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A COMMENT ON PROFESSOR HENDERSON'S EMPIRICAL STUDY OF SINGLE-TIER VERSUS TWO-TIER PARTNERSHIPS IN THE AM LAW 200

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As a practicing attorney asked to comment on a law review article rife with statistical analysis, I hope to provide a pragmatic view of Professor William Henderson's perceptive work—*An Empirical Study of Single-Tier Versus Two-Tier Partnerships in the Am Law 200.*

Professor Henderson's Article is a thorough analysis of a complex subject. I certainly agree with the observation that "the superior profitability of single-tier firms appears to be primarily a function of their reputational capital (and presumably the lawyers and clients the firm attracts) rather than the tier structure per se."[1] However, contrary to Professor Henderson's statement that the superior profitability of large single-tier firms is "surprising," I do not think there are many Am Law 200 partners who are the least bit surprised that such single-tier firms are more profitable than their two-tier competitors.

If one examines the *2005 National Law Journal 250*, only about twenty percent of those firms have single-tier partnerships.[2] Examining the list of single-tier firms with principal offices in one of the largest seven U.S. markets,[3] it appears that virtually all are at the top of any list of law firms based on reputation and prestige. Those firms have not moved to a two-tier structure because they (thus far) have no strong reason to do so. The rewards of achieving partnership with those firms are so great, in terms of prestige and compensation, that excellent attorneys from top law schools will work long hours for many years even if the odds of achieving partnership may be

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1. William D. Henderson, *An Empirical Study of Single-Tier Versus Two-Tier Partnerships in the Am Law 200*, 84 N.C. L. REV. 1691, 1727 (2006).

2. *See 2005 NLJ 250*, NAT'L L.J., Nov. 14, 2005, at 316, S16–S32.

3. These markets are New York, Los Angeles, Chicago, Washington, D.C., San Francisco, Boston and Houston, according to the *NLJ*. *Id.*

relatively slim. Moreover, those firms routinely handle sizeable matters—transactions or litigation—that are staffed with many associates at premium rates.[4] Thus, it is not at all surprising that those firms are more profitable than their two-tier competitors.

I respectfully disagree with Professor Henderson's suggestion that "[t]he higher level of profitability of single-tier partnerships cannot be explained by higher leverage,"[5] as he suggests single-tier partnerships average lower leverage than two-tier partnerships. This might appear to be true based upon the artificial definition of leverage used by *The American Lawyer* in its analysis of major law firms.[6] I would hope that most practicing lawyers in large firms would not view second-tier partners as the precise equivalent of associates in analyzing leverage. In my experience, partners are treated as partners regardless of their particular tier (though I am confident Professor Henderson is correct in his remarks about the voting rights of second-tier partners[7]). Thus, if one views leverage as the ratio of associates to all partners in a law firm, I am confident that single-tier firms have equal or greater leverage than two-tier firms, which surely is a factor in the former's greater Profits Per Partner ("PPP"). That said, even if non-equity partners are viewed as associates in determining leverage, they are certainly a more expensive form of leverage.

Ultimately, I am of the opinion there are two primary reasons why law firms adopt two-tier partnership structures: apparent profitability and concern for colleagues and clients. While on some level these may seem to be conflicting reasons, they are not really at odds.

As noted above, Professor Henderson and *The American Lawyer* equate most non-equity partners as associates in analyzing law firms' PPP. Thus, even someone who last studied statistics as an undergraduate decades ago understands that excluding lesser-paid

4. Billing rates, a key driver of revenue and profitability, are one economic component that receives scant mention in Professor Henderson's Article. Yet, there is little doubt that the high-prestige single-tier firms charge premium rates for the majority of their work. In my experience, two-tier firms often have a broader array of practice groups, including some that are likely to have difficulty charging premium rates due to competitive pressures. As an employment attorney in a two-tier firm, I am very familiar with the pressures to keep our rates competitive with smaller firms that specialize in employment law.

5. Henderson, *supra* note 1, at 1696.

6. Leverage "is the ratio of all lawyers to equity partners," and equity partners "are those who file a schedule K-1 tax form and receive no more than half their compensation on a fixed income basis." *Guide to Our Methodology*, AM. LAW., July 2005, at 109, 109.

7. Henderson, *supra* note 1, at 1711–12 & n.87.

partners from a calculation of PPP will result in a higher published PPP figure. The law firm has not truly made more profits. But the outside world is looking at a PPP figure that reflects only the firm's higher-paid partners (in accordance with the Am Law methodology). This benefits the two-tier firm in its ability to attract both merger candidates and lateral partner candidates. This is no small thing in today's legal marketplace, where many firms believe they must grow or they will wither away.

Law firms also have adopted two-tier partnership structures in an effort to retain solid attorneys who have knowledge, experience, and valuable skills—but who lack either a significant book of business or some other quality that would qualify them for the first tier of partnership. Firms want to retain these experienced attorneys who help form the fabric of the firm. They also want to retain these attorneys whose continuing relationship with the firm benefits clients who are better served by experienced partners with reasonable billing rates as opposed to less senior associates whose lower rates cannot offset their lower levels of knowledge, experience, and efficiency. Of course, these partners' long-term relationships with clients help bind those clients to the firm. Thus, the retention of partners in a second tier benefits both the law firm and its clients.[8]

Whether in single-tier or two-tier partnerships, it is easy for most large-firm attorneys to appreciate Professor Henderson's observation that the average annual billable hours worked by partners has risen steadily from 1,538 in 1985 to 1,703 in 2003.[9] As the practice of law among large firms has become more of a business, the focus on financial performance has increased—and billable hours still generate revenues. While Professor Henderson's Article states that "[o]nce admitted to the partnership, a lawyer in a single-tier firm has little incentive not to shirk,"[10] such a statement is unsupportable. At most Am Law 200 firms, all attorneys—both partners and associates—work very hard. Some partners spend significant hours in necessary non-billable activities such as firm management, client relations, and business development. Moreover, partners are motivated by more than money—professional responsibility, pride, and intellectual challenge are motivators as well. Finally, my sense of today's large law firms is that they react fairly quickly to underperforming partners,

8. Given the relatively recent significant increases in associate compensation among Am Law 200 law firms, it seems to me that clients and firms are getting far more value from non-equity partners relative to less experienced associates.

9. Henderson, *supra* note 1, at 1710.

10. *Id.* at 1694.

and there are financial (or worse) consequences for those who underperform.

While Professor Henderson's Article is replete with keen observations too numerous to mention, it also demonstrates how much the profession of law has morphed into the business of law. Fortunately, not all law firm business decisions are based solely or primarily on economics. Firm culture and collegiality remain important considerations for me and many other attorneys.

Despite these minor points of contention with Professor Henderson's Article, he presents a cogent analysis of partnership structures among large U.S. law firms. It merits the close attention of both academics and practitioners.