1. Large law firms and the success of the growth model

1.1 INTRODUCTION

Law firm leaders today are searching for a strategy and business model for the future which will take advantage of the strengths of today's law firms while counteracting many of the pressures and challenges of today's highly competitive legal marketplace. Through a largely uninterrupted period of approximately 40 years from the late 1960s until 2007, law firms grew and flourished. Law firms became much larger, their substantive ability to serve clients improved, and their profitability grew significantly. Most of the undeniable progress that has been made over the last 50 years has also been accompanied by burdens which threaten to offset the advances. In this chapter, I will focus on the trends that have characterized the last 50 years of law firm growth and development, highlighting both the positives and the negatives. **I believe that the growth strategy, which worked well for so long at large law firms, should be replaced for most large firms by a more focused strategy which takes into account the very fundamental changes in the legal marketplace which have existed since 2008.**

1.2 FIRM GROWTH

In 1970, the largest law firm in the U.S. was Shearman & Sterling, which had approximately 200 lawyers and 40 partners in total. In 2016, the largest firm practicing primarily in the U.S. was Latham & Watkins, which was over ten times as large, having over 2,800 lawyers in 31 offices in 14 countries worldwide and over $2.8 billion in revenue. The largest firm in the world in 1970 was Baker McKenzie, which is headquartered in Chicago but has a verein structure (comprised of a number of partnerships in many countries), and which had grown to over 4,600 lawyers internationally in 76 offices in 41 countries, and declared over $2.6 billion in revenue in 2016. The largest firm in number of lawyers in the world is currently Denton's, which acquired a Chinese firm in 2015, surpassing Baker McKenzie. In September of 2017, Denton's had roughly 7,700 lawyers in 136 offices across 50-plus countries, and reported $2.12 billion in revenue in 2016. Approximately 150 law firms in 2016 consisted of 200 or more lawyers, the size of the largest U.S. firm in 1970. That is impressive and dramatic growth over a period of 47 years, and it was accompanied by a great deal of change in the daily life of lawyers in large firms.

Even the largest firms in 1970 were of a size that permitted many of the lawyers and staff to know each other and their respective work in detail. Firms grew steadily and rapidly between 1970 and 2007, but with the added size and capability came some lack of familiarity with other people in the firm and some loss of closeness and loyalty. The vast majority of lawyers in the U.S. today still work in practices and firms that are much smaller than 60 lawyers, so their relationships with their firms have not changed to such a degree as lawyers in large firms; but they have undoubtedly been affected by many of the other trends in the profession in the last 50 years.

The growth of large law firms allowed them to develop a number of strong practices and open new offices in new markets. Size allowed them to specialize and to achieve a level of sophistication in expertise and experience which was not previously possible. For some lawyers, the excitement of a more vibrant, challenging, specialized and profitable practice was very stimulating; but for others, the loss of intimacy and sense of ownership of their firms was dispiriting. Some partners were not comfortable with the increasing size of firms at various points along the growth curve and left large firms to practice in smaller firms, where they were likely to have a greater impact and more control. For some partners, who stayed with their original and larger firm, their loyalty and connection to the firm suffered. Others had much more exciting and profitable practices than would have been possible if their firms had not grown, and the expanded resources of their firms allowed those lawyers and firms to accomplish a great deal.

The growth of law firms has been accompanied by an explosion of public information about their personnel, operations and profitability, which has added to the mobility of lawyers and to lateral movement of lawyers among firms. This growth in size and greater public visibility has fundamentally and irrevocably changed the legal profession.

1.3 SPECIALIZATION

Specialization has continued to grow over the last 50 years. The growth of firms permitted them to attain the size necessary to organize themselves into professional departments and practice areas; lawyers tended to concentrate on narrower areas because, with larger firm size, there was a greater critical mass of work on which a specialist could focus. This specialization also raised the competitive standard of expertise, which could be achieved only by large firms having the size to specialize or by boutique firms concentrating on a narrow field of practice. Lawyers in smaller general practice firms (as opposed to boutiques specializing in one area of law) tend to have more generalist skills, because they must be versatile to handle a wide range of legal issues for smaller clients.

The standard of technical expertise has become much higher through specialization and has permitted young lawyers at large law firms to support nationally recognized experts in a specialty. Specialization has given lawyers the skills to solve complex problems more easily and has enhanced their experience in a narrow area.

Specialization naturally led to higher billing rates, as the specialist lawyer had expertise that allowed him to start from a more sophisticated level on each case. The steady and dramatic increase of billing rates at a pace exceeding the rate of inflation during the extended period of law firm growth is primarily attributable to the greater value given per hour by lawyers who had specialized in a field and had done past work that prepared them for the current legal issue and the great gains in productivity per hour due to computer systems and technology. Otherwise, clients would not have agreed to the rates. Granted, partner rates represented the greater worth of specialized expertise, while associate rates were elevated as well (in my opinion, much beyond their true value). But clients had no choice – if they wanted the expertise of a partner specialist, they had to pay exorbitant rates for the whole team, including inexperienced associates. That is why clients, as soon as they had the chance after 2008, limited the use of first and second year associates. Although the rationale for that limitation was expressed as “we don’t want to pay to train inexperienced lawyers,” it could be more precisely phrased as “young associates, unlike more experienced lawyers, don’t have the specialized expertise and experience to justify such high rates.” Most clients understood that partners needed associates to do some work and tolerated the steady rise of associate rates until they had the leverage to say “no.”

While specialization increased the expertise of lawyers over this period, it came at some cost to the broad counselling skills and practical judgment of experienced lawyers. There were still some generalists in large firms who offered mature advice and some specialists who were astute in their judgment of people as well as superior in their specialty, but the trend away from an outside partner providing overall practical advice and toward selecting a lawyer and firm based on his and the firm's narrow expertise and track record was pronounced.

