

A PERSPECTIVE ON THE LEGAL HIRING MARKET

THE CLASS OF 2009: RECESSION OR RESTRUCTURING?

BY WILLIAM D. HENDERSON

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What do the NALP numbers really mean? Are we experiencing a major recession or, alternately, a fundamental reordering of the legal services industry?

Every year, NALP reports the employment data for recent law school graduates. Yet, because of the mass layoffs and deferrals taking place over the last two years, special attention is now focused on statistics for the Class of 2009. To its credit, NALP's May 2010 press release (www.nalp.org/2009selectedfindingsrelease) and accompanying Selected Findings (www.nalp.org/classof2009) are remarkably candid documents that attempt to square our perceptions of "The Great [Legal] Recession" with data that show, on the surface anyway, a relatively mild downturn in legal employment.

The seemingly encouraging baseline is an overall employment rate of 88.3%, which is only 3.6 percentage points off the historical high of 91.9% set for the class of 2007. Yet, as noted by the NALP analysis, these figures lose their luster when the numbers are pulled apart. Specifically:

- Approximately 25% of the jobs are temporary in nature.

- A substantial number of graduates are "employed" by law firms but still deferred and without start dates.
- An estimated 2 percentage points of jobs nine months out were supplied by the law schools themselves. This pattern was very uneven, ranging from a few students at some schools to dozens at others.
- 10% of all jobs were part-time, versus 6% for the prior year.
- 22% of those employed were "still looking for work," compared to 16% from the prior year, which suggests a larger proportion of graduates are underemployed.
- The percentage of grads in solo practice increased from 1.9% to 2.9% of all jobs and accounted for over 5.0% of law firm jobs.

Yet, what do the NALP numbers really mean? There is a nettlesome question on the minds of

most law students, law school deans, and law firm partners these days: Are we experiencing a major recession or, alternately, a fundamental reordering of the legal services industry? As someone steeped in the history and statistics of the profession, my money is definitely on the latter. These changes affect both law firms and law schools. Let's start with the former.

STRUCTURAL CHANGES AFFECTING LAW FIRMS

One of the reasons that the current uncertainty is so traumatic for law firms is that it is juxtaposed with several decades of relentless growth and prosperity. According to government statistics, between 1978 and 2003, the percentage of Gross Domestic Product (GDP) allocated to legal expense increased from 0.4% to 1.9%. We know from other sources, such as NALP and the Chicago Lawyers I and II studies, that virtually all of the real income gains during this

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period went to lawyers in private practice who serve large organizational clients — i.e., not small firm or solo practitioners serving the needs of individuals or mom and pop businesses.

Private law firm lawyers prospered during this period because of broader changes occurring in our society. Indeed, over the last 30 to 40 years, the bull market for legal services has been driven by such factors as the growing size and complexity of business, additional state and federal regulation, higher stakes commercial litigation, changes and innovations on Wall Street, and the growth of foreign trade and business opportunities.

This surge in demand for corporate legal services has been the impetus behind the dramatic growth of large law firms. Rather than experiment with new entrants in order to control legal expenses, corporate clients favored established law firms. The relative scarcity of established “brand name” corporate law firms relative to demand meant that law firms could prosper without any significant tinkering with their conservative and traditional business model. Indeed, the firms prospered by adding ever larger classes of entry-level associates (and higher partner/non-partner leverage), which shaped the expectations of aspiring lawyers all the way down to the 21-year-old college senior who was sitting for the LSAT.

One of the downsides of running a conservative but highly profitable business model — and, certainly, such downsides are few — is that law firms were destined to be ill-prepared if

ever exposed to truly competitive market forces. That reckoning is now upon us.

The crux of the problem is that the supply of “brand name” legal talent globally — the very employers who have set salary expectations and absorbed thousands of law school graduates annually — now meets or exceeds the demand. The capacity of this sector is enormous. Over the last 30 years, the average firm in the National Law Journal 250 (measured by number of lawyers) has grown by more than 500%. During this same period, the average number of branch offices has increased from 2.5 to 12. According to a recent study I completed with sociologist Art Alderson, approximately 117 of the NLJ 250 now have branch office networks that are functionally equivalent of one another. The practical implication of this finding is that firms with similar practice areas and geographic capabilities can now be pitted against one another to contain or drive down prices.

