

# Law Firms and Associate Careers: Tournament Theory Versus the Production-Imperative Model

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*Pray look better, Sir, quoth Sancho; those things yonder are no  
Giants, but Wind-mills . . . .*<sup>1</sup>

The career of an associate in a large law firm has been portrayed in stark Darwinian terms: Only the fittest survive the “tournament” that is established by the firm’s partners. Such is the tale told by Marc Galanter and Thomas Palay in *Tournament of Lawyers: The Transformation of the Big Law Firm*.<sup>2</sup> This “tournament theory” explanation for the structure of large law firms has been widely adopted,<sup>3</sup> and has received surprisingly little criticism.<sup>4</sup>

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1. MIGUEL DE CERVANTES, DON QUIXOTE DE LA MANCHA 44 (Peter Motteux trans., revised by John Ozell, 1950) (1605). The Spanish text reads: «Mire vuestra merced—respondió Sancho—que aquellos que allí se parecen no son gigantes, sino molinos de viento . . . .» 1 MIGUEL DE CERVANTES, DON QUIXOTE DE LA MANCHA 198–99 (Angel Basanta ed., 1985) (1605).

2. MARC GALANTER & THOMAS PALAY, TOURNAMENT OF LAWYERS: THE TRANSFORMATION OF THE BIG LAW FIRM (1991) [hereinafter GALANTER & PALAY, TOURNAMENT]; see also Marc Galanter & Thomas M. Palay, *Why the Big Get Bigger: The Promotion-to-Partner Tournament and the Growth of Large Law Firms*, 76 VA. L. REV. 747 (1990) [hereinafter Galanter & Palay, *Big Get Bigger*]. Compare GALANTER & PALAY, TOURNAMENT, *supra*, at 100 (“[T]he 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  $\alpha$  percent of the contestants.”) with CHARLES DARWIN, ON THE ORIGIN OF SPECIES 170 (facsimile of 1st ed. 1964) (1859) (“[N]atural selection . . . gives rise to all the more important modifications of structure, by which the innumerable beings on the face of this earth are enabled to struggle with each other, and the best adapted to survive.”).

3. See, e.g., Alex M. Johnson, Jr., *Think Like a Lawyer, Work Like a Machine: The Dissonance Between Law School and Law Practice*, 64 S. CAL. L. REV. 1231, 1251 (1991); S.S. Samuelson, *The Organizational Structure of Law Firms: Lessons from Management Theory*, 51 OHIO ST. L.J. 645, 654 (1990); Richard H. Sander & E. Douglass Williams, *A Little Theorizing About the Big Law Firm: Galanter, Palay, and the Economics of Growth*, 17 LAW & SOC. INQUIRY 391 (1992) (mildly criticizing but adopting tournament theory). Anthony Kronman cites *Tournament of Lawyers* heavily and, while he does not explicitly adopt tournament theory, he does state that “[t]he associates in a law firm are in competition, primarily for partnerships.” ANTHONY T. KRONMAN, THE LOST LAWYER: FAILING IDEALS OF THE LEGAL PROFESSION 301–02 (1993).

4. What criticism there has been focuses on factors not captured by tournament theory, failing to note that the very basis of tournament theory, monitoring costs, renders the theory inapplicable to law firms. See Vincent Robert Johnson, *On Shared Human Capital, Promotion Tournaments, and Exponential Law Firm Growth*, 70 TEX. L. REV. 537, 553–55, 559–60 (1991) (book review) (criticizing Galanter and Palay for relying on economic rationality, failing to incorporate “lateral hiring, partner defections, law firm mergers,

This Note argues that an associate's employment contract does not enact Mr. Herbert Spencer's *Social Statics*.<sup>5</sup> It demonstrates that tournament theory is inapplicable to large law firms<sup>6</sup> and proposes an alternative model of law firm structure. It argues that, because serious monitoring difficulties do not exist, law firms need not adopt a tournament for their associates. Moreover, it shows that a tournament would not motivate all associates, nor would the tournament be sustainable in the face of changing economic conditions outside the firm. It then presents empirical evidence suggesting that firms are not in fact employing tournaments. This Note proposes that law firm structure is determined not by the operation of tournament theory, but by a production-imperative model. This model suggests that the type of work performed in law firms dictates their structure, that law firms hire associates to keep their costs down and profits up, and that associates come to large firms mainly to improve their lawyering skills and increase their general human capital.