1.4 CLIENT RELATIONSHIPS

The relationship between lawyers and clients has changed greatly over the last 50 years, as an inevitable result of the many changes in the legal market and profession over that time. The sense of competition for clients and lawyers in the legal marketplace of the 1960s and 1970s was much more muted. There is much to be said for the present relationship with clients: the work done by outside firms is more likely to be sophisticated and challenging, and the in-house lawyers that most clients have are generally much more accomplished (many of them in fact were attracted by the increased status and compensation levels of in-house general counsel and the chance to be close advisors to some of the most sophisticated corporate executives), leading to an interaction that challenges large law firm lawyers to be at the top of their game.

Part of this change is a direct result of the growth of large law firms themselves and the pressure on firms to increase profits and compensation to attract and retain talent in a much more competitive marketplace for attracting lawyers as well as for attracting clients. The rapid growth of law firms was accompanied by a steady expansion in demand for legal services for most of this period; but since the economic downturn of 2008–2009, demand has never recovered its momentum, while law firm headcount has continued to grow. As long as growth in capacity did not outstrip growth in demand, rate increases greater than the rate of inflation could be sustained. Today, most large law firms have too much capacity, which tends to put pressure on rates and results in most large firms having lower than optimal average productivity and realization rates (the value of the fees billed in the matter divided by the value of the hours worked on that matter).

The rise of more capable general counsel in-house for clients has interposed the in-house general counsel between the outside law firm partners and the management and board members with whom the outside partners once had a direct and mutually rewarding relationship. Some older lawyers who enjoyed those relationships with business executives rue the changes; but time marches on!

1.5 RISING BILLING RATES; BILLING ALTERNATIVES

Law firm billing rates have increased over many decades and now pose a major problem for today's large law firm business model. Reducing rates would mean reducing profits, and most firms believe that their profitability level is a key to the recruitment and retention of lawyers. Also, the effective billing rate for the clients with the most leverage in billing negotiations is roughly 25% below the stated billing rates, as a result of negotiated discounts. Therefore, to lower billing rates while maintaining the same level of discounts would be very damaging to a large firm's profitability, and large law firms are reluctant to lower their rates when they have no assurance that their clients would lower the discount as well. As growth in demand for legal services has slowed or stopped, the annual billing rate increases at most large law firms have been greatly reduced, reflecting the economic law of supply and demand. One aspect of the high billing rates that might be seen as a blessing is that high rates have caused a stratification of the legal market, with the result that very skilled lawyers charging higher rates are limited to challenging, cutting-edge work. The market requires them to focus entirely on the work that is the most complex and demanding, further building their skill and expertise and reinforcing the stratification. The ramifications for the less market-leading practices at their firms are problematical, however, as I will analyze in this book.

As one would expect, in-house general counsel at client corporations use smaller firms with lower rates for some legal work which they believe those firms can handle well. Other work they bring in house, where they believe their own staff can do the work effectively and where their own costs are lower. As a result, large, high-rate firms have lost a great deal of work that they once did when clients chose them to do a broader variety of work and price was less of a consideration.

In addition, in an effort to cut legal costs, clients have engaged outside firms in discussions of alternative fee arrangements, such as fixed fees. However, clients are wary of fixed fees, lest the firm make a windfall profit. Often, it seems from the perspective of the law firm that the client wants to discuss alternative fee arrangements but is only happy with a discounted hourly fee for the hours actually worked. If the firm is able to handle the matter for less expenditure of time/value than the agreed fixed fee, the client may be concerned that the firm has earned an unjust profit even if the client pays a reasonable fee and the firm took the substantial risk that the project would require more work than expected when setting the fixed fee.

From the client's view, the predictability of the legal expense is important. The client must budget for the project, and if the legal fees exceed the budget there will be negative consequences for the client. From the law firm's view, the legal and factual situation may develop in many ways that are unpredictable in advance, so if the firm agrees to a fixed fee it may have the burden of a low fee for legal results which do not reflect how well the firm handled the matter or how much work the firm was required to do to perform professionally.

Some clients may want a fixed fee without reasonable conditions, and some firms will provide fixed fees under these circumstances because they want the work and are willing to assume the risk of cost overruns. Such are the circumstances of a very competitive market where the client has the upper hand. This is a good example of the consequences of a much more client-dominated market than ever existed before 2008.

1.6 RECRUITING; MOBILITY

Large law firms suddenly had a major problem when the business downturn hit in 2008: they had made commitments to hire associates starting in September 2008, and they had also made offers to summer associates in August 2008 for full-time jobs starting in September 2009. Demand for legal services started plummeting during 2008, well after firms had extended offers both to candidates in the fall of 2007 to work at the firms as permanent associates in September 2008 and as summer associates in the summer of 2008. Firms responded to this glut of unneeded young lawyers in a variety of ways: they paid some of them to defer joining the firm in September 2008 and September 2009; they cut down dramatically on future permanent associate and summer associate hiring; they became more selective in weeding out their existing associates; and they reviewed the ranks of counsel and partners and made some tough decisions to terminate some of them, reduce the compensation of others, and move some equity partners into a non-equity category with a fixed, lower salary. Many firms have a large number of non-equity partners as a result, and the size of that class of lawyers (highly paid and often underproductive) poses a threat to the future financial prosperity of those firms.

While most firms acted swiftly to reduce the large excess of capacity over demand, average hours worked per lawyer declined significantly in 2008 and have still not climbed back at most firms to 2007 levels. Moreover, law firms have not changed their pattern of hiring far in advance of when entry-level lawyers are needed, because they are in competition to hire the best associates and they don't want to make their firms less attractive than their competitors by offering less attractive hiring terms to law students and judicial clerks. Most firms have continued to hope that demand will rise again and therefore have operated with an excess of lawyers and capacity since 2007, which has seriously hurt productivity, firm profits, and also opportunities for young lawyers to gain experience. This situation has been aggravated by the change in the marketplace, as many large clients have exercised their leverage to require that large law firms limit the use of inexperienced associates.

