What Ails the Large Law Firm?

Will the Real FutureFirm Please Stand Up

Bill Henderson | April 2014

"We always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next ten. Don't let yourself be lulled into inaction."

-- Bill Gates, 1996

Prologue

"What Ails Big Law?" was written in the early summer of 2009, shortly after the completion of FutureFirm 1.0—a "collaborative competition" in which teams of law firm partners, in-house lawyers, and junior associates competed with one another to create a law firm that would survive and thrive over the next 20 years. This essay reported the surprising results of the competition along with my own commentary on how these results could be used by BigLaw to adapt to changing times.

Upon completing the essay, however, I filed it away. Back in 2009, law firm leaders had too many emergencies on their hands to listen to the unsolicited advice of a legal academic. Although I thought my analysis had merit, the timing was wrong. A better course of action was to let events play out.

Nearly five years have past since FutureFirm 1.0. To our great relief, the fall-out from the 2008 credit crisis is behind us. To the surprise of some, the large law firm sector has come out the other side substantially intact. Headcounts are slightly up from 2008, and the most firms remain quite profitable. Yet, most law firm managers would probably agree with Bruce MacEwen's sober conclusion that Growth is Dead.

I am circulating "What Ails BigLaw? Will the Real FutureFirm Please Stand Up" because I think most large law firm lawyers would be interested in revisiting the crisis of 2008-2009. Since that time, many short- and medium-term strategies have been tried, and many were successful. But they were also short- or medium-term. Lawyers at many firms are ready to have a conversation about longer-term ideas. Politicians may long for a crisis to make change. Prolonged ruts, in contrast, appear to bring out the best in big firm lawyers.

With this brief prologue in place, it is my hope that "What Ails Big Law?" may be a useful and well-timed message.

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On April 17-19, 2009, the Indiana University Maurer School of Law hosted FutureFirm 1.0, a “collaborative competition” in which law firm partners, in-house lawyers, law firm associates, and students worked together to forge a business model that will enable firms “to survive and thrive over the next 20 years.” At stake was $15,000 in prize money (supplied by Hildebrandt Consulting) and the glory of being crowned a certified thought leader. The formula for the event was simple: pit lawyers’ competitiveness against their deeply held skepticism and risk aversion—ah, something would have to give. As one of the organizers of FutureFirm 1.0, I had the enviable role of being a passive observer to dozens of candid conversations among stakeholders.

This essay summarizes some of the thoughts and observations that emerged from FutureFirm 1.0, including—with the benefit of additional reflection—my own impressions of what ails BigLaw.

To avoid unnecessary suspension, I will offer my bottom line right out of the gate. The big problem faced by today’s large corporate law firms is too many decades of uninterrupted success. Large firm lawyers reap large financial re-wards by operating a very conservative time-and-materials business model. This model assumed (1) that the firm’s elite brand would always command premium rates, (2) that the demand for elite law graduates would never exceed the supply, and (3) that the firm could grow forever with no diminution in the willingness of partners to share risk in a way that would strengthen (or at least support) the long-term interests of the firm.

Now that these assumptions have fallen one after another, many large firms are in the uncomfortable position of needing to innovate when the pressure is on. Innovation is hard to do under the best of circumstances; imagine attempting innovation for the first time among well-heeled lawyers who have short attention spans and widely divergent time horizons.

The real problem presented in FutureFirm was not one of strategy—all the teams broke from the status quo, but they did so in very similar ways, suggesting the best strategies were relatively obvious. Yet, these strategies were going unused because the status quo had worked so well for so long. Unlike a corporation where shareholders who disagree with management can just sell their shares and exit, a law partnership needs the owners to show up on Monday morning to service the firm’s clients. Convincing the partnership to do just that is a change management problem of epic proportions. As a result, a huge number of lawyers are locked into a business structure that, despite its illustrious past, is ill-equipped to adapt to the future. Moreover, clients are also deprived of beneficial changes—which makes U.S. law firms susceptible to non-BigLaw competitors both domestically and abroad.

My "too-much-success" theory requires some context. So let me start with the basic set-up of FutureFirm 1.0.

I. FutureFirm 1.0

The FutureFirm competition consisted of forty players divided into four teams of ten: four partners, three in-house lawyers, and three students/law firm associates. In addition, each team had the benefit of one Hildebrandt consultant. The goal of the competition was to articulate, through two rounds of competition, a new law firm that had the best chance of surviving and thriving over the next 20 years. The task of selecting a winner was given to a panel of 14 judges comprised of law firm partners, an in-house lawyer, a major malpractice insurer, legal academics who specialize in the legal profession, and a Gen Y lawyer. See FutureFirm 1.0 organizing memo (note we slightly modified the rules as we learned more about how the teams responded to the game's incentives).

