in the manner Ribstein identified in his model of large-firm growth: small shops that do not depend on heavy leverage are likely to 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." And in a less-leveraged service firm, more experienced lawyers do a larger fraction of the work, and will be more available to supervise and train less experienced lawyers.[209] This staffing will reduce 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 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.

B. 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 analysis to this point discusses 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 twenty-five years largely 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

---

[209] *See, e.g.*, Jacqueline Bell, *Boutique Biz Model Puts Associates in Driver's Seat*, LAW360 (Dec. 10, 2009), http://ip.law360.com/articles/131608 (describing how both partners and associates take on more substantive work at a litigation boutique).

overlooked is probably better left to social scientists, but it has focused economic analysis of firms' "size" and "growth," on the number of lawyers, rather than on the overall number of firm employees or even timekeepers. Similarly, "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.[210] For example, invention of the typewriter, carbon paper, and then the copy machine eliminated an entire category of support staff—the scriveners 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 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—information processing—has become an increasingly significant part of

[210] *See, e.g.*, GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 7–8 (describing technological innovations and their effect on productivity and practice).

many of the projects entrusted to outside counsel.[211] Document and information gathering and processing were, 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.[212] 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. This attention has come both from associates complaining that this was neither why they went to law school nor what they had been recruited for, and from clients complaining about being charged $250 to $300 per hour for work that could be obtained from competent but less credentialed or even unlicensed staff at a cost as little as one-tenth that amount.[213]

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 have raised significant questions, and are 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, at least uniquely substantial in its impact on patterns of practice within the profession.

---

[211] *See, e.g.*, Kosma, *supra* note 202 ("[D]ocument review can account for more than 75 percent of the cost in a merger investigation . . . .").

[212] Galanter & Henderson, *Elastic Tournament*, *supra* note 10, at 110. *See also* GALANTER & PALAY, TOURNAMENT, *supra* note 4, at 65–66.

[213] *See supra* notes 58–59; *see also* Timmons, *supra* note 207 ("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*, A.B.A. J. (Oct. 21, 2009), http://www.abajournal.com/news/article/lawyers_lament_pressure_to_review_80_docs_an_hour_for_23_an_hour; *Down in the Data Mines*, A.B.A. J. (Dec. 1, 2008), http://www.abajournal.com/magazine/article/down_in_the_data_mines/ (contract lawyer doing document review at $35 per hour).

2. Why Have These Issues, Which Have Been Developing For Many Years, Suddenly Come to the Fore During the Recession?

Assuming all this is right, it still does not explain why things changed so suddenly in the Great Recession. After all, information has been created, stored, and searched digitally for years. Big-firm rates have been increasing for decades, and increasing especially steeply in the last decade. Downsourcing, insourcing, and outsourcing were all established phenomena before 2008.

But the recession increased both discussion and actual use of these strategies significantly.[214] This raises two questions: why did elite firms achieve the scale and structure they did in the face of the gathering forces that appear to be 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 client sophistication and technological innovation's effects on cost structures, that preceded and appear quite independent from it? In short, why now? Our three best guesses focus on various forms of habituation in the marketplace.

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

---

[214] *See, e.g.*, *supra* note 207 and accompanying text; Blakely & Spence, *supra* note 207 ("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.

single project that had traditionally been viewed as a unit. Although some of this may have been attributable to higher search 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). Their outside counsel, who enjoyed good margins on this work, were in no hurry to encourage them.

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 raised 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.

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.[215]

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 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 those changes in high relief, redistribute the workforce involved in them, and accelerate the market's internalization of them.

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

VI. IMPLICATIONS AND PREDICTIONS

As Yogi Berra (or was it Neils Bohr?) said, predictions are hard, especially about the future.[216] They are, however, a good way to test economic models. In our view, the preceding analysis implies several things. Many of them are

---

[215] *See supra* notes 68–70 and accompanying text.

[216] Our ability to tell them apart is limited by our knowledge of their respective locations and momentum. In all events, we have never seen them together.

uncontroversial, and indeed some may already be considered (in a phrase of growing currency) "the new normal." 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 III 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.[217]

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.[218] Technology will continue to lower the cost of coordinating with economically-priced, appropriately skilled workers wherever in the world they may be found. Downsourcing, insourcing, and outsourcing will become more prevalent as clients insist on them, and elite law firms do what is necessary to remain competitive.[219]

---

[217] As 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 or two. So enjoy your snack, and we'll get back to business as best we can.