Until the 1980s, most large law firms built their talent primarily by recruiting lawyers from law school or judicial clerkships and then training and grooming them to be partners in the firm. In the 1980s, partners started to become much more mobile, moving from firm to firm; and law firms became much more willing to recruit lateral partners. Several factors influenced this trend. Law firms had grown significantly in size in the 1960s and 1970s, and law partnerships grew from 40 partners at the largest firms in the country in the late 1960s to over 100 at the largest firms. This growth tended to dilute the loyalty of partners to one another and to the firm, and most partners at large firms lost the sense of being uniquely valuable to their firms. Therefore, they were more apt to move to another firm. As firms grew larger and larger, the personal knowledge, intimacy and loyalty among partners started to erode. Younger lawyers today in large firms haven't ever experienced the close ties between lawyers and staff that exists in firms below 100 lawyers; but most of the lawyers in the country practice in smaller firms or in solo practices and value their sense of identity and independence. In a large firm, one gains substantial prestige and credibility from association with the firm; in smaller firms, lawyers derive more of their reputation from their own accomplishments and track record.

A second trend accelerating the mobility of partners in seeking to move laterally was the new publicity about the financial success of different firms, led by an emerging legal press. In the early 1980s, *The American Lawyer* started writing about large law firms and emphasized the distinctive aspects of different firms; and the magazine started publishing the financial results of different firms gleaned from partners willing to talk or by educated guesses derived from other information. If a partner believed that another firm was more profitable than his own, he might be tempted to test the lateral market and join a firm willing to offer him more compensation.

A third trend contributing to increased mobility in the profession was the expansion of the practices of firms into diverse practice areas and into more geographical locations. If a firm didn't have a strong practice in a legal specialty viewed as important for the firm's clientele and other practices, the firm could seek a lateral partner to lead that practice. If a firm didn't have an office in a market viewed as strategically important by the firm, it was tempted to recruit one or more partners located in that geographical market to open an office.

All these trends converged to increase the mobility of lawyers among firms; and while the movement among firms started with lateral partners, it quickly grew to include the lateral movement of associates, a trend promoted by headhunters who encouraged lateral movement from which they could earn fees. The lateral movement of lawyers to firms they perceived had better financial standing and could pay them better compensation heightened the emphasis of firms on their own profitability. No firm wanted to be viewed as less able to pay partners and associates competitive compensation; conversely, many firms used their high profitability to attract lateral lawyers at both the partner and associate levels.

Furthermore, large law firms were already competing with each other financially in setting associate salaries, and the ability of associates to earn more by jumping to another firm led to large law firms increasing the annual compensation of associates and reacting quickly to emulate increases in the compensation scale at visible big firms.

Over time, during the period of the growth of large law firms until 2007, the compensation of associates increased enormously. The expansion of law firms created a much more competitive market for recruiting from law schools, as firms which once hired 5–10 associates per year were now hiring many times that number. The elite law schools did not increase their class size, so law firms stepped up their efforts to recruit law students from the top law schools. This led to lavish summer programs, higher salaries for summer and permanent associates, and more offers to students from law schools outside the elite, because firms couldn't fill their starting associate classes exclusively from the top-rated law schools. This in turn led over time to more students applying to law school, the good law schools outside the top rank attracting better students, and more law schools placing significant numbers of graduates with large law firms.

The world of large law firms was transformed by these changing patterns of recruitment, the increase in profitability in law firms, and the greater compensation potentially available to associates and partners. During this long period of law firm growth, demand for legal services from large firms also grew enormously, enabling firms to raise billing rates and increase associate compensation. Moreover, astute law firm management became very important to firms competing financially to earn high profits and attract and keep the best talent.

These trends of mobility of lawyers and economic competition among law firms quickly resulted in a stratification of law firms. The top several firms in each regional market were able to attract the best entering associates, which rapidly made those firms even better and widened the gap between the regional leaders and the less profitable firms.

1.7 PRESSURE ON LAWYERS TO BILL MORE HOURS

Another result of this pattern of growth and the greater publicity about the internal workings of large law firms was the pressure for productivity. The law had always been a demanding profession, requiring hard work, attention to detail, and intense focus on quality. However, the greater importance of financial results to firms' success put even greater pressure on each lawyer to produce large numbers of billable hours. Some lawyers always worked to the maximum, but the 1960s and 1970s saw a fairly wide range in terms of both the effort and in the number of billable hours worked by lawyers in large firms. As firms started to adopt lockstep compensation scales for associates because of the large number of associates and the greater publicity about associate compensation, firms stepped up the pressure on associate productivity. The pressure for more billable hours was felt by partners, too. There was a time when a partner felt secure in his position, and comparative compensation among partners was not emphasized. The publication of compensation figures for specific firms by the legal press heightened the emphasis on partners' financial performance. The principal reported numbers for law firms were average profits per partner, gross revenue, and revenue per lawyer. Even a partner doing high-quality work and contributing in many intangible ways to the firm would pull down the firm's financial results if he wasn't also very productive, generating high fees and earning high compensation.

Traditionally, a highly skilled partner could be an expert in the law, spend time teaching other lawyers, write scholarly articles, perform pro bono services, and carry out valuable service on boards of not-for-profit organizations important in his community; and if he chose not to maximize his compensation, it was not a big concern to other partners, so long as they felt he was compensated fairly for what he produced. Today, both at the associate and partner level, there is a pressure to perform financially so that the lawyer is not viewed as hurting the firm's performance in some material way. This is a financially driven pressure that most lawyers choosing the legal profession did not necessarily anticipate, and it makes the internal competition in law firms much more intense. As a result, the choice of an intellectually rewarding practice without much pressure to bring in business, work productively, or attend to the business aspects of legal practice was no longer a viable option for many lawyers in large firms.