To fully tap into the real-world perspective of each participant while shedding any pretense that anyone was speaking on behalf of his or her law firm or corporate employer, we organized the game around the law firm of Marbury & Madison LLP (M&M), a fictional Am Law 200 firm in the midst of an identity crisis. See FutureFirm 1.0 fact pattern. Specifically, there is a disconnect between the firm's self-image—elite, white-shoe, collegial, collaborative—and hard market evidence. A full description is contained in the detailed game problem, but here are some of the key facts:

- ***Size and Geographic Spread.*** M&M has 335 lawyers spread across offices in Chicago (the HQ office), Washington DC, San Francisco, and a middle-market city.

- ***Firm Structure and Financials.*** In the 2008 Am Law league tables, M&M ranked #123 in total revenue ($210 million) and #138 in profits per partner ($675,000). Despite its shift to a two-tier structure a few years ago, M&M is relatively low leverage (135 equity partners; 15 non-equity; 185 associates).

- ***Governance.*** M&M is governed by a twelve member Executive Committee and a Managing Partner who possesses—by design—little significant authority.

- ***Practice Areas.*** M&M owes its stature to insurance defense/coverage litigation plus corporate, labor & employment, and regulatory compliance work for various legacy industries (steel, automotive, airlines). In recent years, however, the firm has established a respected, and profitable, intellectual property practice.

- ***Associates.*** The firm gets decent Am Law Midlevel Associates ratings for "training and guidance," "levels of responsibility," and "attitudes toward pro bono," but is below average on "billable hours policy," "family-friendly environment," "communication toward partnership," and "attitudes toward diversity." Associate attrition has been roughly 17% annually for the last few years, though the rates are higher for female and minority lawyers.

- ***Clients.*** The partners are more impressed with the firm than the clients. According to an industry-wide survey, M&M partners believe they are doing an exemplary job 67% of the time, versus 42% in the eyes of their clients.

- ***Lateral Movement.*** In recent years, some heavy-hitter partners have decamped for larger and more profitable cross-town rivals.

The basic concept of the game is that the M&M Executive Committee has formed an ad hoc FutureFirm Task Force to evaluate the firm's business model. To avoid a partner echo chamber, the Task Force is asked to collaborate with M&M associates and in-house lawyers employed by some of M&M's key clients.

Granted, when Anthony Kearns and I dreamed up the concept for FutureFirm 1.0 in the fall of 2008, we knew that the BigLaw market was heading into a recession. But what we failed to fully anticipate was the depth of the financial problems. Thus, when the game rules stipulated that "the efforts of the Task Force are taking place in real time – i.e., April of 2009," we tapped into a sense of urgency and impatience that would have been virtually impossible to create with a hypothetical fact pattern. Thus, in keeping with other market trends, M&M recently laid off 45 staffers and deferred the start dates of the incoming class of associates (35 total).

M&M's financial prospects are very similar to other Am Law 200 firms. Although M&M profits per partner were down a mere 4% in 2008, the fiscal year ended in September. For fiscal year 2009, firm revenues and hours billed are down 10% year-to-date. On the transactional side, the number is down a disturbing 17%. The Executive Committee is daunted by the prospect of having to allocate the spoils of a shrinking economic pie—stealth associates layoffs and partner de-equitizations are short-term fixes with long-term collateral effects. Moreover, it may be impossible to wring out enough savings to keep the firm's most important rainmakers.

To get the real world flavor of FutureFirm, it is worth discussing the background of the players and judges. Participants included law firm partners from several major markets (San Francisco, Chicago, New York, London, Minneapolis, Indianapolis, Boston, Seattle, Los Angeles, Portland). Their firms ranged from high-end boutiques started by former BigLaw partners to firms in the Am Law 25. In-house participants came from a wide array of client lawyers, including the CEO of a large privately held company, a venture capitalist, and senior lawyers and deputy general counsel from several Fortune 500 corporations. Finally, each team had one law firm associate from an Am Law 200 law firm and two law students who had previously worked as a summer associate. The students/law firm associates were drawn from several law schools (Indiana, UC Berkeley, Georgetown, USC, and Columbia).

The competition took place over two rounds. During Round 1, which lasted all day Saturday, participants formulated a business model which was presented during a late afternoon plenary session. Each team had 15 minutes of presentation followed by 15 minutes of questions from the judging panel. During Round 2, which took place Sunday morning, each team had 15 minutes to present the key features of their model along with any changes or refinements from Round 1. Thereafter, the judges deliberated while the participants enjoyed a well-deserved brunch in the stately Tudor Room in the Indiana University Memorial Union.

II. Key Results

Despite the fact that all four teams worked in isolation, the common themes were striking. The umbrella theme tying together all the presentations was "client focused"—which is no surprise since (a) the clients were in the room, and (b) the whole enterprise depends upon their greater legal spend. But the specific deal points were often quite similar and inevitably included the scuttling of the billable hour, customized alternative billing strategies, new data collection systems, greater information sharing with clients, and intensive associate training (e.g., secondments with clients).