Yet, excess capacity tells only part of the story. As legal budgets inside corporations have continually outstripped the growth in company revenues, general counsel increasingly don the hat of manager as well as company lawyer in order to control or drive down expenses. With so much money at stake, it is now cost-effective to build sophisticated cost control systems that enable in-house lawyers to compare law firm price and quality over time. Although these metrics are currently being developed and deployed by only a small proportion of Fortune 500 companies, they are gradually gaining momentum as peers in other in-house departments witness their effectiveness in stretching legal budgets.

Even without sophisticated tools, in-house lawyers are obtaining cost savings through a “disaggregation” process that unbundles the services of junior attorneys from highly experienced senior lawyers and sends the lower level work to outsourcing firms or contract attorneys. Although clients are still willing to pay \$500 to \$1,000 per hour for seasoned partners, the type of work that has long supported the large law firm leverage model is starting to dry up. Going forward, the legal services sector will be subject to the same bottom line imperative as other private companies: workers and managers will have to figure how to do more with less.

MOVING FROM INPUTS TO OUTPUTS

The economic forces affecting legal employers are destined to have a major impact on law schools and legal education. With changes in information technology, law firms in the years to come will be evaluated less by the pedigree of their lawyers and more by the quality and cost-effectiveness of their service. Academic credentialing, after all, serves as a heuristic for ability. A better indicator of quality is recent past performance — and this is exactly what the Association for Corporate Counsel hopes to achieve by its Value Challenge initiative, which includes a database that compiles law firm information-based perceptions of technical expertise, responsiveness, efficiency, and value. Legal On-Ramp, which is an online forum for in-house lawyers, is essentially pursuing the same agenda at the individual practitioner level.

Within the law school world, the movement to an output-based world requires enormous change in mindset. If you ask a law faculty member what distinguishes a top-ranked school from its second, third, or fourth tier counterparts, he or she is likely to say that the top-ranked school has better scholars. While that may be true, the economic stature of top-ranked law schools is almost entirely a function of a school’s place within the law firm entry-level hiring market. In a series of articles, UCLA professor Russell Korobin has argued persuasively that law school rankings are not a measure of academic quality (as law professors believe they ought to be). Rather, they serve a coordination function that enables the smart, motivated students to meet up with employers who offer the most attractive employment opportunities.

Professor Korobin’s theory of legal education is supported by strong empirical evidence. In 1998, the Association for American Law Schools commissioned a study to assess the validity of the *U.S. News & World Report* annual rankings of law schools. One of the study’s most significant findings was that 90% of the variation in the overall rankings could be explained just by the entering credentials of the students admitted.

My own research with Professor Andrew Morriss further supports the input-based nature of the entry-level law firm hiring market. In a statistical model that focused on the

number of law firms that came to a school to conduct on-campus recruiting, we observed that a school's median LSAT score in combination with its *U.S. News* rank explained approximately 75% of the variation in OCI recruitment patterns. A much smaller portion of the OCI activity is explained by geographic proximity – all else being equal, a middle-ranked school in a major legal market will garner significantly more corporate law firm interest than a comparably ranked school in a remote location. Recent work by Professor Paul Oyer at Stanford Business School documents that another fraction of law firm hiring is based upon alumni connections.

In reality, there is very little variation in hiring patterns left which could be imputed to things like quality of a law school's curriculum or the rigor of its teaching. Law professors like to argue that educational quality ought to matter. I agree. But that is not the world we live in. As an economic and empirical matter, law school outputs appear to be totally irrelevant to the law school hiring market. Yet, one output – employed at nine months – has a significant effect on annual movements in the *U.S. News* rankings. As a practical matter, these changes in the rankings are too small to significantly impact on employer behavior. Yet, within law schools themselves, rankings are the proverbial tail that wags the dog.

The people who understand this reality best are law school deans. Many deans begin their tenures with inspiring plans for the future of their law schools. But they soon discover that important constituents, such as alumni, students, and the university central administration, are very focused on minor changes in the school's *U.S. News* rankings. A ten spot drop in the rankings can easily derail efforts to improve the curriculum. And a drop from the second to third tier can easily end a deanship.

