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AN ACADEMIC VISIT TO THE MODERN LAW FIRM: CONSIDERING A THEORY OF PROMOTION-DRIVEN GROWTH

*Frederick W. Lambert**

TOURNAMENT OF LAWYERS: THE TRANSFORMATION OF THE BIG LAW FIRM. By *Marc Galanter* and *Thomas Palay*. Chicago: The University of Chicago Press. 1991. Pp. xii, 197. \$27.50.

INTRODUCTION

Professors Marc Galanter¹ and Thomas Palay² in *Tournament of Lawyers* have made an important contribution to the scholarship on lawyers and the legal profession. They render a lucid history of the evolution of the American law firm from its early antecedents. *Tournament of Lawyers* also deserves praise for suggesting further academic inquiry about law firms and lawyers as they engage in intense competition and undergo fundamental change.³

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1. Evjue-Bascom Professor of Law and South Asian Studies, Director of the Institute for Legal Studies, Director of the Disputes Processing Research Program, University of Wisconsin, Madison.

2. Professor of Law, University of Wisconsin, Madison.

3. By undertaking to study law firm promotional patterns the authors have, perhaps unintentionally, suggested a broader scholarly inquiry that addresses the path of lawyers from the beginning of law school. Whether one knows it or not when one decides to go to law school, the decision lets one in for an intensely competitive evaluation by grades, law review, and moot court. Another evaluation process, which Galanter and Palay call the tournament, awaits after the relatively short three years of law school. Law graduates can choose among many different kinds of legal jobs; strikingly, though, year in and year out, considerably more than three fourths of the graduates of America's elite law schools begin a six- to ten-year apprenticeship culminating in selection or rejection for the title of partner in a law firm. The forces motivating this apparently relentless march by a supermajority of law graduates may be the quest for prestige, the need to repay student loans, or simply the decision to take the path of least resistance down the road of achievement.

Thus, in view of the number of intelligent people entering larger law firms, it is surprising that the partnership tournament has not been the subject of more academic study and commentary. Even less serious study has focused upon the law school as a business, social, or political entity. Law schools serve to train future participants in the tournament. They function in part as service businesses; revenue from students accounts for a large part of their financial resources. Yet few legal scholars have examined the content of the law school experience and how well it prepares students to begin the tournament. See *infra* notes 6 and 14. But see Alex M. Johnson,

At the same time, however, the authors' failure to consider internal and external forces bearing on law firm operation distorts their explanation of the extent to which promotion of associates to partnership propels exponential growth of law firms.

In Part I, I summarize the authors' theory of law firm growth based upon shared human capital built around competition for promotion to partner. In Part II, I question whether a comprehensive theory of law firm growth may disregard the supply of and demand for legal services. In Part III, I describe some unique financial attributes of the modern law firm, and certain functional and economic relationships among its constituents, which the authors have overlooked.⁴ Criticism of the specific components of the authors' thesis appears in Part IV. Finally, in the Conclusion, I emphasize the value of this book. Even with its imperfections, *Tournament of Lawyers* brings the reader face to face with the law firm as a historical and contemporary business entity. It stimulates further inquiry into both the law profession and, perhaps, the role of the law school⁵ as the source of participants in the tournament.⁶

I. EXTENDING PORTFOLIO AND AGENCY THEORY TO EXPLAIN GROWTH

Galanter and Palay describe the modern law business in terms of a sharing of human capital among partners and associates through the organization of the firm.⁷ The capital-sharing model derives from portfolio and agency theories of economics, the former viewing the

Jr., *Think Like a Lawyer, Work Like a Machine: The Dissonance Between Law School and Law Practice*, 64 S. CAL. L. REV. 1231 (1991).

4. I contend that the authors have failed to connect the firm's reliance on revenue — the life blood of the thinly capitalized law firm — to the firm's unique vulnerability to fluctuations in demand for legal services and, now more than ever, external events. See Amy Stevens & Paulette Thomas, *Legal Crisis: How a Big Law Firm Was Brought to Knees by Zealous Regulators*, WALL ST. J., Mar. 13, 1992, at A1, col. 6. Much of my criticism comes from personal experience gained during 17 years of law practice with three firms in a large city. Observations based upon such personal history are concededly anecdotal in any academic sense. But they are grounded in many years of direct participation in the processes that the authors analyze, and they are consistent with journalistic commentary.

5. Cf. Jonathan R. Macey, *Allan Bloom and the American Law School*, 73 CORNELL L. REV. 1038 (1988) (book review).

6. The authors note that promotion to partnership resembles superficially the "up-or-out promotion to tenured status" in academia. They state: "The analogy is limited by the different character of the exchanges of human capital between tenured and untenured department members and the different constraints on growth faced by the academic department." P. 11 n.35.

7. Pp. 89-98. The authors rely on the work of Ronald Gilson and Robert Mnookin. See Ronald J. Gilson & Robert H. Mnookin, *Coming of Age in a Corporate Law Firm: The Economics of Associate Career Patterns*, 41 STAN. L. REV. 567 (1989) [hereinafter Gilson & Mnookin, *Coming of Age*]; Ronald J. Gilson & Robert H. Mnookin, *Sharing Among the Human Capitalists: An Economic Inquiry into the Corporate Law Firm and How Partners Split Profits*, 37 STAN. L. REV. 313 (1985) [hereinafter Gilson & Mnookin, *Human Capitalists*].

firm as the focal point for diversification of risk.⁸ In seeking to maximize the value of the ability to practice law and at the same time reduce risk, the lawyer pools her human capital with others', thus creating the law firm. In contrast, agency theory focuses on how the firm seeks to maximize the gain from cooperative behavior by minimizing the potential for participants to pursue their individual self-interest.⁹ Maintaining controls on opportunistic behavior entails costs that are balanced against the increased efficiency of the firm.