To make the changes cost effective, associates on all four teams traded in M&M's $160K associate cost structure (proposed starting salaries were in the $80,000 to $125,000 range). In exchange, partners agreed to concessions that enhanced the associates' long-term prospects with the firm—e.g., a three-year employment contract, shortened partnership track, a return to a single-tier partnership, generous profit-sharing, a business development budget, and deferred compensation program designed to payoff law school loans. Interestingly, all four teams indicated that they were willing to forgo elite law school credentials in order to hire graduates who could be cost-effectively trained. And student players from elite law schools made a convincing case that the new model offered them a much more attractive value proposition than a $160K model that offers neither training nor security nor a healthy firm culture.

Another theme touched on by the teams was a realization that M&M could not be all things for all clients. One team committed itself to winnowing its client base in favor of its largest clients, thus reducing the likelihood of losing desirable work due to irresolvable conflicts of interest. To escape the relentless cost-cutting efforts of general counsel from major corporations, another team decided to focus on the underserved middle market, where M&M lawyers could serve as trusted advisors and develop long-term relationship with business owners. A third team was going to distinguish itself through a very lean cost structure and a single relationship manager who would be directly accountable to GC's to deliver high quality cost-effective results. This so-called "throat to choke" would ensure the development of an institutional memory that could eventually achieve Six Sigma performance.

To my mind, it is all-too-easy to draw the wrong conclusions from Future-

Firm. For many critics, the FutureFirm models did not go far enough—indeed, several interested observers suggested that FutureFirm should have been a "clean-sheet" exercise rather than case competition stifled by baggage of a hypothetical firm.

Yet, here is the rub: during FutureFirm 1.0, our players were constrained by a very realistic set of facts that essentially mimicked the model Am Law 200. In turn, four teams of stakeholders converged on several key changes to the business model—billing practices, pay structure, training, client relations. Yet, as the participants weighed the likelihood that the hypothetical M&M partnership would sign onto these (relatively obvious, sensible) changes, many worried that such a conversation would precipitate a Heller-esque death spiral. Several FutureFirm partners concluded that it was better to pull the plug on Marbury & Madison LLP rather than live another day pretending that a collection of warlord partners with large portable books could provide the nucleus of a truly healthy and vibrant law firm.

So the real takeaway of FutureFirm 1.0 is not some genius insight that will transform the marketplace. Rather, it is more fully appreciating the profound structural constraints that impede the most basic and necessary changes to the BigLaw model. This is the type of market failure that would ordinarily warrant intervention by a regulator. Yet, this authority is scattered among the judicial and legislative branches of fifty states and the District of Columbia. Arguably, the best hope for significant change is a rash of large law firm failures, which would give rise to new law firms that can rewrite the rules for the benefit of clients and the next generation of lawyers.

III. What Ails BigLaw?

BigLaw is plagued by several structural problems. Its most serious impediments, however, are not these structural problems per se, but the settled expectations and dulled imagination produced by several decades of large profits and high prestige. Why change how you do business when a riskless time-and-materials model has worked so well? Similar to the effects of family money and the second and third generation offspring or an industry giant (like, say, General Motors) with the huge proportion of a large and lucrative market, too much uninterrupted success and comfort can breed insular thinking and a lack of proportion. In my observation, lawyers with elite educational credentials too often believe that their high incomes are the result of their skill and achievements rather than a hierarchical regional and national guild system, albeit one that is gradually losing its market power.

Unfortunately, it has been at least three generations since partners at most major corporate law firms have had to think like ordinary business people—controlling costs, taking risks, investing profits back in the business, etc. Note that I am not assigning blame—it is quite rational to gravitate toward opportunities where the rewards are relatively high and risks are relatively low. But a large second-order effect of huge, uninterrupted success is pride, complacency, and loss of objectivity.

As for the structural problems, they go much deeper than issues of ego or business acumen. The first issue pertains to the changes in the supply and demand for corporate legal services. On the demand side, the clients with the largest legal spend are transnational entities within a globalized economy. Over time, their legal needs have steadily increased in volume, breadth, and complexity. For decades, this steady rise in demand fully propped up the supply side, enabling law firms to continue to utilize the traditional promotion to partner tournament model, adding two or three associates for every lawyer who made partner.

Over time, the typical large law firm became much larger. Between 1979 and 2008, the average firm in the NLJ 250 increased from 102 to 535 lawyers (+525%), while the size of the partnership swelled from 45 partners to 213 (423%). Similarly, the average number of offices per firm has swelled from 2.5 to 10.2. The typical NLJ 250 firm now has 65 lawyers working foreign countries compared to two in 1979. Sharing risk with 45 partners, most of whom you see on a daily basis, is very different from sharing risk with 213 partners dispersed throughout the globe, many of whom you have never met. Moreover, in many firms, over 50 percent of the partners entered the firm laterally. See 2008 Hildebrandt study. The overall average in the NLJ 250 is about 33 percent. If there is such a thing as firm culture, it is unlikely to be enhanced by high rates of partner mobility. Thus, money, rather than shared firm history and values, becomes the primary glue holding the firm together.