Because of reduced law firm hiring, the Class of 2009 employment numbers are something very much on the minds of law school deans. The advent of *U.S. News* rankings 20 years ago seemed to reinforce an implicit law school hierarchy that was already in place. (For evidence on this point, see Charles Kelso's 1972 study commissioned by the AALS, which documented a strong correlation between a school's educational resources, such as faculty size and library holdings, and its placement with large and medium-sized law firms. See Charles Kelso, *The AALS Study of Part-Time Legal Education*, 1972.) When *U.S. News* made this hierarchy more explicit, a school's academic reputation became reinforced by the LSAT and undergraduate GPAs of its entering students. As a result, significant movements in the *U.S. News* rankings are virtually impossible to achieve. Conversely, relatively small movements, which dramatically affect the morale of students, alumni and faculty, can be driven by very small changes in the underlying inputs.

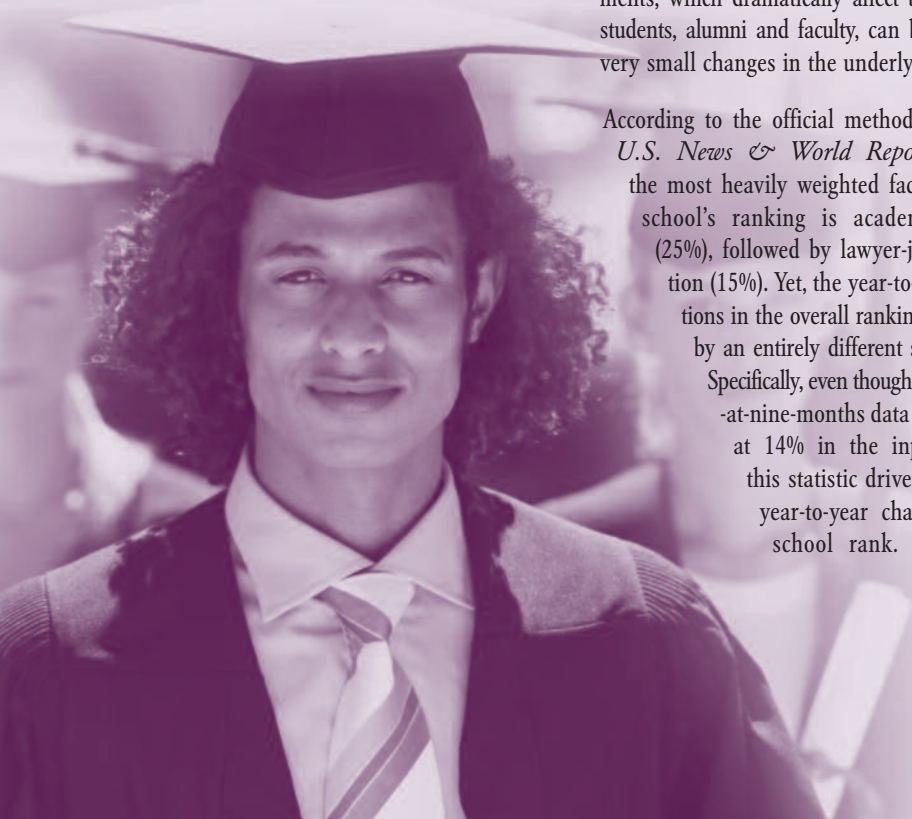
According to the official methodology of the *U.S. News & World Report* rankings, the most heavily weighted factor in a law school's ranking is academic ranking (25%), followed by lawyer-judge reputation (15%). Yet, the year-to-year fluctuations in the overall rankings are driven by an entirely different set of factors. Specifically, even though the employed-at-nine-months data are weighted at 14% in the input formula, this statistic drives 23% of the year-to-year changes in law school rank. The second

most influential input in year-to-year change is direct expenditure per student. Academic reputation, despite its 25% weighting, accounts for only 6% of the annual movements.

The disparity between official weighting of the *U.S. News* rankings and year-to-year fluctuations is driven by idiosyncrasies in how the underlying inputs are aggregated into a single, unitary score. To make inputs like LSAT, UGPA, reputation, employment, and bar passage commensurable, *U.S. News* transforms each input array into "standardized scores" where the average or median score is roughly zero and a school's relative position is measured in standard deviations. For example, in 2009, Harvard and Yale topped the list in academic reputation, with input scores of 2.82 standard deviation units. In contrast, my law school, Indiana University, had an academic reputation of 0.94 standard deviation units – well above average, but nearly two units removed from our elite counterparts.