The description of the sharing that occurs between partners and associates simply constitutes an extension of the theories explaining the organization of the firm.¹⁰ The relation of the associate to the firm reflects investments by both the associates and the partners accompanied by expectations on each side and mechanisms designed to prevent opportunistic conduct much like those designed to deter self-interested behavior in the firm.

The "tournament" constitutes the process of evaluation by the partners of associates over the six- to ten-year period of apprenticeship. Adapting portfolio and capital sharing theories to the tournament, the authors describe the associates as contributors of labor, intelligence, law school training, and other abilities. The partner and firm contribute experience, reputation, and client relationships. Associates, initially net borrowers of the firm's human capital, seek to build their own human capital so as to become contributors to the firm. Promotion to partnership at the conclusion of the tournament depends upon the associates' having demonstrated the potential to enhance the firm's capital and profitability (p. 100).

Associates are motivated by the goal of making partner; this constitutes a form of deferred compensation that they have forgone during the years of apprenticeship. Because the deferral of compensation represents the return on a speculative investment of time and effort by the associates, they monitor the partners' conduct to determine whether promotion occurs consistently and thus fulfills the firm's implied promise to reward the most able at the conclusion of the tournament. Conversely, the partners, as lenders of human capital, monitor the associates' behavior to prevent opportunistic conduct that would diminish such capital. Such conduct may take the form of inadequate work, defecting with firm clients, or diminishing the firm's reputation (pp. 99-100).

Previous scholarship has used portfolio and agency theory to describe the underlying basis for the law firm and the dynamics of invest-

8. Gilson & Mnookin, *Human Capitalists*, *supra* note 7, at 322-23.

9. *Id.* at 333-34.

10. Gilson & Mnookin, *Coming of Age*, *supra* note 7, at 572-73 n.19 (referring to the work of B. Holmstrom on career patterns in firms).

ment and expectation arising from the promotional structure.¹¹ Professors Galanter and Palay extrapolate the economic theory of the firm and the promotional process into a theory purporting to explain why firms grow exponentially (pp. 88-89). They contend that the transaction embodied in the tournament significantly and independently influences the exponential growth of the law firm.¹²

In Chapter Five, the authors create and defend the thesis that law firm growth derives from promotion-to-partner competition. Using data dating back as far as 1922, they construct an econometric analysis of growth of representative firms chosen from the Martindale-Hubbell directory of lawyers; the data show obvious increases in the number of lawyers and confirm that much growth has occurred since 1970. Observing the data, the authors state:

Many observers subscribe to a "shock theory" of recent firm growth. Until the early 1970s firm growth curves (of both partners and total lawyers) could be viewed, so the description goes, as straight lines sloping gently upward. . . . Suddenly, sometime around 1970, some "external shock" caused growth to increase dramatically, thereby increasing the steepness of the growth line. Thus the "shock" theory posits constant, though different, absolute amounts of growth (slopes) and implies decreasing rates of growth both prior to and after 1970. [p. 78; emphasis added]

We are neither told the identity of the "many observers" nor referred to any source that posits a theory of *decreasing* rates of growth before and after 1970. Many of the graphs confirm increasing growth, at least after the early 1970s. Nevertheless, the authors launch into a three-part regression analysis estimating a "kinked linear function," an "exponential function," and a hybrid "kinked exponential function,"¹³ an example of which appears in Figure 1. After this

11. *Id.*

12. They state that "roughly half of the growth is a by-product of the mechanisms used by law firms to govern the sharing of human capital." P. 88.

13. Pp. 78-83. The regression analysis is best understood by reference to the words of the authors and an example of the graphs they employ. They construct their model as follows:

To compare the estimated kinked linear function, we use ordinary least squares to regress size of firms against time. To account for the structural break around 1970 we use a dummy variable to account for shifts in either the slope or intercept after that point. Thus the model we estimated is

$$Y_t = A + B_1T_n + B_2(T_n - T^*)D$$

where Y = the number of attorneys in the firm at time t , T_n represents the time periods from 1 to n , T^* is the year in which the external shock occurs, and $D = 1$ if $T_n > T^*$ and $D = 0$ otherwise. B_1 is the slope of the function to the break and $B_1 + B_2$ is the slope afterwards. Because we are dealing with time series data, serial correlation problems are assumed to affect the efficiency of the ordinary least squares regression estimators, making them appear more precise than they really are. We could easily correct for the bias in the precision of our estimates by employing generalized least squares. But because we are not really interested in the precision of the estimators and because we do not want to ascribe undue sophistication to our results we have chosen not to do so. In any event, the R^2 's tend to be quite high using ordinary least squares, and the basic results are unlikely to change substantially even if the serial correlation were eliminated.

R^2 is the proportion of the variation in the dependent variable explained by the regres-

FIGURE 1

The following representative graphs (p. 80) reflect the authors' regression analyses. Actual growth is compared to kinked linear function (KLF), exponential function (EF), and kinked exponential function (KEF).

Figure 1: Latham & Watkins

econometric demonstration of the near-obvious, the authors contrast their views with those of another group of unspecified theorists:

In contrast to those who see law-firm growth in terms of a line with a sudden, one-time change in slope — and, therefore, as fully accounted for by an early 1970 shock — we view the size of firms as the result of continuous growth of an exponential nature.

. . . In our view law firms do not grow exponentially by accident. Instead, *structural features inherent to the big law firm fundamentally influence their growth patterns.* [p. 87; emphasis added]

What compels the inexorable conclusion that exponential growth derives fundamentally from "structural features"? The success of the authors' thesis depends on their convincing the reader that a functional connection exists between the promotion-to-partner tournament and exponential growth. In the next several sections, I suggest that such a connection is difficult to establish. The influences of demand for legal services and the fragility of the law firms' financial structure cause conduct not necessarily consistent with the theoretical dynamics of the tournament. The monitoring process that the authors depict contains uncertainty that minimizes its utility for ordering the partner-associate transaction.