[218] *See, e.g.*, *infra* notes 220–23 and accompanying text.

[219] *See, e.g.*, CLAY & SEEGER, 2010 LAW FIRMS IN TRANSITION, *supra* note 77, at 5 (2010 Altman Weil survey of firms of 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 LEGAL INTELLIGENCER (July 6, 2010), http://www.law.com/jsp/cc/PubArticleCC.jsp

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 are hired as highly compensated BigLaw associates are over.[220] Leverage may fall even further than it has to date as a result.[221]

?id=1202463299917. *See also* Elie Mystal, *Outsourcing: It's Not Just About The Money*, ABOVE THE LAW (June 9, 2010, 10:09 AM), http://abovethelaw.com/2010/06/outsourcing-its-not-just-about-the-money ("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").

220 *See supra* notes 75–87 and accompanying text (showing much smaller entering class sizes currently, and anticipated going forward).

221 One 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 [sic] 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 memorandum 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 two to one in some practices—a level not seen at many large firms for thirty years or more. *See* David Lat & Elie Mystal, *The New BigLaw Business Model, According*

The number of well-compensated, indefinite-term nonpartnership positions at large law firms will increase. Slowing the decrease in leverage resulting from reduced hiring and retention of associates, indefinite-term nonpartner attorney positions (variously denominated nonequity partners, senior associates, counsel, or the like) will continue to increase. These positions will increasingly be offered in lieu of partnership to highly qualified technical specialists, former "service partners," and other 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 (to the extent they are not replaced by technological substitutes). Aside from the classes of well-compensated nonpartners (associates, nonequity partners, counsel), a separate class 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 (and some law firms) are increasingly outsourcing abroad.[222] As competition between their work

---

to O'Melveny & Myers, ABOVE THE LAW (Sept. 16, 2009, 6:05 PM), http://abovethelaw.com/2009/09/omelveny_myers_strategic_plan.php. *See also* Elie Mystal, *NALP 2010: New Litigators Be Warned*, ABOVE THE LAW (Apr. 29, 2010, 11:21 AM), http://abovethelaw.com/2010/04/nalp-2010-new-litigators-be-warned/; *see also supra* notes 44–45 and accompanying text.

[222] *See supra* note 207; Justin T. Miller, *Second-Tier Associates, A New Trend in Big Law*, THE RECORDER (July 14, 2010), http://www.law.com/jsp/ca/PubArticleCA.jsp?id=1202463535998. For example, WilmerHale recently announced it is hiring forty "discovery attorneys" at $55,000–$60,000 per year to staff a legal process center located in Dayton, Ohio, a city in which the firm's only office is a back-office "business service center." Irene Plagianos, *Wilmer is Hiring...in Dayton*, AMLAW DAILY (Jan. 24, 2011), http://amlawdaily.typepad.com/amlawdaily/2011/01/wilmerdayton.html. Similarly, the London firm Freshfields recently chose to react to

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.[223] These are becoming the assembly-line jobs of the twenty-first 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.[224] Alternatively, this class of workers may become quite small and more specialized as technological substitutes for human document review that are now just entering the market replace most of the personnel this work currently employs.[225]

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

anticipated demand by increasing use of contract and outsourced staff. *Freshfields Expects More Work Than It Can Handle,* LAW SHUCKS (Apr. 15, 2010), http://lawshucks.com/2010/04/freshfields-expects-more-work-than-it-can-handle/.

[223] The 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" the work 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) are unclear. But the number of people doing this kind of work on these kinds of terms will undoubtedly increase.

[224] *See generally* ROBERT A. BROOKS, CHEAPER BY THE HOUR: TEMPORARY LAWYERS AND THE DEPROFESSIONALIZATION OF THE LAW (2011); *cf.* Richard Acello, *E-Degree*, A.B.A. J. (Jan. 1, 2010, 7:39 PM), http://www.abajournal.com/magazine/article/e-degree/ (reporting advocacy for standards and certification for e-discovery workers).