The structural changes on the client side are equally dramatic. The enormous growth of transnational corporations has given rise to a highly bureaucratized in-house legal department in which the general counsel, rather than the outside counsel, has taken on the coveted role of being "trusted advisors" to the C-suite executives who run the company.

The rise of the modern general counsel (or chief legal counsel) is characterized by two trends that are moving in two diametrically opposed directions. First, legal services are increasingly viewed as one more variable cost that can be controlled when stretched with modern management techniques, including sophisticated metrics applied to all outside vendors. And if the legal department goes over budget, the top in-house lawyers are likely to take a hit on their bonus. Second, the cost-cutting has its limits. If a general counsel has to inform the board of directors of an adverse legal outcome that affects the fortunes of the company, his judgment is less assailable if he can say that he hired the best lawyer from the best firm. In other words, BigLaw grew, in part, because of garden variety agency costs. Cf. Bruce MacEwen, Nobody Ever Got Fired for Hiring Skadden, Adam Smith Esq. Blog, April 21, 2004.

Not surprisingly, over the last several years, the Am Law 50 firms have leveraged their "brand" and gradually pulled away from the rest of the large law firm universe. Much of this growth has been achieved through lateral recruitment, with well-heeled partners from the Am Law 51 to 200 moving upstream in search of a "larger platform." See Henderson & Bierman, An Empirical Analysis of Lateral Lawyer Trends from 2000 to 2007.

As legal strategy became the providence of general counsel, institutional relationships between clients and firms steadily eroded. Being a brand firm did not mean that clients were loyal to the firm; rather, it meant that the firm was more credible when pitching business. Legal spend was increasingly allocated through a transaction-based approach that focused on a combination of cost and quality--i.e., a "brand" provided by the individual lawyer, the firm, or both.

With law firms having less sway on client's decision-making, longstanding referral networks among regional firms began to collapse. Thirty years ago, all large firms except Baker & McKenzie were regional. Under the old "best friends" system, firms could refer clients to out-of-town firms without fear of losing their core business relationship. As general counsel showed a willingness to fire and hire new outside counsel, rather than give their competition an opportunity to get their foot in the door, firms began to expand geographically to keep pace with their clients' geographic footprint. Not surprisingly, the staffing of satellite offices is often accomplished by raiding the partnership ranks of the established firms within a regional market. Although the market for lateral talent is often cast as national or global in scope, over 96% of all partner lateral movement occurs between offices within the same metropolitan area. In others words, the competition may look global, but it is experienced in a very local and personal way.

In a recent study of large law firm economic geography, Art Alderson (Indiana Sociology) and I used network analysis and block modeling techniques to categorize various branch office configurations. See *The Changing Economic Geography of Law U.S. Law Firms*. We were stunned that 117 of the NLJ 250 had functionally equivalent geographic platforms, with offices in New York, DC, Chicago, LA, San Francisco, London and sundry branch offices in the Sunbelt and/or the Pacific Rim. 117 firms is a lot of competition in some very high-cost markets. Thirty years ago, these future Am Law 200 firms divided up industrial, banking, and insurance clients among a few rivals within a comfortable regional guild. Now these same firms have grown into each others' backyards, each with massive capacity, high fixed costs, and a strategic plan of getting more of that lucrative, price-insensitive work. When the capital markets froze up in late 2008 and clients collectively tightened their legal budgets, the BigLaw business model that operated on autopilot for nearly a century finally hit a wall.

Although there is a lot of discussion about law firms adopting a more "corporate" management structure, the lines of authority on an organizational chart should not be confused with actual control over the firm. The true power resides with powerful rainmaking partners. If they decide to leave, law firm managers lose revenues but very few fixed costs. In turn, the shrinking profit pie can touch off a second wave of defections. And, God forbid, a third. To stave off disaster, law firm managers increasingly focus on the lateral market, since these are the folks who can bring in the required revenues. With the thinning of firm cultures due to firm size and geographic dispersion, the decision to stay or go increasingly turns on money. (Marc Galanter and I analyze this shift in our *Elastic Tournament* article.)

So my bottom line is that the common themes that emerged from FutureFirm 1.0 make an enormous amount of business sense—four teams of highly motivated lawyers all converged on several similar innovations. Unfortunately, they are destined to be ignored by BigLaw managers because the premise of the game—to create a law firm that will "survive and thrive over the next 20 years"—is incompatible with the time horizons of rainmaking partners. Am I exaggerating? Check out Jason Fagone's terrific article on the final days of Wolf Block, which revealed the lack of trust among the top fifteen rainmakers of the firm. Essentially, these lawyers asked themselves if they could all be counted on to stay with the firm in the years to come. Despite their professed affection for one another, they doubted their collective willingness to stay the course. Thus, dissolution became the only sensible course of action. See "Wrongful Death," Philadelphia Magazine, June 2, 2009.