II. GENERAL CRITICISMS OF METHODOLOGY AND ASSUMPTIONS

As a preliminary criticism, the absence of direct empirical data constitutes a shortcoming that detracts from the credibility *Tournament of Lawyers* will be accorded in the legal community. The authors are both academics; neither appears to have experience in big law firm practice, although this could be considered an objectifying advantage.¹⁴ Accordingly, their work suffers from abstractness that

sion of the dependent variable on the independent variables. Thus it is a measure of how closely the estimated function approximates or resembles the actual function.

We use this date [for the beginning of the study] only because 1922 is the earliest volume of *Martindale-Hubbell* available to us at the University of Wisconsin Law School.

To estimate $f(t)$ we take the natural log of both sides of the exponential equation which results in

$$f(t) = \text{Ln}(Y_t) = \text{Ln}(Ae^{Bt}) = A + Bt$$

We then used ordinary least squares to estimate $f(t)$ and again ignore serial correlation problems.

To estimate the kinked exponential functions we use a dummy variable to account for shifts in either the slope or intercept after 1970. Thus the model we estimated is

$$\text{Ln}Y_t = A + B_1T_n + B_2(T_n - T^*)D$$

where $\text{Ln}Y$ = the log of the number of attorneys in the firm at time t , T_n represents the time periods from 1 to n , T^* is the year in which the external shock occurs, and $D = 1$ if $T_n > T^*$ and $D = 0$ otherwise. B_1 then is the estimate of slope of the function to the break and $B_1 + B_2$ is the slope after 1970. Again no attempt was made to correct for serial correlation.

Pp. 78-82; nn. 3-7 (citation omitted).

14. Consider, hypothetically, the impact of a study by practitioners on the American law school. Imagine for a moment that the practicing bar is interested, monetarily or otherwise, in the inner workings and structure of the elite American law schools. Then hypothesize that two concededly bright practitioners decide to undertake a comprehensive study of the basic changes in the structure and academic focus of American law schools between 1960 and 1992 using law review article titles, the *Directory of Law Teachers*, the subject matter of teachers' postgraduate

they could have cured by collecting supporting data directly from the subjects of their study. The academic literature of the profession confers on Erwin O. Smigel the status of pioneer for his study of large New York law firms—a study that used interviews and questionnaires to collect data on employment and promotional practices.¹⁵ The authors would command and perhaps persuade a much wider audience if they had done something similar.¹⁶

A more fundamental shortcoming of *Tournament of Lawyers* relates to the authors' unwillingness to confront the reality that availability of legal business is a far more significant factor in law firm growth than are promotional structures.¹⁷ A fundamental assumption underlying their theory of growth is

that the rapid growth we currently observe relates directly to the specific governance structure used by law firms to protect shared human assets from opportunistic conduct. *Throughout this section we assume that revenue or labor-supply constraints will not hinder a firm's growth. Clearly this assumption is unrealistic, but we make it here for expository con-*

training, and various polls ranking the best law schools. I suspect that a study based upon such secondary data would evoke a considerably lower level of confidence than one that relied upon direct interviews with legal academics and students.

15. His work, *The Impact of Recruitment on the Organization of the Large Law Firm*, presented in 1958 to the American Sociological Society, revised in 1960 and published in book form in 1969, represents the first comprehensive effort to study in more than a popular or anecdotal manner the structure and workings of the large law firm. The work is based upon hundreds of interviews with lawyers in large New York law firms; Galanter and Palay refer to it prominently in their lucidly written historical treatment of the rise of the modern large law firm to the point in time around 1960 they denominate the "Golden Age of the Big Law Firm." Pp. 20-36.

16. They also would have deflected criticism of their thesis expressed in Vincent Robert Johnson, *Of Shared Human Capital, Promotion Tournaments, and Exponential Law Firm Growth*, 70 TEXAS L. REV. 537 (1991) (book review). In reacting to Johnson's criticism of the authors' empirical case as "less than overwhelming" the authors responded vaguely that "[i]f he [Johnson] knows of better data or techniques by which to test the [authors'] hypotheses, we would be interested to hear about them." See Marc Galanter & Thomas Palay, *Exponential Misunderstandings: A Response to Professor Johnson's Review of Tournament of Lawyers*, 70 TEXAS L. REV. 565, 568 (1991). Studies like those of Smigel could have corroborated the authors' statistical case.

17. Consider, for example, the introductory comments of a leading commentator on law firms at a September 1991 seminar entitled "How to Fire Associates and Slow Growth: Some Lessons Learned from the Trauma of Downsizing":

In this session we're going to discuss firing associates, slowing down on partner promotion, and reducing growth. Again, I want to stress that this is simply the chickens coming home to roost. Law firms built up in their systems, in the combination of responding to every bit of demand that was out there, the inability to turn away business. Plus, the simple mathematics of leverage and the need to keep feeding leverage by offering partnerships to associates and then having to replace those associates with two or three for each partner you make—the consequence of that ultimately had to be the kind of wrenching change a lot of firms are going through. What are the pitfalls of doing this? Is there any way to do this well?

Short-Term Pressures, Long-Term Opportunities, AM. LAW., Sept. 1991, at 21 (remarks of Steven Brill).

Consider also the effect of an agreement to settle a dispute with the Office of Thrift Supervision for \$41 million by the New York law firm of Kaye, Scholer, Hays, Fierman and Handler in March 1992. See Stevens & Thomas, *supra* note 4.

venience and then relax it below, in the last section of the chapter . . .
[p. 98; emphasis added]

The authors recognize that the assumption excluding revenue as a growth factor compromises the force of their theory.¹⁸ Yet even when they reintroduce the issue of demand in the last section of the chapter (p. 116), they imply that the validity of their theory is unaffected whether or not demand is taken into account as an important factor. During the discussion of their thesis, they relegate the demand component to a one-page afterthought (pp. 112-13) and a footnote.¹⁹ Ignoring the demand component, they "argue that one cannot fully understand the growth of the big law firm without recognizing the role of the internal growth imperative created by what we term the 'promotion-to-partner tournament'" (p. 88).