[225] *See* John Markoff, *Armies of Expensive Lawyers, Replaced by Cheaper Software*, N.Y. TIMES, Mar. 4, 2011, at A1, *available at* http://www.nytimes.com/2011/03/05/science/05legal.html?nl=todaysheadlines&emc=tha23&pagewanted=all.

more challenging and responsible tasks; and as the number of partnership-track associates falls, they also may get more access to supervision and training. As it always has, however, the job will still typically involve a fair complement 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 than many have in recent years.

The traditional two-class paradigm thus will continue to fan out into a four-class structure, though the longer-term viability of a distinct class of partnership-track associates is in question. As described above, significant changes in the traditional two-class structure of partners and partnership-track associates are already underway. With varying degrees of formal recognition, more and more firms are implementing a four-class structure in their professional census, including a more concentrated core of true equity partners, a shrinking population of partnership-track associates, a growing population of indefinite-term nonpartner specialists and service-providers, and a growing population of staff and contract attorneys relegated to routine work such as legal process.

The longer-term future of the partnership-track associate as a distinct class of employee is in question. Our analysis suggests the possibility of some degree of return to the original Cravath model, in which firms actively acculturate, train, and provide associates graduated amounts of responsibility to prepare and select those deemed suitable for partnership, while outplacing the greater numbers who do not make partner. This is to some degree inconsistent with retaining more nonpartners to provide experienced and specialized client services. Having such experienced nonpartner attorneys handle more advanced and challenging work senior associates could be doing could interfere with the training and selection process traditionally focused on candidates for partnership in the traditional Cravath System.[226]

There are, of course, alternative models that may emerge in response to these changes. One alternative could be a firm that hires very few junior lawyers and does not consider most training its responsibility.[227] Such a firm would offer no formal partnership track and limited chances for advancement based principally on business generation. Most partners in such a firm would be acquired laterally. Another possible alternative is the corporate-workforce model of a continuum in the lawyer ranks from bottom to top. In such a structure, advancement in grade and compensation could be based on a periodic evaluation of marginal productivity, and there would be no radical division between the partners and everyone else. Each of these features could be adopted at different firms in different combinations or degrees. Again, we do not advocate any of them, nor can we confidently predict which may emerge; we simply observe that they are all plausible products of current trends.

Equity partnerships will grow more slowly, and be more rigorously limited to those demonstrating success in business generation and control. 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

[226] As discussed above, one of the significant trends in the evolution of the "elastic tournament" over the last twenty years is the erosion of firm-specific capital. This has correspondingly reduced the need for, and use of, 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 supra* notes 142–49 and accompanying text.

[227] Such a firm would provide, at most, only the advanced skills training that relatively autonomous senior associates have historically gotten from doing their jobs under the supervision of partners or nonpartner "counsel." This raises the question where junior lawyers will learn their trade.

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" reached only through control of substantial amounts of profitable law business.[228] After this shakeout, many equity partnerships will continue to grow (or begin to grow again), by both lateral acquisition and internal promotion, but generally only of persons selected for their ability to attract and control law business and thus enhance the partnership's internal referral network as described in Part IV above.

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 will continue to produce will cause many firms to shrink, or grow only slowly—particularly as measured by the census of more highly-compensated partners, associates, and indefinite-term nonpartners (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, perhaps many, large firms to resume growth. But given falling costs and pricing for legal process

[228] *See supra* note 78; Zillman, *New Normal*, *supra* note 59, at 59 (70% of Am Law 200 firms expect to dismiss partners in 2011; 31% plan to de-equitize partners). The thinking behind such tactics is reflected in the O'Melveny strategic planning memo, *supra* note 221: "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." *See also* Karen Sloan, *Lateral game is on, but the rules have changed*, 32 NAT'L L.J. (Apr. 26, 2010), *available at* http:// www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202448812975 (active lateral hiring market focuses strictly on substantial portable billings).

and similar work, they will generally grow more slowly than they have over the last twenty 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 relational capital, leading to profitability greater than the partnership's current mean. They will tend to splinter off partners with lower margins and profitability.[229] Partners whose current practice environment is less complementary to their relational capital, or who otherwise perceive a better environment elsewhere, will also move. 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 and complementarity, like water, seek their 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