To most lawyers, the growth of compensation for lawyers in large firms was a welcome by-product of the changes in the large firm legal marketplace over an extended period of over 40 years, from the mid-1960s through 2007; but that higher compensation has been accompanied by a ratcheting up of the pressure to bill more hours, specialize more, and attend more to the business aspects of legal practice, while still maintaining very strict standards of quality control. The stress level of a big-firm practice has undoubtedly increased.

1.8 CONSOLIDATION

As law firms grew larger in size, those partners managing large law firms were afraid that their firms would be left behind and also saw advantages in increased firm size. However, adding offices and new practices often required recruiting laterally, and law firms came to realize that many of the partners available laterally were overpriced or not impressive enough to add much to the existing firm. Rather than diminish their lateral hiring standard, law firms came to realize that by combining with other firms they might add size, offices, and practice specialties much more efficiently by consolidation with another firm rather than by competing in the highly competitive lateral market. In addition, some firms simply wanted to expand their capabilities and geographic scope more rapidly by a merger with another firm or by an acquisition of a smaller firm. Today's large law firms are more often a product of a number of acquisitions/combinations and extensive lateral hiring rather than purely internal growth.

The law firm consolidation movement gained momentum during the 1980s and 1990s and continues today, although most "mergers" are acquisitions by a larger/dominant firm of a smaller firm. Very few successful mergers of two equally large firms took place; and, despite the commentary to the effect that the legal profession would soon consolidate the way the public accounting professionals had, for a number of reasons that level of extreme consolidation never took place. Eventually, a law firm gets so large that conflicts impair its ability to accept clients who are adverse to existing clients. Also, large size must be managed, and the quality and distinctiveness of lawyers tends to become diluted with greater size. Even though some firms of over 2,000 lawyers exist today, no firm has a significant share of legal business in the U.S., much less worldwide. In fact, the growth in size of large law firms was accompanied by a steady growth of demand for legal services in this country and worldwide in the long period of law firm growth before 2007. Although individual law firms are much larger than they were in the 1960s, the worldwide legal marketplace has expanded dramatically and is not dominated by just a few large firms.

There are, however, some very significant trends in the consolidation of the legal industry. As firms have carried out more and more mergers (or acquisitions), the barriers to consider for expanding by merger or being acquired have diminished. When law firms were smaller, partners would consider an expansion by merger, a firm-changing transaction and would worry whether the combination (even if the firm were the "acquirer" firm) would change the firm culture for the worse. For example, one of the major barriers to early mergers was the unwillingness of partners to accept all the lawyers of the merged or acquired firm, i.e., those who had not been hired and/or elevated to partner according to their own firm's hiring and elevation standards (more about that concern in section 1.9 of this chapter, "Firm Culture and Governance").

Another barrier to mergers was fear of dilution of profitability. As firms grew larger and appeared to be improving their profitability while growing in size, that concern also diminished. Of course, some firms chose not to expand by merger for that very reason: by merging with another firm with lower profits per partner, the firm's own profits per partner would be diluted. Advocates of law firm mergers argued that the combined firm's compensation system would address the perceived problem by making sure that lower-contributing lawyers at both combining firms would not be paid more than they were worth after the merger. Most firms had modified their compensation systems as they grew larger and more diversified (both geographically and in number of practices) to pay the partners in the less profitable offices and practices less than the partners in the more profitable offices and practices. As pointed out in the "Profitability" section of this chapter (section 1.10), however, many firms do not have the discipline to make wide differentiations in compensation for lawyers of the same vintage generating markedly different profits.

1.9 FIRM CULTURE AND GOVERNANCE

A distinctive firm culture makes lawyers and staff more loyal to the firm and take pride in the firm's accomplishments. As firms expand and grow, often they lose the distinctive qualities that emanated from the personalities of partners who founded and once dominated them. Firms went through a phase in the 1980s of assembling glossy brochures to promote themselves and serve as a primary marketing tool. One of the common complaints at the time, repeated by many clients who were insulted by the self-promoting banality of the brochures, was that every firm sounded the same; even every practice area at a large firm sounded the same.

It becomes more difficult to maintain a close and distinctive firm culture when a firm grows in size and many lawyers and staff don't know each other. At some point, lawyers and staff alike give up keeping track of the new arrivals, and they don't make the effort to take an interest in new people joining the firm. As new people join a large firm, many of them don't expect to meet all the existing lawyers and staff at the firm and don't realize the potential benefits of knowing as many people in the firm as possible. At least at the practice group and office level (except at the largest offices), there are few enough people involved, and they have enough in common through participating in the same office or practice area, to have a reasonable chance of getting to know and work with at least a subset of the firm. But it takes considerable effort, and many people haven't experienced a smaller-firm setting and don't appreciate the benefits of knowing people in the firm community. The trend in growth of law firms was therefore accompanied by a distinct change of the culture of the larger firms. The much larger firms were not so cohesive, the partners' loyalty to the firm and their fellow partners was diminished, and younger lawyers joining a much larger and rapidly changing firm did not feel as secure in their prospects or in their identity and status in the firm. Of course, the argument could be made that the large firms have a more widespread reputation, offer more practices, and are more diversified, which are countervailing strengths to the loss of intimacy and loyalty.