There is, however, a conflicting and confusing recognition of the importance of demand that distorts the development of their theory. Initially, the authors observe a built-in promotional "growth engine" (p. 88) that requires firms to grow exponentially in order to maintain their existing organizational structure. Then, introducing the discussion of promotional mechanisms, they inject the seemingly contrary observation that "[i]f a firm's required growth [presumably determined by tournament forces] outpaces either the relevant supply of labor or the firm's revenue base, further growth becomes impossible without changes. A firm that does not or cannot grow must restructure — that is, transform itself — or face failure" (p. 89; emphasis added). This passage and others near it confuse the reader because they convey conflicting premises. In text appearing on the same pages (pp. 88-89 & n.17) the authors embrace and then reject revenue generation as a *sine qua non* of firm growth.²⁰

As noted, the authors frequently cite Professors Ronald Gilson

18. In contrast, the authors' disregard for labor supply may be reasonable because the supply of entry-level lawyers will probably never contract to such a point as to curtail growth separately and independently. Recent history suggests that new lawyers will always be available, albeit at some perhaps elevated price. But an increase in the price of labor must be factored into the cost of running a law firm profitably and the consequent effect on demand for legal services. In order to run the firm, to make it grow, to keep it stable, even to contract it in an orderly manner, there simply must be clients willing and able to pay. Pp. 116-20.

19. The authors dismiss demand for legal services as follows:

[O]ne might argue that the law-firm growth curves simply mimic the growth in demand for big law firm services. That is, law firms might have grown exponentially because the demand for their services has grown exponentially. This is an intriguing hypothesis but one whose exploration is hampered by a lack of available data. General census data on the demand for big law firm services go back only as far as 1967 and are gathered only at five-year intervals. Thus it is impossible to determine whether the growth in general demand has been exponential. Data on the demand for specific firms' services are almost totally nonexistent.

P. 88 n.17 (emphasis added). Why rely on general census data? Why not ask some representative law firms to share anonymously records relating to historical growth? The failure to include demand for legal services as an explanation for law firm growth is a major flaw of the authors' argument.

20. The authors' historical sources, however, do not equivocate when they unambiguously connect the acquisition of new legal business to law firm growth. In analyzing excess human

and Robert Mnookin as the proponents of the thesis that law firm organization reflects a sharing of human capital.²¹ Yet they fail to discuss or cite a 1990 article by Professor Gilson²² analyzing whether lawyers' concern with continuing demand for their legal services constrains them from according systemic interests priority over client business objectives. Gilson's article considers the effect of supply and demand for legal services on, for example, the role of the lawyer as a "gatekeeper" against frivolous, purely strategic litigation. It does not directly address, much less controvert, the authors' growth theory, but it does recognize the considerable influence of demand for legal services in shaping the behavior of lawyers in the law firm. Gilson's approach also indicates the need to articulate the economic connection between the demand for legal services and law firm expansion in framing a theory of law firm growth.

Demand must be an integral part of any growth theory based on shared human capital because demand constitutes perhaps the most meaningful index of the amount of capital available for sharing. Without an increasing demand for services, the lawyer and the firm cannot

capital, the authors quote a historian's description of the relationship between the founding partner of the New York firm of Shearman & Sterling and David Dudley Field.

We assume that at least some attorneys will have surplus human capital — that is, more capital assets than they can productively use by themselves. Fittingly, the historian of the Shearman and Sterling firm begins his narrative with the fortuitous first meeting of Thomas Shearman with David Dudley Field:

Shearman was then twenty-five, and Field fifty-six; Shearman had just been admitted to the bar . . . and had no clients and nothing to do, while Field was a famous lawyer with more clients, and would-be clients, and more of their business, than he wanted or could possibly have handled.

P. 90 (quoting WALTER K. EARLE, MR. SHEARMAN AND MR. STERLING AND HOW THEY GREW 1 (1963)) (footnote omitted). Similarly, the authors quote Karl Llewellyn's observations about the complementary relationship between associates and partners. As to the latter, Llewellyn notes:

He plans. He guides. He worries. He may still slave. He often makes final decisions. He always is responsible. But above all, he is, and he is valued as, a *business-getter*. The measure of him is the business he can summon from the vasty corporation deep. He is to attract more orders for services than he or twenty like him can supply. . . . He cashes in, then, as an enterpriser, putting his own label on the work of others.

P. 90 n.22 (quoting K.N. Llewellyn, *The Bar Specializes — With What Results?*, 167 ANNALS 177-78 (1933)).

21. See *supra* notes 7-11 and accompanying text.

22. Ronald J. Gilson, *The Devolution of the Legal Profession: A Demand Side Perspective*, 49 MD. L. REV. 869 (1990). Professor Gilson states in connection with his analysis of the devolution of the legal profession:

The study of professionalism by lawyers and sociologists has been dominated by a myopic, albeit understandable, focus on the supply side of the traditional market for legal services. Similarly, the response of the organized bar to the perceived transformation of the profession into a business — what I have called here the devolution of the legal profession — focuses on supply side responses: exhortations, more or less specific, to rekindle the Brandeisian spirit in all of us. In contrast, my argument counsels a very different approach to professional renewal: *The promise for resurrecting important elements of professionalism lies in understanding the demand, not the supply, side of the market for legal services. The traditional structure of professionalism, dominated by elite outside counsel and sheltered by information asymmetry, has been rent by changes in the market.*

Id. at 916 (emphasis added; footnotes omitted).

enhance the economic base necessary for the sharing transaction to occur. The authors have thus inverted the relative importance of the tournament as a variable when compared to the external demand for services as each influences law firm growth. The authors casually note that declines in demand and revenue may result in the slowing of promotion and hiring, but they do so only as an afterthought (pp. 116-20). They should have analyzed the pervasive impact of demand for legal services on the capital-sharing model of the law firm.