[229] *See supra* note 188. 2009 was another active year for partner mobility, with 2775 Am Law 200 partners changing firms. Jeff Blumenthal, *American Lawyer: Law firm churn hits all-time high,* PHILA. BUS. J. (Feb. 24, 2010, 5:23 PM), http://www.bizjournals.com/philadelphia/blogs/law/2010/02/american_lawyer_law_firm_churn_hits_all-time_high.html. 2010 appears to have shown a similarly torrid pace. *See, e.g.*, Leigh Camping-Carder, *Lateral Market Sees Busiest Month This Year,* LAW360 (July 1, 2010), http://www.law360.com/ip/articles/178556. The nature and characteristics of the moves have not yet been analyzed, but observers are noticing growing spreads in the range of partner pay as some firms pay dearly to recruit rainmakers. Nathan Coppell & Vanessa O'Connell, *Pay Gap Widens at Big Law Firms as Partners Chase Star Attorneys,* WALL ST. J. (Feb. 8, 2011), http://online.wsj.com/article/SB10001424052748704570104576124232780067002.html; Steven Harper, *The $5 Million Man,* AMLAW DAILY (Feb. 11, 2011), http://amlawdaily.typepad.com/amlawdaily/2011/02/fivemillionharper.html (analyzing the economics necessary to support such packages).

nascent stratification between "super-elite" and "semi-elite" firms emerging in the data.[230]

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.[231]

Summary. 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

---

[230] *See* Galanter & Henderson, *Elastic Tournament*, *supra* note 10, at 138; *see also* Press & Mulligan, *supra* note 99 (noting, in 2009 financial results, increasing separation of the first quintile of (predominantly New York-based) Am Law 100 firms from the remainder); Dimitra Kessenides, *The Am Law 100 2010: Catching Up with the Class of 1985*, AMLAW DAILY (May 10, 2010, 6:00 AM), http://amlawdaily.typepad.com/amlawdaily/2010/05/classof1985.html.

[231] *See* Abigail Rubinstein, *What Boutiques Can Do to Keep Luring Laterals*, LAW360 (May 5, 2010), http://ip.law360.com/articles/166217.

balance, remain paramount at least up to sizes at least 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 that 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.[232] More and more students thus have been required to borrow greater and greater sums to fund their legal educations, leaving a substantial proportion of today's law graduates entering the job market with $100,000 or more in debt. Then-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.[233] A

[232] *See* Elie Mystal, *Even U.S. News Suggests Law School Tuition Is Getting Ridiculous*, ABOVE THE LAW (July 15, 2010, 10:58 AM), http://abovethelaw.com/2010/07/even-u-s-news-suggests-law-school-tuition-is-getting-ridiculous/; *see also* Katy Hopkins, *As Law School Tuitions Climb, So Does Demand*, U.S. NEWS & WORLD REP., July 14, 2010, *available at* http://www.usnews.com/articles/education/best-law-schools/2010/07/14/as-law-school-tuitions-climb-so-does-demand.html.

[233] David Lat, *Changes in Legal Education: Some Thoughts from Dean David Van Zandt*, ABOVE THE LAW (Feb. 3, 2010, 8:23 PM), http://above

more detailed economic analysis exploring the variables affecting differently situated students suggests that, for many prospective law students, that break-even point may be significantly higher.[234]

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.[235] That high-end salary spike is explained by the quarter or more of all law graduates who were taking large-firm jobs by 2008.[236] But

thelaw.com/2010/02/changes-in-legal-education-some-thoughts-from-dean-david-van-zandt.

[234] Herwig Schlunk, *Mamas, Don't Let Your Babies Grow Up To Be . . . Lawyers* (Vanderbilt Law & Econ. Working Paper No. 09-29, 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1497044. 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 talented prospective lawyers may not covet BigLaw work no matter how lofty the salary, may be happy 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.

[235] *Id.* at 11 (citing NALP, SALARY DISTRIBUTION CURVE, CLASS OF 2009, *available at* http://nalp.org/salarydistrib (last visited Mar. 4, 2011)); *see also* Henderson, *supra* note 53 (observing spikes around $50,000 and $125,000 for 2006 law graduates).