One of the idiosyncrasies of using standardization is that scores can be heavily influenced by outliers. For example, there is a hard cap on LSAT scores. Therefore, the highest LSAT input in the *U.S. News* rankings formula is roughly 1.6 standard deviation units – once again, Harvard and Yale. Yet, in theory, there is no absolute limit on per pupil expenditures – the sky is the limit. Therefore, with expenditures of nearly \$100,000 per pupil, Yale Law School is roughly 5.8 standard deviation units from the mean, over 1.5 units ahead of Harvard, whose per pupil expense equals only \$80,000 per year. In all probability, this explains Dean Elena Kagan's laser-like focus on fundraising. In the long run, increasing endowment dollars is the only way that Harvard will ever top Yale in the annual *U.S. News* rankings.

Yet, far and away the most troubling and problematic input is the input about graduates employed nine months after graduation. Although this statistic has a hard cap of 100% employment, in theory a school's entire class could be unemployed. Yet, for the Class of 2008, the median employed at nine months data was a remarkable 96.0%. Thus, within the *U.S. News* rankings formula, the top ranked schools tended to top out at 1.00 standard deviation years. Yet, many lower ranked law schools have input scores in the range of -1.00



to -5.00 standard deviations. As a result, a very small change in a school's employed-at-nine-months data can produce a drop of ten or more places in the *U.S. News* rankings.

The practical effect of this system is that law schools have a strong incentive to use Enron-like accounting methods to prop up their employment numbers. Yet, the employment data for the Class of 2009 may be the straw that breaks the camel's back. Law schools that train our nation's future leaders cannot afford to squander their reputation capital by misleading entering students. Similarly, the ABA Section on Legal Education can no longer preside over an accreditation system that accurately counts the number of books in the law school library but cannot make a distinction between the law school graduate who works for Goldman Sachs versus Best Buy. According to the official ABA statistics, both work for business. Indeed, any law school graduate who needs to pay the rent will quickly become employed.

Yet, what law students and prospective students want to know is very reasonable: how will their \$100,000+ legal education enhance their overall employment prospects over the course of their lifetimes? This is an empirical question worth answering. And in the output-based world we are now entering, it is all that really matters.

CHANGES ON THE HORIZON

Most law firm managing partners and administrators I talk with privately acknowledge that the world has fundamentally changed. What stymies the retooling process is the difficulty of convincing millionaire partners that their business model is broken. For many, the phone is still ringing. Their clients are willing to hire them. Because prosperous partners often have relatively short time horizons, they are likely to be skeptical of any changes in their human capital model that costs them either time or money.

Yet, changes in the recruiting model have been forced upon them by general counsel who reacted to the associate salary wars (which produced the now famous bi-modal salary distribution) by refusing to pay exorbitant hourly rates for first- and second-year associates. General counsel reasoned that many of these lawyers leave the firm before they understand the clients' businesses or have any

practical legal expertise. If law firms have to absorb the cost of training first- and second-year lawyers, they have a strong incentive to hire fewer of them and keep them longer.

These dynamics do not necessarily favor the most highly ranked law schools. Data from the *After the JD I and II* studies document that elite law school graduates tend to be less satisfied in large law firm environments and tend to leave at higher rates. Similarly, data I have analyzed from the *National Law Journal* show that regional law schools' graduates become partner at higher rates than their elite law school counterparts, even at many of the nation's most prestigious law firms. A simple explanation for this pattern is that corporate law is not for everyone and that a disproportionate number of elite law school graduates gravitated toward this sector because it pays well, looks good on their résumé, and enables them to pay off their debt. Yet, these are not the kind of lawyers that fit the corporate law firms of the future.

Going forward, we can expect to see fewer associates hired by large corporate law firms and more rigorous screening, including behavioral interviews, psychometric tests, and parsing of résumés in search of non-academic indicators associated, at statistically significant levels, with long-term success within particular law firms. In an environment where clients increasingly evaluate firms based on value, grades and law school attended are less important.

In reality, changes in law firm hiring patterns are an enormous opportunity for law schools to shake up the traditional hierarchy. Law schools that can demonstrate that their "outputs" – smart, motivated, well-trained, and versatile graduates – match up well with the needs of legal employers will inevitably create more job options for their students. Most law students are very capable. In the future, their competitive advantage may be the quality and relevance of the training they received in law school – i.e., the value added. ■