III. THE THINLY CAPITALIZED LAW FIRM BUSINESS

To further highlight the importance of demand in explaining law firm growth, and to introduce the detailed analysis of the authors' reciprocal monitoring thesis contained in Part IV, I propose to address the following questions: What is a law firm in a structural and economic sense; how does it differ from other businesses?²³ The law firm exists as a very thinly capitalized entity that typically renders services for cash that is due upon presentation of a statement. It distributes profits periodically and generally does not retain significant earnings. It might accurately be described as a conduit for cash that first must be applied to expenses in the form of labor, office space, furniture and equipment, promotional costs, and the cost of borrowed money, if the firm's working capital is financed externally.

It accounts for its operations on a modified cash basis. This means that the law firm profit and loss statement matches cash revenues with accrued expenses and periodically distributes the difference to the partners as profit. Thus the modified cash basis of financial reporting accurately and usefully reflects operations. In contrast, the law firm's balance sheet less accurately portrays the financial position of the firm. It typically shows cash and other tangible assets owned, but *not* accounts receivable, on the left hand side, and current liabilities on the right hand side. Obviously, by ignoring accounts receivable this method of financial reporting will not provide an accurate measure of the firm's net worth, but this may be relatively unimportant in the law business if one views the principal revenue producing assets of the firm as intangible, i.e., human.

Why do most law firms not retain earnings in a manner similar to other businesses? Some law firms that are conservatively managed do retain income and reflect the retained amount as increases in the capital accounts of the partners. This, of course, reduces the current distributions to partners in the interest of having a reserve available to weather downturns in revenue collection. A variation on this practice distributes profits less frequently or considerably after their realiza-

23. In this Part, I draw on numerous conversations with former colleagues in law practice, executive directors, and consultants retained to analyze firm operations and productivity.

tion; in effect, delayed distribution amounts to a short-term loan from the partners to the firm.

More typical, however, are distribution policies designed to put current profits in the partners' hands soon after realization. Historically, pressure emanated from the partners to accelerate distributions because of personal needs for cash²⁴ and a historical pattern of ever-increasing profits that made the need for retention of profits seem unnecessary.

Finally, as partners developed opportunities to join other firms, they began to take into account the timeliness of return on their human capital, seen as their client base, as a major factor in determining whether they would stay at their firm. This was not lost on the managers of law firms; they did not want their productive partners to defect. Pressure mounted to distribute cash quickly and in larger amounts, driven in part by the fear of partner defection, accentuating the already thinly capitalized financial base of the law firm. This resulted in additional pressure on firms to require prompt payment from clients.

This explains why firms became ever more revenue-conscious. The determinants of associates' success in the firm focused more and more on the quantity of hours billed, because this measure translated directly into cash income when collected and increased the firm's percentage of marginal profit. Firms hired nonlawyer professionals to oversee collection and cost cutting. Yet reduction of costs effected limited savings and entailed the critical danger of compromising the quality of client service, so the driving force of the successful large law firm became revenue generation.

These financial dynamics in the modern law firm render the historical *partner-associate* nomenclature on which the authors rely less valuable for purposes of analyzing firm growth. What are partners and what are associates? The instinct to peruse Martindale-Hubbell is misplaced if one is seeking to understand what is actually happening in the law firm as business entity. A general partner in an enterprise has unlimited exposure for liabilities, contributes property or labor or both, has some say in management, and is entitled to both operating and liquidating distributions along with certain tax consequences. Not all of those listed as partners on the firm letterhead possess the most important rights of partnership; some are only nominal partners.

In contrast, an employee, by agreement or otherwise, works for a

24. As to the personal habits of an important partner, see Richard Behar, *A Lawyer's Precipitous Fall from Grace*, TIME, Mar. 16, 1992, at 52. The author notes how one of the former partners of Harvey Myerson in the failed New York firm of Finley, Kumble viewed Myerson's behavior as a cause of the failure of the firm. "In late 1987, not long after Myerson emerged as the firm's key partner, Finley collapsed into bankruptcy amid power clashes, soaring salaries and strangling debt. In his vengeful 1990 book, *Conduct Unbecoming*, former partner Steven Kumble tags Myerson as the main culprit in the breakup, partly because he squandered money."

fixed salary and may be terminated. Some partners' relationships to the firm resemble that of employment yet differ in that an employee, of course, generally has an unqualified right to accrued wages and does not share in the liabilities of the enterprise. The nominal partner generally *does* share in the firm's liabilities but legally has no right to distributions unless the firm generates profit.

The authors' thesis that partnership constitutes a "prize" in the form of deferred compensation also fails to recognize that partnership may be awarded only nominally. Employees may be presented as partners to the outside world. Their role in the firm, however, in terms of participation in management or compensation, will be severely curtailed or absent.²⁵ Accordingly, the increase in the number of partners in any given firm does not provide a reliable basis for the authors' promotional theory of growth.

The authors give some passing attention to the creation of nonequity partnerships and a "second-tier" status for associates as means of slowing growth (p. 118). They conclude their discussion of constraints on future growth of law firms by recognizing that "the firm will have junior partners, senior partners, members of the executive committee, managing partners, and the like" and that "the firm will become increasingly hierarchical and will take on the characteristics of the proverbial 'corporate ladder'" (p. 120). The authors also speculate about the future shape of the law firm (pp. 121-31), but they do not consider the functional relationships of the participants in the tournament and the external factors, such as demand for services, that make the tournament a dependent phenomenon.