[236] *See supra* note 54 and accompanying text. A recent survey yielded the unsurprising observation that 75% of recent law graduates considered their debt level as significant as any other factor in choosing their first job. *Career Center Survey Results: A Generation of Debtors (Part I)*, ABOVE THE LAW (Feb. 15, 2011), http://abovethelaw.com/2011/02/career-center-survey-results-a-generation-of-debtors-part-1/.

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 fraction of prior levels.[237]

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.[238] 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 competitive entry-level job candidates down the scale. They are displacing some of the graduates in the job market who had in past years taken up less remunerative positions in government and at smaller private firms.[239] 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 total investment of time and money law school represents for them.[240] Some are finding that the only

[237] *See supra* Part II.C.

[238] *See supra* note 235 and data cited.

[239] We do not suggest that these jobs are less important or fulfilling, just that they pay less and that this economic differential affected the career choices of many law graduates. 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 good many more leapt blindly into the deep than discovered that they enjoyed the swim.

[240] In a particularly vicious twist on this irony, the Ohio Supreme Court refused a recent Ohio State law graduate permission to take the bar exam on the ground that he had "neglected his personal financial obligations [including $170,000 in student loans] by electing to maintain his [$12 per hour] part-time employment with the Public Defender's Office

law-related jobs available to them (other than the default attempt 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 or 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 exacerbated 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 other words, 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 matriculants as "hapless lemmings."[241] At the same time, law school

in the hope that it will lead to a full-time position upon passage of the bar exam [which the decision now bars him from taking pending reapplication], rather than seeking full-time employment . . . ." *In re* Application of Griffin, Slip Op. No. 2011-Ohio-20 at 4 (Jan. 11, 2011). *See generally* JOSEPH HELLER, CATCH-22 (1961).

[241] Debra Cassens Weiss, *Angry Law Grads, Beef, Blog and Move On; Tuition Makes $15K Total in 80s Seem Paltry*, A.B.A. J. (Aug. 16, 2010), *available at* http://www.abajournal.com/news/article/angry_law_grads_beef_blog_and_move_on_big_tuition_pales_next_to_15k_total_i (quoting 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.

applications rose to record levels during the recession, though this likely reflected the short-term absence of immediate alternatives in the job market more than any perceived increase in the value of a JD, and application rates appear to be falling again as the economy begins to turn.[242] 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.[243]

But the bitter lessons of experience will eventually seep into the market. To the extent that the market is rational—

[242] *See* Karen Sloan, *Hope drives rise in law school applications*, NAT'L L.J. (July 12, 2010), http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202463410108; Sara Randazzo, *Law School Applications Down*, S.F. DAILY J., Feb. 24, 2011, at 1, *available at* http://www.dailyjournal.com/subscriber/SubMain.cfm?seloption=NEWS&pubdate=02/24/2011&shNewsType=NEWS&NewsId=-1&sdivId=&screenHt=710#section=DJStoryContent.cfm%3Fseloption%3DNEWS%26pubdate%3D02/24/2011%26shNewsType%3DNews%26NewsId%3D914431%26sdivId%3DmainContent1 (chart *available at* http://www.dailyjournal.com/DJEditorialAttachment/24-Chart.pdf) (2011 law school applications down about 12% nationwide from 2010, though quality of those applying as measured by LSAT scores and GPA is stable or increasing; Hastings admissions dean: "the word is out that a cushy job is no longer a sure bet").

[243] A 2010 survey of pre-law students by the Kaplan test preparation company 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. Press Release, Kaplan, Inc., 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), *available at* 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*, ABOVE THE LAW (Apr. 13, 2010, 10:16 AM), 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 . . . .").

and we believe it is at least rational enough to matter—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 that schools 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: (1) those whose prospects for economic success in the profession are more marginal, and who are considering a legal education for predominantly economic reasons; and (2) 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.[244]

Second, among those still committed to pursuing a legal education, there will be increased scrutiny of the value proposition particular institutions offer.[245] In other words,

[244] *See* Randazzo, *supra* note 242 (stating that there were 12% fewer law school applicants in 2011 while overall quality of applicants was as good or better).