At some point, governance of a large organization must be efficient, even-handed, and not idiosyncratic. The right balance between organizing formally and allowing some independence and distinctiveness must be found. Size encourages and demands centralized management, and partners who no longer reasonably have a say in decisions may lose interest in the activities of the firm. Firms which once had weekly meetings of partners cannot keep up that practice once they reach a certain size, and something is lost by partners and even other lawyers and staff not understanding everything that is going on. Essentially, the firm becomes an institution, which needs to be governed differently to take advantage of its greater size, scope, and practice diversity. Rather than being disappointed with the involvement they have lost, partners of a growing firm probably should seek to trust centralized management and to focus more on developing the firm's practice specialties and offices rather than participating in firm business decisions generally. But that often goes against human nature.

In defense of centralized management, there is very little value added by most partners participating in routine administrative and operational matters. In fact, it can be difficult to administer a firm fairly if each partner insists on weighing in to be sure that the staff members and younger lawyers that support his practice are well treated. Most large firms have long since made the transition to a highly professional administrative staff which manages the firm's operating facilities and people on a firm-wide basis, with the firm's best interests in mind; and most partners support that transition (see Chapter 9, "Strong Administrative Staff"). However, it is essential to keep partners abreast of major administrative developments and of issues that affect the professional practice and strategy of the firm. For example, most firms still require partner approval when it comes to the annual budget, decisions on opening new offices and new practices, the elevation of new partners, major lease commitments and buildouts, major credit arrangements with banks, and lateral partner hiring. How information is disseminated to partners to inform them adequately to vote on these matters and the method of voting itself are difficult issues, because much of the information is confidential and firms have to move expeditiously in competitive situations. But the undeniable fact is that partners who are not involved in making the decisions and setting the policy in a law firm often lose interest in keeping up with current firm events, and they lose some measure of feeling that it is "their" firm.

As firms grew to be quite large, the trend in governance was toward centralization, with the task of managing a large firm evolving into a full-time job. Some leaders, who established their credibility and gained the confidence of their partners, actually proposed and set strategy for their firms; most leaders, while they gained centralized control of administrative matters, didn't have the support of the partnership to set strategy. Therefore, the management of large law firms evolved toward centralized control of administrative matters; and generally the lawyers in management positions hired Executive Directors and chief administrators of finance, operations, and information technology which were very capable and expert. However, most firms also defaulted to a growth strategy, with the nature of the growth being determined by the relative demand for different legal practices. Leading partners in various departments pushed for lateral hiring, and managing partners accomplished those lateral hires, mergers or acquisitions, and expansion of offices. **Most firms were not strategic about limiting growth or eliminating practices or offices which were not up to the standards of the firm in the competitive marketplace. Most practices and offices performed adequately until the recession, so it was not a crucial issue.**

1.10 PROFITABILITY

As individual law firms' financial results came to be public knowledge through the increasingly pervasive legal press, firms came to manage themselves much more deliberately to increase average profits per equity partner. Obviously, partners would be much happier with management if their partnership profits were high – except those partners who were de-equitized or lost their jobs through their poor financial performance. A firm with high profits would provide its partners with little incentive to look elsewhere and at the same time be attractive to lateral partners. When public information about private law firms first started to become available in the early 1980s, some partners were initially nervous that high profits would cause some clients to be resentful of their high compensation or question their high billing rates; but as the competitive compensation information became more and more available, high profitability and high billing rates were seen by most persons inside and outside law firms, including clients, as a sign of prestige and high quality. Now that the market has turned, clients' longstanding resentment of high-earning lawyers in large firms has had an effect in the severity of their attitude.

By the mid-1990s, the pattern of disclosure of profitability to the press was grudgingly accepted and prevalent among most large firms, and firms began to tinker with methods to increase reported profits. Profits per partner can be increased if some lower-paid partners are subtracted from the calculation. Firms began reclassifying some partners as non-equity partners, so as to make the firm's average profits per equity partner higher. Also, some firms refrained from reporting to the press the compensation of the partners in the first two or three years after elevation to partner on the theory that they were not really representative of the range of partner compensation because they were brought in at a somewhat arbitrary level equal to other new partners for a few years. Alternatively, some firms elevated lawyers to non-equity partners for a few years and then later promoted them to equity partners when their compensation was higher.

If the information about profits per partner is available, it is hard to argue that it is not relevant to an analysis of how a firm is performing financially and how competitive it is with other firms. Therefore, large law firms must manage themselves to be profitable, if only to recruit and retain talented lawyers.

In order to be profitable, law firms must organize themselves to have high average productivity. In the 1960s, lawyers in large firms had some options about how hard to apply themselves. If they committed themselves fully as professionals, practiced to a high standard, and paid attention to clients' needs, they probably were among the more highly compensated partners in their firms. The gentlemanly, leisurely approach was still a viable option – partners could balance their lives, take long summer vacations, work only 1,200 to 1,400 billable hours per year, participate in a few nonprofit boards, and have a balanced career working with intelligent people. Except in a few lockstep New-York-City-based firms (where the nature of the lockstep forced most partners to compete with their partner classmates to see who could produce the most value for the firm), a partner could have the option of earning less money and still be considered a worthy colleague, as respected in society at large as his harder-working partners. Over the years, the demands of partners in large law firms have increased greatly, and partners no longer have the choice of working less intensely and earning less. Their firms need to show high average partner profitability, because the partner profits are effectively public numbers. A few partners may be classified as non-equity and earn less without hurting the firm's public numbers; but within the firm, they are not treated as peers of the equity partners, which generally makes a big difference to them and to their status within the firm. Moreover, the work ethic of large law firms is a lot more uniformly demanding today than it was 50 or 60 years ago, and it is much more rigorous in the U.S. than most of the rest of the world for a number of reasons, including the competition among firms for talented lawyers and public reporting in the press of law firm profits.