With the general description of the law firm as a thinly capitalized entity and the distinction between partners and employees as background, I pose the following questions as means of assessing the validity of the components of the growth theory the authors construct. Do the authors accurately describe the tournament as a competition that results from a mechanism of governance of shared human capital with deferred compensation paid as a prize to the winners in exchange for their willingness to take less compensation in the short run as employees (associates)? Or is law firm promotion more comparable to the continuing competition among junior and senior vice-presidents seeking the next higher level of employment where, after the obligatory celebration, new competition for another promotion commences? And, more important, is there any predictable relationship between the deferral of compensation during the time spent as an employee and the rewards conferred by entry into the partnership? A coherent the-

25. Thus, rather than relying heavily on the Martindale-Hubbell directory of lawyers and law firms, the authors should have undertaken an independent empirical inquiry to determine whether the associate-partner ratios they employ in their tables represent meaningful and uniform data.

ory of growth in the modern large law firm must go beyond mere nomenclature and take into account the firm's capital structure and the participants' financial relationships.

IV. EVALUATING THE TOURNAMENT THEORY OF GROWTH

The authors expand their variation of the Gilson-Mnookin capital-sharing theory by adverting to monitoring of conduct between the partner and associate participants in the tournament. Establishing the validity of the monitoring function constitutes one of the indispensable underpinnings of their thesis. As an organizing feature of the promotional process, monitoring creates the discipline that rationalizes the structure and that powers exponential growth of the law firm.

In this section I analyze in detail the authors' description of the rules, rewards, and incentives of the tournament. They state:

[1] *The rules are simple. . . . In effect the firm holds a tournament in which all the associates in a particular "entering class" compete and the firm awards the prize of partnership to the top α percent of the contestants. The firm evaluates associates on their production of two goods: high-quality legal work and their own human capital. . . .*

[2] *The tournament provides the assurances and incentives required by both the associates and the partners. Associates now have an incentive to produce the maximum combination of legal work and human capital.*

[3] *By declaring in advance that, on average, it will promote a fixed percentage of the associates after a period of time, the firm has obligated itself to distribute a fixed amount of compensation to the winners of the tournament. Regardless of who wins the tournament the firm must pay out the same prizes. This point is essential to the firm's compensation scheme because it communicates to associates that it is in the firm's own interest to award the prize of partnership to those who have produced the largest combined bundle of output, quality, and capital. To award the prize on other grounds would saddle the firm with less productive attorneys at no savings in prize money.*

[4] *Moreover, the associate easily can verify that the firm pays out the agreed-to prizes by observing how the present and preceding classes fare and whether the firm continues to recruit new classes of associates.*

[5] *If the firm intends to continue recruiting new associates, current associates may safely assume that the firm will continue to adhere to the implicit contract rather than risk the adverse reputational and motivational effects associated with breaching. [pp. 100-02; emphasis added, footnotes omitted, paragraphing altered]*

The inclusion of the authors' statement seeks to minimize the possibility of misunderstanding the authors' description of the central elements of the tournament as the model for their thesis of growth.²⁶

26. I do not read the last four pages of chapter 5 (pp. 116-20), entitled "Confronting the Restraints on Exponential Growth," as intended to conflict with the theories advanced in the first part of the chapter (pp. 77-116). The authors cover their bets to some extent by recognizing

Each portion of the statement has significant flaws.

1. The "rules" of the tournament, if there are any, are not simple. The so-called entering class may over time be contracted and expanded by terminations, voluntary departures, and lateral hires, any of which may occur piecemeal or as the result of law firm mergers, special needs of cases, or otherwise. This obviously changes the calculus even in the last year of the tournament as to who may win or lose.

The authors render a picture of fixed, almost statutory, standards conveyed at the hiring point and designed to govern partners and associates for the entire period of the monitoring process. This was a truer picture of the law firm not so long ago. Lawyers were recruited with the pitch that the only important index of performance was "quality of work," as opposed to the quantity of hours billed. Clients came to the firm for very good legal work; qualitative rather than quantitative standards determined promotion. This, of course, created a believable and sometimes accurate picture of the law firm as a magnificent environment in which to apply one's intellect while making good money in the short run, and very, very good money in the long run.

In virtually all large law firms, however, the standards of promotion upon which one might have been recruited in, say, 1977, changed dramatically as the tournament developed. Consider a hypothetical memorandum from a firm executive committee in 1982 in which associates, who entered a firm that earlier espoused the quality-of-work pitch, were advised that "qualitative evaluations of associates will, of course, continue to take into account the commitment and contribution to the firm by associates in terms of billed hours, particularly in matters where the firm's clients require special efforts because of unique legal issues and important consequences flowing from their resolution." The message conveys the reality of a changing firm ethos; nothing remains permanent in an economic enterprise dependent on revenue for survival. Associates recruited in 1982 or 1987 (or 1992!) could only speculate about the timing and nature of future changes in the tournament they entered. The authors do not address the fluidity

external forces that may inhibit growth. They then abandon this hedge, however, on the next to last page of the book when they state:

But there is little to suggest that the great promotion-to-partner tournament is on the wane. Nothing has reduced both the partner's and the associate's need for protection from opportunistic conduct. Partners still require a method of motivating and monitoring associates. Associates continue to need assurances that hard work will be honestly evaluated and rewarded. The promotion tournament solves both problems. We can envision firms having more and more elaborated tournaments, and we see evidence of that in the tiering of partnerships and the firing of some associates earlier. We can see the reduction of the promotion-to-partnership core relative to the entire mass of the firm, but we find no evidence that the core is not going to continue to grow. [The authors note that firms may break apart and that there may be periods of decreasing growth] . . . The changes which have occurred and, we believe, will continue to occur, are designed to extend and supplement the tournament, not to replace it.

P. 137 (emphasis added).

of the "rules" of the tournament as a potential defect in the rationality of the system that they claim governs the tournament. There are many distortive forces.