The difficult coordination problem of getting rainmakers to commit to the long term is compounded by ethics rules that bar non-compete agreements and ownership interests by non-lawyers. If lawyer non-compete agreements were enforceable, rainmakers could collectively bond themselves to the firm, thus making it safer for all partners to invest their time and money into strategies that would pay off over the medium to long term.

Likewise, the time horizons of partners could be dramatically increased by outside investors. Why do law firms need access to non-lawyer capital? Specifically, the funds are needed to guarantee partner incomes for a period of years as the firm invests in capital-intensive human resource systems, business processes, knowledge management, and alternative pricing models. In fact, talented equity partners could make even more money if it were willing to undertake some risky but quite promising innovations.

For a firm like Marbury & Madison LLP (150 partners and 185 associates), the capital needed might be hundreds of millions of dollars. A lot of money, but the purpose of the funds is to reduce the opportunity cost of highly accomplished lawyers who have the market credibility to warrantee the quality of the legal work—a critical link toward acceptance of a new delivery model. If the partners were guaranteed their incomes, they would probably be willing to split the higher profits with their private equity guarantors. This is Capitalism 101.[1] Further, if the innovations enable the firm to build a substantial and lucrative niche, the upside could be quite large, at least for the early adopters. More significantly, this process could spark a new era of "firm-specific capital"—i.e., the value created is specific to the firm rather than mobile partners who can take it with them to a crosstown rival. Firm-specific capital creates market power, and market power provides lawyers with everything they want: money, reputation, and the ability to pursue non-economic objectives, such as take long, uninterrupted family vacations, offer sabbaticals for partners, and take-on important pro bono work, etc. In their heart of hearts, I believe that most BigLaw lawyers want to work for a firm with firm-specific

[1] Since the UK and Australia have recently permitted non-lawyer investment in law firms, we will see all of this play out globally in the next few years. In the meantime, the US will be at a competitive disadvantage.

capital.

Over the last several years, I have analyzed a lot of data on the BigLaw sector. But frankly, my greatest insights come not from multivariate regression or network analysis, but listening, and trying to reconcile, the ideas, values, and impressions of three generations of lawyers—my students, practicing lawyers and law firm managers, and recently retired large law firm partners. Through these many conversations, I am left with the overwhelming impression that the "traditional" large law firm law model no longer fits the desires or preferences of the majority of stakeholders—young lawyers, equity partners, or clients.

Although equity partners make more money, they enjoy little long-term security and work longer hours than virtually anyone in the firm. I know that law firm partners are shocked, truly shocked, by this statement, but the vast majority of law firm associates and law students—particularly those from elite law schools—do not envy the life of the equity law firm partner. BigLaw is a place to pay down debt and build the résumé for a better opportunity that will materialize at some point in the future. It is my observation, however, that these "better opportunities" are often nebulous and ill-defined concepts. Young lawyers and law students more readily identify what they don't want. In the case of BigLaw, it is the long hours and lack of autonomy without the benefit of intrinsically interesting work or a sense that they are valued by their employer.

Because so many law students and recent law graduates are so tentative on their commitments to life in BigLaw, it is remarkable that firms have nonetheless engaged in a salary bidding war for their services. See "How the Cravath Model Produced the Bi-Modal Distribution," Legal Professions Blog, July 18, 2008. Granted, the majority of these associates went to elite national law schools, which satisfies pedigree requirements of the traditional hiring model. But only a small percentage of these young lawyers actually wanted to build their careers in these practice settings, a finding overwhelmingly corroborated by the second wave of research coming out of the After the JD Study. See, e.g., Dinovitzer & Garth, "Not That Into You," The American Lawyer, Sept. 2009. After paying too much for entry-level talent that was not fully committed to the enterprise, firms tried to pass the $160K+ cost structure on to their clients. Is it any wonder that clients are finally playing hardball with outside counsel? See, e.g., Association for Corporate Counsel (ACC) Value Challenge.

IV. Will the Real FutureFirm Please Stand Up?

When I try to predict the structure and attributes of the real FutureFirm—one that will "survive and thrive over the next 20 years"—the most plausible models seem to divide into two distinct groups.

First, law firms like Marbury & Madison will slowly disintegrate, often because many of their partners decide that it would be easier to jump ship to a "larger platform" or, alternatively, to start their own smaller firms with a more manageable cost structure. For the latter group, they can split the cost saving with their clients, enjoy a clean slate to implement some commonsense ideas, and be small enough to be governed by group norms. Further, the principals will love the fact that they are no longer living in the Above-the-Law fishbowl. But more importantly, with their personal guarantees on the bank loans and the office lease, and daily face-to-face contact with one another, the founding partners are going to have a shared, long-term time horizon.