[245] A cooperative endeavor surveying thousands of students at numerous accredited law schools found nearly 70% of first-years were "strongly influenced" by the desire to "work[] toward financial security" in their decision to attend law school. Survey, Student Engagement in Law School: In Class and Beyond, L. SCH. SURV. OF STUDENT ENGAGEMENT, 2010

the market among law schools for qualified applicants will become more competitive. We see this playing out in several ways:

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).[246]

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

---

ANN. SURV. RESULTS 10 (2010), *available at* http://lssse.iub.edu/pdf/2010/2010_LSSSE_Annual_Survey_Results.pdf.

[246] A survey of LSAT takers by Kaplan in October 2010 found that 86% considered a law school's ranking "very" or "somewhat important" in choosing a school; 30% saw it as the single most critical factor. Only 8% considered job-placement statistics most important. Press Release, Kaplan, Inc., Kaplan Test Prep Survey: Aspiring Law School Students Place Rankings Above All Else (Nov. 16, 2010), *available at* http://www.businesswire.com/news/home/20101116005536/en/Kaplan-Test-Prep-Survey-Aspiring-Law-School. The survey did not explore whether respondents saw any relationship between law-school rankings and postgraduate employment prospects. In a striking illustration of the noisiness of this signal, a recent Internet "crowd-sourcing" poll on law schools' relative prestige allowed respondents to rank the very same law school under two different names—Franklin Pierce and the University of New Hampshire (with which Franklin Pierce became affiliated in 2010, changing its name accordingly). "UNH" was rated twenty places higher in the prestige rankings than "Franklin Pierce." Dan Filler, *UNH Law Tops Franklin Pierce? Law School Rankings Show the Power of a Name*, BRIAN LEITER'S LAW SCHOOL REPORTS (Jan. 24, 2011, 6:55 AM), http://leiterlawschool.typepad.com/leiter/2011/01/crowdsourced-law-school-rankings-show-the-power-of-brand.html.

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 twentieth century. Few new scholars practice for any length of time, and many, 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.[247]

Despite the disconnect between "prestige" within the academy and "prestige" outside it, more prestigious institutions seem 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.[248] As

---

[247] *See generally* Brent Evan Newton, *Preaching What They Don't Practice: Why Law Faculties' Preoocupation With Impractical Scholarship and Devaluation of Practical Competencies Obstruct Reform in the Legal Academy*, S.C. L. REV. (forthcoming), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1646983; *see also* RICHARD A. POSNER, OVERCOMING LAW 82–84 (1995).

[248] We 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 cultural and other constructs inherent in all of them. We simply suggest 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. Although recent empirical work confirms this pattern, see Debra Cassens Weiss, *Why Annulkah Can't Get a BigLaw Job: Everest-Climbing Super-Elite Grads Preferred*, A.B.A. J. (Jan. 13, 2011), *available at* http://www.abajournal.com/weekly/article/why_annulkah_cant_get_a_biglaw_job_super-elite_grads_mount_everest_climbers, a leading researcher has recently questioned it, beginning an empirical analysis of the narrower set of qualities that reliably predict BigLaw success. *See* William Henderson, *Why The Job Market Is Changing*, NAT'L JURIST, Oct. 26, 2010, at 20,

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 or fourth quintile of her class over a so-called second-tier graduate in the second quintile of his, all other things being indistinguishable.[249]

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 twenty but maybe fewer than ten, 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

available at http://www.nationaljurist.com/content/critical-issues/why-job-market-changing; *but see* Steven Harper, *Lies, Damn Lies and Statistics*, AMLAW DAILY (Nov. 19, 2010), http://amlawdaily.typepad.com/amlawdaily/2010/11/talenttraits.html (suggesting reasons why the Henderson study may be unlikely to produce useful information).