After the legal press made public average profits per partner at the largest law firms, it made a public relations difference to the firm whether its average profits were higher than its principal competitors. High profits also affected the firm's reputation in the legal profession. This greatly increased the pressure on every partner to be productive and to be efficient at turning billable hours into firm revenue. In fact, many lawyers never made the adjustment to this productive routine, which requires remarkably consistent focus. Many lawyers of large firms, when they move to work in-house at clients or to other careers, say that the daily discipline of filling out a time sheet is an element of the routine of big-firm life that they most relish giving up. For younger lawyers joining the large law firms in the last 25 years, working at least 1,800 billable hours became the aspect of professional life that most irked them. Now that the legal marketplace is highly competitive, most firms demand high productivity, which will result in high average profits; for if the firm allows a wider spectrum of productivity, by compensating lawyers less for less productivity, that would result in reducing average profits per partner and making it harder to recruit and retain excellent lawyers.

1.11 THE LEGAL MARKETPLACE OF TODAY AND THE FUTURE

As I have recounted in the Introduction and in this chapter, the marketplace today is fundamentally different than it was before the business downturn of the Great Recession of 2008–2009; and the marketplace of the future is not likely to revert to the large-firm-centric marketplace that had evolved through 2007. So long as large law firms have excess capacity and relatively low productivity (in hours billed per lawyer), the client – not the law firm – will be in the driver's seat. Many firms with the capability to handle cases well will make themselves available to handle them and will be likely to offer discounts and advantageous terms in order to win the business. In-house general counsel will usually require every outside firm to announce billing rate increases in advance and seek approval of the proposed rates from the client. Law firms will also be asked to give estimates for legal projects before being retained, and price will certainly be a consideration for the selection of counsel for most matters.

Staffing of matters by large law firms will also be subject to approval of the client in many cases. The necessary rotation of personnel on cases due to lawyer departures, the press of other work from other clients, or simply the growth of a lawyer who was playing a supporting role and their replacement with a suitable younger lawyer are all instances where the law firm formerly had some discretion to do what was reasonable for both the law firm and the client. Now this area is often subject to directives or policies imposed by the client. Often clients request that young lawyers be "seconded" to the client (placed on the client's staff for a while) to suit the needs of the client. These are all situations where most partners at large firms in the past used reasonable judgment and did not take advantage of or disadvantage the client, although there were certainly occasions where law firms, when they were in the driver's seat, were insensitive to the client's needs.

Mid-size and small firms have taken advantage of the opportunity that has been created by this major shift in the market. Some large clients and individual clients had already been choosing smaller firms as a viable and more affordable alternative for work that the smaller firms could do competently and at a much lower cost than the large firms. The smaller firms had always had a niche provided by their lower billing rates for certain clients who were very price sensitive, such as individuals, family businesses, insurance companies (defending many claims for which their insurance was responsible), or governmental clients who had limited budgets, intricate cost-controlling regulations, and a procurement staff. Many accomplished lawyers prefer to work in smaller firms for many of the reasons explored in this book (primarily, lower billing rates, which results in less client resistance and an advantage in building a practice), and during the period of growth of large law firms demand for lower-priced legal services was growing as well. In fact, the growth in size of the large law firms was accompanied by an exodus of many accomplished and talented lawyers from the large law firms, either because they didn't make partner at large firms and had to leave because of up-or-out policies, or they left because they preferred to practice in a smaller firm where they had much more control over their lives and schedules, they could offer lower billing rates to clients, they were under less pressure to bill many hours, and where they knew other lawyers and staff better or more intimately in a smaller setting.

Many corporations with large in-house legal staffs were faced with a similar choice as large law firms: dispense with the temporarily expendable in-house lawyers or keep them on the staff in hopes that demand would rebound. I should also emphasize that clients themselves faced a serious crisis in their own businesses in many instances. The financial crisis of 2008 affected the entire global business community, and for many financial clients the crisis was either fatal or life-threatening. In-house general counsel faced overwhelming pressure to limit their legal expenses, although in many cases the legal issues these clients confronted were crucial to their existence. In contrast to law firms, which adapted remarkably well to the financial crisis, the clients' problems were more extreme and more threatening to their survival.

1.12 IN-HOUSE LEGAL DEPARTMENTS

The growth of in-house legal departments at businesses and other organizations has paralleled the growth of law firms over the past 50 years. The quality of in-house legal departments has also improved, as legal departments have welcomed many of the lawyers who for one reason or another left a career at large firms. The principal legal officer of a large corporation is in many ways a job superior to that of most partners at large law firms, and many of the top partners of prestigious firms have chosen to lead in-house legal staffs. More and more over the past 50 years, the in-house general counsel is looked to by the officers and directors of the company as the primary legal advisor, a role which was long held by partners of outside law firms. This has happened for several reasons. First, the amount of legal business demanded by some companies today requires the management of a seasoned lawyer who is also familiar with the company, is loyal to the company, and spends his full-time devoted to company affairs. Once, independent legal advice from a partner of a leading law firm was thought to be preferable to advice by an in-house general counsel, who might favor the company or management's view of issues because his job was dependent on loyalty. Now, however, many chief executives want their chief legal advisor to be totally accessible and not preoccupied with other clients. Whether this results in the most objective and best advice depends a lot on the people involved, but certainly many outstanding lawyers serve as in-house general counsel, stand up to a strong-willed CEO and render dispassionate advice – even when that conflicts with the CEO's plans and preferred strategy.

Many CEOs prefer to consult with their in-house general counsel first, in order to think things through, with the option of seeking outside legal advice if the issue may be in the gray area or the company wants to obtain truly independent advice in connection with regulatory enforcement or private litigation matters.

Putting aside issues of independence, it makes eminent good sense to organize a large in-house legal staff who are well-versed in the legal issues critical to the company, familiar with the personnel and business strategy of the company, and totally dedicated to the company's legal issues. Most Fortune 500 companies have in-house legal teams which operate like law firms, although they generally recruit from law firms rather than law schools. As law firms have become more selective about partnership election, many associates who don't make partner or who don't like the pressure to bill hours and the inevitable work conflicts at law firms choose to go to in-house legal departments, where the hours are believed to be more regular and a lawyer serves only one client rather than many clients.