Two law firms that fit this model are Summit Law Group (in Seattle) and Valorem (in Chicago). To add an element of realism to FutureFirm 1.0, we invited lawyers from both Summit and Valorem to participate on the partner teams. All of these lawyers left BigLaw partnerships to pursue a business model that they believed would better align the interests of clients with their outside lawyers. Certainly, every Marbury & Madison firm contains these types of renegade lawyers. When they founded their own firms, they dumped the large, expensive offices that reflect a firm hierarchy. In its place are highly functional workspaces designed to maximize collaboration, productivity, and workplace comfort. Billable hours—unless demanded by clients—are gone. In their place are flexible fee agreements that reward efficiency, information sharing, and results.

The Summit and Valorem models are so commonsense that I am certain that many other BigLaw lawyers will pursue this option. Thus, a whole new generation of very sophisticated, technically competent corporate lawyers will have first-hand experience with alternative billing, which should open the door for major innovations. The only open question is whether any of these firms will want to scale and diversify their operations so they can compete more effectively for larger scale litigation and transactional matters that are currently done by BigLaw. In the years ahead, corporate counsel trying to stay within their budgets will be more willing to have that conversation with upstart firms that have developed a credible brand for both cost-saving and results.

Second, we can conceive of a FutureFirm that evolves from an existing BigLaw firm. Many think this transition is impossible; and I think it will be very difficult. But based on the alternative (extinction) and the upside (more money for lawyer-owners than a traditional BigLaw partnership), this scenario could actually play out.

The core idea is a high-leveraged model that scuttles the promotion-to-partner model in favor of owner and non-owner lawyers. The owner group would be comprised of former rainmaking partners who want to move to a business structure that compensates them for the higher level of risk for taking bundles of legal matters on a flat fee or alternative fee basis. (Think of it as something akin to a leveraged MBO.) Conversely, non-owner lawyers would receive less total compensation, but would get other offsetting benefits that are currently unavailable under the traditional BigLaw model--e.g., predictable vacation, flexible work schedules, profit-sharing, reduced billable hour requirements, promotions and job security based on managerial and technical competence rather than rainmaking.

Admittedly, this approach will only work if there is substantial inefficiency embedded in the current BigLaw time-and-materials model. Specifically, once the incentive structure is turned on its head and profitability becomes a function of optimizing cost and quality simultaneously, lawyers would leverage technology, eliminate redundancy, and generally develop new solutions ("products") to old problems. To my mind, the staffing and case management skills of most well-run plaintiffs' firms, who do so much with so little, provide clues on how much fat is on the bone. Thus, with the right group of rainmaking lawyer/owners, I would bet my entire net worth on this concept. Moreover, in my conversations with insiders at many firms, similar ideas are beginning to percolate. Lawyers who dismiss these ideas tend to forget that business as usual is no longer a viable business strategy. See Richard Susskind, The End of Lawyers?: Rethinking the Nature of Legal Services (2008).

Consider the basic business logic from the perspective of three key stakeholders: clients, the lawyer workforce, and the lawyer-owners.

Clients. The typical customer of a BigLaw firm is a public or privately held corporation with a chief in-house lawyer responsible for hiring and monitoring outside legal counsel. These lawyers are under tremendous pressure to control their legal budget. Conversely, they are vulnerable to second-guessing/hindsight bias in the event of a bad outcome from a major transaction or litigation matter. So, from their vantage point, the ideal option is a low-cost/fixed-cost option from highly-skilled lawyers at a name brand law firm. For lower stakes, where an adverse outcome is unlikely to attract the attention of senior management, lower-cost regional providers may be the best option. Hence the extraordinary downward pressure we now observe on law firm fees. And because of the enormous overcapacity in BigLaw right now, many firms are willing to reduce rates in order to hang onto work. With the lower fees comes the need to slash associate pay or reduce entry level hiring in favor of the lateral spot market.

In reality, the only way for a BigLaw firm to significantly increase profitability in this environment is to (a) lock-in a predictable stream of revenue and (b) reduce costs. To my mind, the best way to achieve this objective is to go to the firm's best clients[2] and request portfolios of matters in which the firm warrantees quality and assumes the risk of cost overruns. The BigLaw brand in combination with a brand partner provides the GC with some internal cover within the corporate hierarchy. And the alternative fee arrangement helps the GC keep his or her legal budget under control. Of course, for the model to benefit the law firms, they would have to signficantly reduce costs while simultaneously maintaining or improving the quality of their services.