First, the firm evaluation process, *in terms of who wins and who loses the tournament*, usually involves institutional factors that do not necessarily relate to "high-quality legal work" and "human capital," as subjective as these so-called "goods" can be individually. For example, how does a firm's strong desire to be known as a "national firm" affect the frequency of promotion? How is an associate, who is hired laterally and given six years of credit toward partnership, evaluated in comparison to associates who have spent their entire careers at the firm? What happens when the partner who recruited an associate and for whom the associate did excellent work for five years leaves the firm to become a judge, or when the partner's major client is taken over or goes bankrupt? What will be the effect, if any, of the firm's stated commitment to minorities and women in the promotional process? The authors fail to recognize how institutional factors beyond the power of the associate bear on the promotional process.

Second, the authors ignore several multiple and overlapping client relationships in the firm that must be considered in understanding the evaluation of associates. Each associate serves a complicated matrix of persons inside and outside the firm, each of whom has something to say about the ultimate promotional decision. Junior associates in large law firms frequently work for senior associates, who evaluate the juniors and report to other more senior associates or to a partner. Senior associates, nearer in time to the crucial promotion decision, obviously have their own interests uppermost in mind. Thus they may skew evaluative information on the juniors in order to impress the partner and thus promote themselves. Skewing may take the form of subtle nonsubstantive criticisms conveyed to the partner — for example, that the junior associate being evaluated does not adequately conform to "firm tradition" in executing legal work.

Inevitably, the work of an associate ranges beyond her own department to partners or senior associates in other specialized areas who lack the substantive knowledge necessary to evaluate her work reliably. These partners and senior associates are the internal patrons of the diversified entity — one of the benefits of practicing in large law firm. But in addition to not knowing much of the associate's area of expertise, lawyers for whom the associate works may have a separate departmental self-interest in promoting their own associates—an intrafirm rivalry—that can distort their evaluation of an associate outside their department.

The associate also interacts with the clients outside the firm, who constitute the all-important source of firm revenue. They, too, may play a substantial role in the evaluation process. These clients' evalua-

tions may emphasize personality, school and family background, gender, race, or age, or the willingness of an associate to tailor advice favorable to client objectives.²⁷

Third, the firm's needs over the life of the tournament also may distort the process of evaluation. The short-term need for hard-working junior personnel to carry out the objectives of a big legal project may result in an artificially high or at least vague interim evaluation of an associate, particularly when the partner knows that termination is available at the end of the tournament sequence. At that point, the firm may resort, perhaps with good reason, to different standards of assessing the goods. In any event, a strong possibility exists that the firm will convey indeterminate information to associates in order to discourage their departure from the firm.

When the authors observe that "award[ing] the prize on other grounds [i.e., not involving productivity] would saddle the firm with less productive attorneys" (p. 101), they merely state the obvious fact that the firm will act in its self interest. They ignore how the firm defines its institutional goals, the array of multiple clients who evaluate associate work, and the external business factors that alter the need for and value of personnel during the tournament. The authors' simplified explanation of promotion as a contest with relatively fixed rules does not adequately address the realities of the modern law firm associate.

2. No empirical evidence supports the proposition that the tournament provides reliable "assurances *and* incentives" required by partners and associates.²⁸ The authors elsewhere acknowledge the limitations on monitoring between the partner and the associate, which stem from the subjective nature of evaluation of associates' work:

Where part of A's [associate] compensation involves a possibility of promotion to an ownership interest in P's [partner] business, A also seeks assurance that, if he meets implicit conditions, P actually will promote him. . . . But monitoring output in the provision of legal services to clients is difficult and costly. While P can measure the number of hours A puts in, she has a more difficult time assessing how many "quality" hours A has worked. Ultimately, the assessment of A's output comes down to a subjective evaluation of performance by those charged with observing him. Because of the inherent subjectivity of the assessment, A cannot costlessly verify it. . . . Thus, no monitoring system can assure the honest reporting of A's contribution — an assurance essential to accurate compensation under an output-based or piece-rate compensation

27. Cf. Robert Gordon, *The Independence of Lawyers*, 68 B.U. L. REV. 1, 33-36 (1988).

28. Of course I am not asserting that I have empirical data establishing the contrary. I am simply stating that the authors have failed to establish even a *prima facie* case for the existence of real assurances and incentives.

scheme — because A cannot independently verify (prove) his precise contribution. [pp. 96-97]

This touches upon but understates the asymmetry of information, bargaining power, and authority that exists in the large firm partner-associate relationship. Only recently have law firms supplied associates with any of the hard data, such as billed and collected or written-off hours, that they use in the evaluation process.

Even if provided with reliable data to monitor the partners, associates lack an effective enforcement mechanism other than leaving the firm or transferring to a different department. If the latter option exists at all, it disappears after the first couple of years of practice because of specialized departmental functions; one simply cannot easily retool into a different substantive area of the firm. In short, when the firm breaches the bargain, the associate's only meaningful remedy is to depart the firm, a decision which carries its own perils, including uncertainty and lack of reliable information. Placement specialists brokering the market for associates usually work on a commission basis and thus have a conflict of interest that makes them suspect as sources of reliable information. Other than the questionable hearsay of contemporaries and anecdotal reports in publications such as *The American Lawyer*, means of verification do not exist.

A firm cannot be entirely whimsical in its promotion policies without suffering from associate attrition and a bad recruiting reputation. Except for cases of gross departure from established procedures, however, meaningful monitoring and enforcement of the promotion bargain by the associate are very difficult.

3. No firm of which I am aware does, or reasonably would, "obligate itself to distribute a fixed amount of compensation to the winners of the tournament." *A fortiori*, the firm never is *meaningfully* bound to pay out the same "prizes." Indeed, as the authors seem to suggest in the concluding four pages of Chapter Five, there may be no winners of the tournament if the firm is beset by general economic problems.²⁹ Associates may be promoted to partner, but declines in firm revenue may cause them initially to make less money as partners than the remaining associates. Thus the prizes may be dramatically different, and may be enjoyed only temporarily, if the firm fails to cope with a business decline or what the authors call inadequate human capital.