As law firms have grown much larger over the last 50 years, in-house legal departments have also grown. Currently, they employ many lawyers who were formerly at law firms and are generally of high caliber in both administrative efficiency and the quality of their legal work. The top in-house lawyers may earn more than many partners in private firms, because their compensation includes stock options or other awards which may become of considerable value if the company is successful.

The recession of 2008–2009 caused many in-house legal departments to stop growing or even contract. Even with growth curtailed since the recession, however, the in-house legal departments constitute a large pool of jobs which are viable and attractive alternatives to a career in a law firm. This wasn't often the case in the 1960s and 1970s, when in-house legal departments were much smaller and the top in-house lawyers generally did not have as much access to officers and directors of the companies and were not, for the most part, ambitious, accomplished lawyers who could otherwise be top partners in leading law firms. So just as law firms grew dramatically in size and profitability during the last 50 years, the in-house body of lawyers grew in size, compensation, and sophistication during the same period.

1.13 GOVERNMENT LAWYERS

The number of lawyers employed by various Federal, state and local governments has also increased rapidly in the last 50 years, mirroring the growth in lawyers in large law firms and in-house legal departments. Certain government criminal prosecution offices are understaffed today, as there are many more laws to enforce, and budgets for government lawyers are limited. In various state and Federal agencies, there are many more regulations to administer; and depending on your political point of view, this morass of government regulation is justified by the threat of unfairness and injustice, or is a great burden on the functioning of the private economy. Certainly, the large law firms have profited greatly from this explosion of government regulation, as large firms have specialized in securities laws, trade regulation, complex taxation, and labor laws; and patent filings and proceedings are necessary to protect valuable intellectual property. In this country, much more than most others, lawyers are essential to doing business and to the proper regulation of business, while the legal justice system is essential to enforcing the rule of law as well as protecting essential human rights and liberties. In much of the undeveloped world, the lack of an efficient, sophisticated legal system stifles investment or makes it much riskier; and various rogue elements and oligarchies, including some dictatorial regimes, use the lack of a mature legal system to take advantage of other, less powerful people.

It is beyond the scope of this book to explore the fascinating implications of the uneven growth of the legal system and the role of lawyers in the economy in this country contrasted to the countries of the developed and undeveloped world, but the growth in number of government lawyers is highly relevant to the analysis of the legal marketplace in this country now and in the future. Unless there is a great simplification of the Federal, state and local regulatory scheme, which is unlikely, there will continue to be many government lawyers required to administer and enforce the legal system, and many lawyers in private law firms and in-house at companies required to monitor the compliance process with this vast legal framework and to defend against unfair enforcement and/or facilitate proper compliance.

Law firms specializing in government regulation have grown rapidly as this complex regulatory system has developed, and it is necessary for such firms to recruit experts from the government from time to time to advise private industry on how to comply with the regulatory framework and navigate it to companies' advantage. Many large U.S. law firms have offices in Washington, D.C. and also have expertise in the state and municipal legal framework in which their clients operate. Washington, D.C. law firms frequently recruit lawyers of various levels of experience from Federal agencies, and often lawyers specializing in government regulation leave private practice for positions in the government. After serving for a while and getting valuable experience, they often return to their firm or the private sector. This process of exchange of legal talent from the private sector to the public sector and back is one of the key ingredients of our sophisticated government regulatory system in this country; and it also prevents parties from gaming the system, limits bribery and corruption, and creates confidence in a predictable legal system. It affects the legal market in many ways. First, there are many lawyers employed in government and private practice as a result of the complex regulatory system in this country – many more lawyers per capita than in most other countries in the world. Second, there has been a large demand for legal services relating to governmental matters in the private sector in the period we have been discussing, and the sophistication of the legal issues involved has grown exponentially. Finally, as the developing world achieves modern economies, there will be a large demand for legal expertise to regulate those economies or there will be great consequences and risks of the lack of a strong legal system to protect fairness and enforce contractual rights.

1.14 EVOLUTION OF THE LEGAL TALENT POOL

In 1970, the legal talent pool in law schools was less than 20% women, and there were very few minorities. Over the last 50 years, the number of lawyers in the profession has grown exponentially, and large law firms have dramatically increased in size. Yet, while large law firms have sought many more first-year associates, the elite law schools have increased their number of students only slightly. The hiring process became much more competitive throughout the period of expansion of law firms from the 1960s to 2007, as law firms increased their numbers of first-year associates from under ten to as many as 150 per firm. Moreover, the number of women studying law increased dramatically, from under 20% at most law schools in the late 1960s to 50% by 1995, and it has stayed at 50% since that time. The number of minority law students increased rapidly as well, as law schools sought to diversify their mix of students; large law firms sought to diversify their cultures, and clients encouraged a diverse team of lawyers working on its cases. Meanwhile, the atmosphere in most large law firms changed from a resistance to alter the hiring and cultural patterns, to active encouragement of adding female and minority lawyers to capitalize on the availability of this strong talent pool, to better balance the cultures of law firms, and to please clients. At the same time, the law firms increased their scope of hiring by considering additional law schools. In the 1960s, most firms were content to hire first-year associates from elite law schools in the upper part of their class by grades. Suddenly, to satisfy their expansion needs, they had to hire more of the class in elite law schools and to hire top-ranking law students from a wide range of formerly not top-rated law schools. A larger percentage of their hires were women and minorities.