Workforce Lawyers. Now consider the benefits of the model from the perspective of non-owner lawyers who need to perform high-quality work under budget. Based on current market conditions, any BigLaw firm would be flooded with résumés for any legal job offering substantive legal work in a

[2] Note the emphasis on "best" clients. I know one large firm partner who did alternative fee arrangements for 25+ years before retiring. These arrangements turned out to be highly lucrative for both the partner and his firm. However, he stated emphatically that these arrangements grew out of a strong client relationship. He had built a solid foundation. He felt it would be impossible to build a viable or satisfying practice by pitching work based on price alone. The precondition of such an arrangement has to be trust.

major legal market with a pay scale that ranged from $80,000 for entry-level lawyers to $200,000+ for senior lawyers. I doubt this market oversupply will change anytime during the next several years.

And note, this idea is less an option than a way for a firm to survive under prevailing market conditions. If the soft market for lawyers is due to soft demand from clients, the challenges to the business model are unavoidable: if a firm promotes partners and adds no associates, it dilutes profits and the rainmakers may decamp; alternatively, if the firm promotes virtually no one to partner, it creates a cancerous morale problem among associates. Offering a "third way" may be welcome by many within the firm; and the most ambitious could still make it to equity if they possessed the talent and stamina. Further, by ditching the high associate cost structure, the firm could take advantage of a favorable labor market for junior level talent.

Although the pay would be lower than traditional BigLaw, the workplace would offer a much more collaborative, interesting, and flexible work environment than a circa 2008 Am Law 200 firm. The biggest distinction would be a relatively flat internal hierarchy and the formation of work teams to handle a portfolio of legal matters. Each team would have one or more supervising attorneys (often but not always an owner/former partner) who would set project budgets, monitor quality, and generally tend to the relationship with the client. Conversely, the team would share in the upside if the projects are completed under budget or the outcome triggers a success fee with the client. Individual lawyers could also receive bonuses for any innovations that reduced costs and/or increased quality in a way that was scalable or transferable to other legal work.

The team-based approach offers several advantages over the traditional BigLaw pyramid. First, it taps into the truism that two heads (or four or six) is better than one, even if the one head working alone went to an elite law school. Second, it builds in redundancy into the system, so workloads can be balanced across the teams and lawyers can enjoy more predictable hours, turn off their Blackberries on vacation, and work part-time without fear of schedule creep or workplace stigma. Third, as demonstrated by the breakthrough empirical research of economist Scott Page, diversity along the lines of race, gender, age, ideology, and other attributes is a bona fide advantage in any setting that relies upon teamwork for innovation. See, e.g., The Difference: How the Power of Diversity Creates Better Groups, Firms, Schools, and Societies (2007).[3] Obviously, this significantly broadens the hiring pool. Fourth, the team-based approach fully aligns the interests of the group in pursuit of a common goal—the best legal service for the lowest possible cost. When a team member violates group norms, they get thrown off the island. Inefficiencies that spring from billable hour quota and origination credits will be a thing of the past.

In my experience, very few lawyers actually want to be business people, especially if it requires time and energy of the typical BigLaw equity partner. This trend seems to be even more pronounced among the current generation of young lawyers and law students. (Note that this does not necessarily signal a change in generational taste; rather, equity partnership is less appealing as the job has become more grueling, less secure, and less collegial.) Instead, the majority of lawyers want similar things: interesting work, the opportunity to grow as a professional without destroying personal or family relationships, a good income, and to be part of an organization that reflects values that they admire. In many respects, the desired value proposition is similar to the one offered to a manager at Procter & Gamble or an engineer at Google. The solution, obviously, is not working harder; it is working smarter.

Lawyer-Owners. The firm would be owned by a relatively small number of lawyers/partners who collectively possess (a) the willingness, business acumen, and financial wherewithal to take risks, (b) a longer term time horizon, and (c) crucially, the legal knowledge, client relationship skills, and overall market credibility to warrantee the quality of the firm's work. Regarding (c), here is the last, best chance for many BigLaw lawyers to cash in on the value of their "brand" firm. With the massive overcapacity of so many law firms, the market power of virtually all BigLaw brands is declining. Therefore, these firms should use that brand to seed a model with better long-term prospects.

While I suspect that the vast majority of BigLaw partners will scoff at this statement, my proposed FutureFirm model of "high-quality/alternative billing" offers a much better upside for the rainmakers and law firm managers who own the firm. Why?

First, they are likely to make more money. This is a high leverage model that is

[3] During the 2008-09 academic year, the entire Indiana Law 1L class was divided into groups of seven for several challenging and complex group projects. Although we were unaware of Page's book, the instructors (including myself) did notice how the most diverse groups (age, race, gender, ideology, work styles) tended to be top performers.

scaleable and has enormous growth potential. The whole venture is based on the systematization and productizing of work formerly done by BigLaw under a time-and-materials approach. Whereas BigLaw partners made seven figures, the owners in this model could make eight figures—a fact that they are unlikely to share with *The American Lawyer* because the firm will no longer need to focus on attracting or retaining lateral lawyers with their high PPP.