As noted in Part III, the elevation of an associate to the nominal status of partner does not have independent significance to the firm or the person.³⁰ One must know the financial ramifications of promotion to understand whether or not it reflects a change from employment status to real partnership. Most of the financially sophisticated part-

29. See *supra* note 26.

30. See *supra* text accompanying notes 24-25.

ners in a law firm know their power as partners in the firm derives directly from their ability to attract clients and enhance firm profits.

There are, of course, partners who view the firm's promotion of associates as fulfilling an implied obligation undertaken many years ago to reward fairly both loyalty and good work. Discussions of promotion to partner do sometimes include terms such as "obligated" or "promoting a fixed percentage of associates." In recent history, however, the dialogue frequently is wrenched back to reality by the partners' having real power (a much smaller population than those listed in the Martindale-Hubbell directory), who influence promotion according to whether it positively or adversely affects the financial viability of the firm. The outcome of the tournament turns on such cold-blooded self-interest, colored as it is by the institutional factors that have been described and by the prevailing business climate in the firm when the promotion decision is made. These comments should be interpreted not as criticism of the firm but rather of the authors' failure to consider a much broader array of factors bearing on the outcome of the tournament.

4. Observing rates of promotion for present and preceding classes does not, contrary to the authors' statement, provide a reliable index for monitoring firm conduct. Associates may *attempt* to use promotion rates to monitor the conduct of the firm. But rates of promotion in the short run only reflect the indecipherable interplay of institutional, business, and individual factors. The relative importance, if any, of rates of promotion as a predictive mechanism cannot be deduced in the compressed time in which monitoring must occur. In short, one cannot extrapolate future promotional patterns from the past. Even if the firm deviates intentionally or otherwise from the bargain struck at the inception of the tournament, the mix of available data, even assuming complete access by the associate, creates only a speculative basis for monitoring.³¹

The firm operates with considerable latitude in how it promotes and terminates; also, promotional decisions constitute only a part of business decisionmaking. Do we conclude from the actions a firm takes in a one- or two-year period that it continues to adhere to past practices of promotion, has repudiated such practices, or is merely engaging in short-term aberrational conduct? Even the managers of the firm may not have confident answers to these questions.

5. Finally, monitoring of firm recruiting does not necessarily serve as a meaningful index of the reliability of near-term promotional

31. This broad generalization has exceptions. An associate may realize that her chances for promotion are excellent under almost any circumstance because of the obvious, undisputable value of her services. At the opposite extreme, an associate may know that, no matter how valuable he has been in contributing to the work of the firm, he has virtually no chance of promotion.

prospects, at the very least for some of the reasons stated in the preceding paragraph. The economic and institutional considerations motivating recruiting of new associates may reflect temporary responses to current business conditions. Recruiting needs may not correlate to a firm's decision to promote senior associates. In the long run, as the authors state, there may be some correlation between recruiting and promotion, but recruiting behavior in the short term generally does not confirm whether the firm will perform any implicit bargain thought to arise at the point of hiring.

CONCLUSION

Even with the defects and omissions in the authors' growth hypothesis, their book should be praised as a lucid history and a stimulant to further academic inquiry. In this general sense, *Tournament of Lawyers* may be of most value as a medium for focusing the now-considerable law school resources in the social sciences³² on the study of law firms and lawyers.³³ Recent developments suggest that the relation of the law firm even to its clients may be undergoing fundamental change as a result of alterations in law firm operation and structure over the past decade.³⁴ A period of stability — the authors described an earlier one as the golden age of the large law firm, circa 1960 (pp. 20-36) — may return, but it is not in sight in 1992.

Interestingly, the law school, as the creator of a large part of the human capital the authors describe, has remained relatively immune from the upheaval occurring in law firms. But there exists at least anecdotal evidence that law schools now may be experiencing some of their own financial stresses with respect to sources of revenue. If this becomes a trend, what will be the effect on the law school of the future? To date, the seemingly sparse academic study of the law profession has been directed *from* the law school *to* the law firm and lawyers. Very little academic energy has been focused on how the law school conceives of its purposes — both the purely academic and the instructional — in relation to what goes on in the changing world of the law firm. There has been virtually no commentary on the obligations a law school undertakes in the bargain it strikes with its student clientele

32. Professor Ellickson advanced the view that the law and economics movement should "increasingly look to psychology and sociology in order to enrich the explanatory power and normative punch of economic analysis." Robert C. Ellickson, *Bringing Culture and Human Frailty to Rational Actors: A Critique of Classical Law and Economics*, 65 CHI.-KENT L. REV. 23, 23 (1989). Indeed, one could assert that the social sciences outside of the realm of economic analysis might serve well as independent sources of inquiry concerning a wide range of legal and social issues. In particular, I believe there is an acute need to apply these disciplines to study not only the modern lawyer and law firm, but also to explore the functions and motivations of the law schools and law teachers, who supply human capital to the legal profession.

33. The authors even suggest in a footnote that a study of law faculty promotional practices would be valuable. See *supra* note 6.

34. See *supra* note 4.

as they enter the academic equivalent of the tournament described by the authors. We do know that many of the consumers of legal education go deeply into debt in order to enter and pay for the training and evaluation process that qualifies them for large law firm employment and promotion.³⁵ Are their expectations met? Are they prepared? In stimulating thought on these issues, Professors Galanter and Palay in *Tournament of Lawyers* give the reader much to think about beyond their theory of law firm growth.

35. One of my students, employing the terminology of economic analysis suggested by Professors Gilson and Mnookin, described law students' borrowing to pay for law school simply as a collection of individual mini-leveraged buyouts similar in form to the megabusiness transactions of the 1980s. The slight variation, of course, substitutes human rather than hard assets as the capital burdened by substantial debt that must be repaid from the returns, if they materialize, on a leveraged investment in legal education. Historically, the investment paid handsome returns monetarily and otherwise over the career of the large firm lawyer. The future remains uncertain at least in terms of the numbers of students who will realize on their investment.