[249] The 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 prove of greater interest to their clients.

expected to insist on meaningful post-graduation employment information.[250]

Schools with loyal alumni hiring networks will enjoy an advantage in entry-level placement.[251] 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, Idaho, 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 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.[252]

---

[250] *See* Kashmir Hill, *The Secret to '100% Employed at Graduation': Duke's Bridge to Practice*, ABOVE THE LAW (June 10, 2010, 10:40 AM), http://abovethelaw.com/2010/06/the-secret-to-100-employed-at-graduation-dukes-bridge-to-practice/. *See also* Elie Mystal, *SMU Will Pay You to Hire Their Graduates*, ABOVE THE LAW (May 14, 2010 11:01 AM), http://abovethelaw.com/2010/05/smu-will-pay-you-to-hire-their-graduates/; Karen Sloan, *ABA's Young Lawyers Division adopts resolution on truth in law school education*, NAT'L L.J. (Feb. 14, 2011), http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202481866114&ABAs_Young_Lawyers_Division_adopts_resolution_on_truth_in_law_school_education; David Lat, *Law School Transparency Group Seeks Data from Law Schools*, ABOVE THE LAW (July 21, 2010, 4:00 PM), http://abovethelaw.com/2010/07/law-school-transparency-group-seeks-data-from-law-schools/.

[251] This 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.

[252] Some 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. More generally, both public and private schools conventionally thought of as outside the super-elite are beginning to respond to

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 (and faculty) 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.[253]

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

---

competitive pressures with pricing strategies. *See* Karen Sloan, *Three Law Schools Freeze Tuition Rates*, NAT'L L.J. (Feb. 23, 2011), http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202483053900&src=EMC-Email&et=editorial&bu=National%20Law%20Journal&pt=NLJ.com-%20Daily%20Headlines&cn=20110224NLJ&kw=Three%20law%20schools%20freeze%20tuition%20rates (noting several schools holding tuition to "improv[e] the value proposition of law school in these challenging times").

[253] 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, teaching loads outside the more elite schools 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. *See* Brian Tamanaha, *My "Dean's Vision" Speech*, BALKINIZATION (Nov. 16, 2010, 11:43 AM), http://balkin.blogspot.com/2010/11/my-deans-vision-speech.html.

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. The institutional American law school, as it entered this context and for many years afterwards, provided little or no practical training.[254] The law school case method aspires to teach students common-law doctrine and its historical antecedents, and how to "think like a lawyer" in using them, but little more. This was often adequate preparation for a professional environment that assumed new lawyers would be taught on the job how to do what lawyers actually do, analogous to the articled 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.[255]

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 law graduates into 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 rapidly rising 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

[254] This 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 in this age 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, *supra* note 247, at 82.

[255] *See supra* notes 10–11 and accompanying text.

programs and skills classes, at first and often still today marginalized within the institution and poorly integrated into the traditional curriculum.[256]

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.[257] The respective

[256] The law schools that offer to instructors of clinical and practice skills 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 legal 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.

[257] On 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*, A.B.A. 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*, LAW360 (Sept. 16, 2009), http://www.law360.com/ip/articles/112994. And a number of large firms are stepping up training programs to pick up some of the slack created by the decreased incentives and opportunities for hands-on instruction and learning in actual practice contexts. Tom Huddleston, Jr., *Survey: Associate Training Gaining* Steam, AMLAW DAILY (Nov. 17, 2010), http://amlawdaily.typepad.com/amlawdaily/2010/11/assoc-training.html. 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 L.J. (June 29, 2009), *available at* http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202431818898&For_some_firms_an_extra_step_for_the_newest_recruits; *see also* Triedman, *Associate Pay Cuts*, *supra* note 88. As discussed above, a growing number of national and international firms are abandoning

competencies and resources of the academy and the Bar, and how each could or should bring them to bear, is beyond our scope here; we thus do not presume to predict 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.[258] 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.

---

seniority-based (often referred to as "lockstep") associate compensation in favor of "merit"-based compensation that depends significantly on the acquisition of skills and experience. *See supra* notes 90–92 and accompanying text.

[258] Further, 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 among most corporate clients and most prospective law students). Neither prospect seems likely.

VII. CONCLUSION

Previous explanations for the growth and configuration 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 actual market 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 know-how, 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 several conjectures, which we offer with varying degrees of confidence. We are confident, however, that the economic forces we identify are salient ones 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 other trends—particularly those that characterize the twenty-first century "elastic tournament" environment—have rendered the lives of the lawyers that live with them impoverished socially and emotionally, bleaker and more isolated. 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.[259] 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.

[259] *See, e.g.*, Galanter & Henderson, *Elastic Tournament*, *supra* note 10, at 1906 n.142.