Second, the firm's long-term brand is based on superior business processes and innovative use of technology, not the résumés of individual lawyers. Therefore, the firm can bow out of insane salary wars for associates and partners. Further, because the superior results are the product of teams (both lawyers and other knowledge workers), it will be very difficult for lawyers to replicate these results at a rival firm. Indeed, many of the firm's best ideas could be proprietary intellectual property. In other words, this approach creates firm-specific capital—the strongest glue possible for any professional service firm. Some of my earlier writings and research have explored the economics and data that undergird this approach. See, e.g., Are We Selling Results or Résumés?: The Underexplored Linkage between Human Resource Strategies and Firm-Specific Capital (2008 working paper).

Third, such a structure pulls the plug on the growth imperative of the promotion to partnership tournament (and its concomitant profit sharing limitations and power sharing illusions). Under this model, lawyers have jobs as long as they are contributing to the economic vitality of the organization. Admission into the ownership tier would involve an honest dialogue on the demands and sacrifices of making this leap. The vetting process itself would be both much more rigorous and much more transparent. One of the sources of instability in the current model is the expectation among mid-level associates—a much smaller group than entry level associates—that they have a legitimate shot at partnership. See Henderson & Zaring, *Young Associates in Trouble.* As noted above, promoting them creates the need for additional associates to maintain leverage and profitability; in the future, client demand is unlikely to be sufficient to support such growth, at least for all firms. Conversely, failing to promote the best associates, despite considerable toil and sacrifice for the benefit of the partnership, foments distrust and disloyalty among the entire junior lawyer workforce that is very difficult to reverse. Most good lawyers understand the value of effective expectation management. This new model does just that.

V. Conclusion

I do not want to diminish the immense difficulty of identifying and transitioning to a law firm business model that fits the emerging business landscape. Large organizations are inherently complex and fragile. And because of their peculiar history and regulatory limitations, law firms must deal with additional layers of complexity. Most corporate law firms have been rolling downhill for several decades, picking up size, prestige, and profits along the way. Now the lawyers within these massive, successful organizations have to rewrite the rules of their own governance while billing 2,000+ hours per year. To some extent, the rational solution for most partners is to put their head down and focus on their clients under the theory that, when the smoke clears, they will always have someplace to land.

But this is not the first time the US business lawyers have been flummoxed by the difficulty of creating a stable business structure. A few years ago, my co-author, Professor Marc Galanter, quipped that Paul Cravath "invented" the large law firm. I remember thinking to myself at the time why someone would need to invent something so seemingly obvious. The large law firm enabled greater specialization, the efficient training of lawyers, scalability to meet the needs of clients, and greater profits. Yet, as I dug into the history of the corporate bar in the U.S., I was surprised to see a pattern of mentorship that failed to produce large, stable partnerships. Once the master trained a junior to perform sophisticated legal work for a substantial business client and the junior attained similar profession stature and ability, the master was reluctant to split profits in a way that reflected their relative contributions. After all, the master trained the junior. There was disagreement on if and when such a debt could be fully repaid. See Otto E. Koegel, Walter S. Carter: Collector of Young Masters, or the Progenitor of Many Law Firms (1953).

In the 1890s, Paul Cravath found himself in such an arrangement with Walter Carter. Carter was an eminent New York City business lawyer who had a special knack for identifying and cultivating exceptional legal talent. Like many who came before and after, Cravath became Carter's partner but not his equal. So Cravath left the firm and eventually rose to prominence in the firm that would eventually be called Cravath Swaine & Moore. There, Cravath deployed Carter's training principles, but added on an incentive structure that (a) focused on providing quality and value to the firm's sprawling array of clients, and (b) trained more lawyers to his high-quality standards so the firm could keep pace with demands of his satisfied clients. The combination of training, profits, and future opportunities held the organization together and enabled it to grow. In essence, everyone's best option, including clients, was to remain loyal to the system that Cravath had created. Eventually, the value of this structure was obvious to others. Hence its widespread adoption by law firms throughout the nation.

The Cravath model has become, over time, the traditional model. Today, its primary virtue is its ingrained familiarity and the lack of any obvious successor that is likely to make all, or even most, of the stakeholders better off. Ironically, its limitations are most pronounced in law firms that have enjoyed the longest run of success. Transitioning to a new model, therefore, is going to take world-class leadership and change management worthy of several business school case studies. Discussing these challenges openly is one of the necessary precursors to this lengthy process. Judged on this basis, FutureFirm 1.0 was a major success.

Professor Bill Henderson

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Based on his incisive analysis of the structural changes occurring in the legal profession, Professor Henderson was recently included on the National Law Journal's list of The 100 Most Influential Lawyers in America. In 2012, he was named among the Top 5 Most Influential People in Legal Education by The National Jurist magazine. In 2009, Henderson was named a "Legal Rebel" by the ABA Journal in recognition of his influence on legal education and the changing economics and structure of the legal profession. Bill speaks to law firms, law schools, and legal organizations all over the country, sharing insights on the future of legal services and the results of his empirical research.

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