As a result, starting in the mid-1990s, large law firms started to hire roughly 50% women and substantially more minorities. The culture of most law firms changed from a seniority-driven hierarchy to a more diverse atmosphere of creativity and talent. Moreover, as law firms expanded rapidly, many more slots for partners were opened up, and the number of partners grew dramatically. I have touched on the greater work ethic of law firms throughout this period, and the greater emphasis on productivity and profitability. Technology played its role in this cultural shift, as lawyers were increasingly able to work efficiently remotely from home rather than relying on physical files and workplace-provided office services. That permitted work away from the office, which appealed to many men and women.

1.15 FINANCIAL REWARDS

In the 1960s, private practice of law at large law firms paid well, but the amount lawyers were being paid was not public information. Many intelligent college graduates chose to go to law school because it was an intellectual pursuit which involved associating with other bright lawyers and, as one of our partners at Hale and Dorr liked to say, "involved no 'heavy lifting'." Lawyers at large firms had often been involved in political and government affairs, and the interest in participating in political affairs motivated many people to become lawyers. Partners at large law firms made a good living, but much less than the wealth a businessman could amass, not because lawyers did not earn high incomes compared to business executives – because they did – but because a partner in a law firm was not able to build up an equity interest in the law firm which could be realized when he withdrew, retired or died.

A lot of the publicity about the greed of lawyers and their high compensation omits this key point – that law is generally not a profession chosen by people who want to operate a business and amass wealth. Most lawyers are intrigued by understanding the legal process, the intellectual challenges of the law, and, for some, serving society and being involved in government in some way.

Through the growth of large law firms since the 1960s, however, partners of large law firms started to earn substantial incomes. The approximate average equity partner profits at *AmLaw 100* firms are shown in Table 1.1.

Table 1.1 Average equity partner profits according to AmLaw 100

Year	$
1985	300,000
1990	350,000
1995	400,000
2000	600,000
2005	700,000
2010	800,000
2015	900,000

This steady climb in income was accompanied by a growth in the starting salary of first-year associates in New York City large firms, which was followed by most other large firms in the country, as shown in Table 1.2. In addition, the associates received a flat first-year bonus of an additional amount.

Table 1.2 First-year associates' starting salaries in New York City large firms

Year	$
1985	65,000
1990	80,000
1995	85,000
2000	140,000
2005	160,000
2010	160,000
2015	160,000
2016	180,000

This steady climb in remuneration for lawyers in large firms, combined with the fact that this information was increasingly more public, changed the way lawyers and others looked at lawyers' compensation. In the 1960s and 1970s, most lawyers felt and said that they didn't go into the private practice of law for the money, but rather for the intellectual challenge, the chance to work with smart people, and some mixture of a fascination with the law and the legal system, as a stepping stone to a career in politics or public service, and/or out of a desire to help people seek justice. Certainly, the graduates of the leading law schools had served as judges and in various political positions, including Presidents, Congressmen, Senators, Cabinet members, Governors, and in various state and local offices. Most people knew that Franklin Delano Roosevelt was a lawyer before becoming a much more effective and successful politician, obviously the Supreme Court Justices were lawyers, but a series of lawyers had also held prominent national political leadership positions, including Wendell Willkie, Thomas Dewey, Dean Acheson, John Foster Dulles, Richard Nixon, Gerald Ford, Bill and Hillary Clinton, and Barack Obama, as well as many members of Congress, Senators and Governors.

Over time, being a partner in a major law firm was becoming much more financially rewarding than it had been before the long period of law-firm growth; and the in-house general counsel of major companies became even more highly compensated as well as more respected. Lawyers came to receive much more publicity from a growing active legal press and there was much more coverage in *The Wall Street Journal* and *New York Times* of legal issues and personalities, both successful and unsuccessful. The demise of Dewey & LeBeouf, for instance, attracted much more press coverage than the long record of success of Dewey Ballentine, one of its predecessors.

College graduates were drawn in greater numbers to the legal profession, both for the traditional reasons of public service and a possible career in politics and also, increasingly, because of the well-publicized financial rewards. Particularly for many bright young college students who didn't have a burning desire to go into business and build something, a career as a lawyer, or at least going to law school, became a default option for many college graduates. This helped the legal profession and large law firms by attracting a much broader pool of intelligent, ambitious people to a legal career, including an increasing number of women who saw a legal career as a field where intelligence was at a premium and where they could prove their value through their reasoning, writing and speaking skills.

By 2007, many lawyers had seen increasing financial rewards throughout their careers, uninterrupted by any hiatus or decline. The severe business downturn of 2008–2009 affected large law firms, as they experienced an immediate drop-off in demand (see the Introduction to this book and previous sections in this chapter, especially section 1.6 "Recruiting and Mobility"), leading to an immediate decline in law firm revenue. Large law firms responded remarkably well to this crisis, cutting expenses dramatically, including young lawyers and staff, and preserving partner profits at almost the same level as before 2008. Most large firms also treated younger lawyers with sensitivity, deferring their arrival dates and paying them a stipend in the interim, when firms were confronted with more lawyer capacity than was necessary to do the available work. Demand gradually increased and law firms reduced the number of lawyers hired; but law firm profits, which were saved from a dramatic decline at most firms, crept back up at a much less robust pace than they had increased over the long period culminating in 2007.

Many lawyers have benefited from the long period of growth of large law firms. Most lawyers who graduated from law school in the late 1960s and early 70s and who joined large law firms made more money than they realistically expected from the practice of law. Also, the trend for specialization in large law firms meant that most lawyers focused on a narrower area of practice over the years and came to know it better and in more depth, rather than being expected to address many practice specialties. This allayed some of the concern regarding not being correct in legal judgments and afforded a higher percentage of time spent in pursuing challenging issues and matters, which commanded higher fees. As law firms became more specialized, lawyers learned to rely on their colleagues who were expert in different areas, and reciprocally received legal work in their specialty from colleagues.