Part I of this Note presents the tournament theory explanation of law firm structure. Part II examines the economics literature about tournaments and concludes that tournament theory is not applicable to law firms. It criticizes tournament theory for predicting too much about law firms—namely, that tournament theory also requires partners to progress through a series of tournaments throughout their tenure at a firm. The Part demonstrates that tournament theory fails to consider that many associates may not be participating in the tournament. It also shows that a tournament would be unstable because of fluctuations in the market outside the firm, and presents evidence that, contrary to Galanter and Palay's assertion, a fixed percentage of a firm's entering classes are not promoted to partner. Having rejected the dominant explanation for law firm structure, the Note goes on to develop an alternative model that more accurately reflects the reality of law firm life. Part III proposes the production-imperative model, in which law firm production requirements, the desire of young attorneys to develop their human capital, and

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and spinoffs" into their model, and slighting importance of demand for legal services); Frederick W. Lambert, *An Academic Visit to the Modern Law Firm: Considering a Theory of Promotion-Driven Growth*, 90 MICH. L. REV. 1719, 1734 (1992) (book review) (asserting that Galanter and Palay's "simplified explanation of promotion as a contest with relatively fixed rules does not adequately address the realities of the modern law firm associate").

5. See HERBERT SPENCER, *SOCIAL STATICS* 415 (New York, D. Appleton & Co. 1865) (1850) ("If [beings] are sufficiently complete to live, they *do* live, and it is well they should live. If they are not sufficiently complete to live, they die, and it is best they should die."); cf. *Lochner v. New York*, 198 U.S. 45, 75 (1905) (Holmes, J., dissenting) ("The Fourteenth Amendment does not enact Mr. Herbert Spencer's *Social Statics*."). In the United States, Spencer was even more influential in social theory than Darwin. RICHARD HOFSTADTER, *SOCIAL DARWINISM IN AMERICAN THOUGHT* 31 (rev. ed. 1955).

6. For the importance of large law firms to understanding the legal profession, see KRONMAN, *supra* note 3, at 272-73; ROBERT L. NELSON, *PARTNERS WITH POWER: THE SOCIAL TRANSFORMATION OF THE LARGE LAW FIRM* at x-xi, 1 (1988); Vincent R. Johnson & Virginia Coyle, *On the Transformation of the Legal Profession: The Advent of Temporary Lawyering*, 66 NOTRE DAME L. REV. 359, 364-65 (1990); Elizabeth Chambliss, *New Partners with Power? Organizational Determinants of Law Firm Integration* 7-10 (1992) (unpublished Ph.D. dissertation, University of Wisconsin (Madison)).

market demand interact to create the associate career patterns characteristic of large law firms.

### I. GALANTER AND PALAY'S TOURNAMENT MODEL OF LAW FIRM STRUCTURE

This Part discusses the origin of tournament theory in economics and outlines Galanter and Palay's incorporation of tournament theory in their description of law firm structure. Tournament theory arose when economists attempted to explain a puzzling feature of the labor market. Although ordinary market theory states that workers will be paid the marginal product of their labor,<sup>7</sup> an executive typically receives a dramatic pay increase if he or she is promoted from among several vice presidents to become the chief executive. It seems implausible that only several days after the promotion the new chief executive is contributing dramatically more to the company than he or she had as a vice president so as to warrant the pay increase. Tournament theory attempts to explain why earnings might be tied to job category rather than to productivity. Since it is difficult to determine the productivity of "supervisory or managerial" workers in a bureaucracy,<sup>8</sup> firms turn to a tournament to motivate their workers. The tournament model focuses on the incentives created for all workers by a prize awarded to the "tournament" winner.<sup>9</sup>

Galanter and Palay offer the most developed application of tournament theory to law firms. Their story of law firm structure starts by emphasizing the importance of human capital. In economics, the classical factors of production are land, labor, and capital. "Capital" refers to goods that are employed to increase the productivity of land and labor (e.g., machinery).<sup>10</sup> By analogy, the term "human capital" is now used to refer to "the stock of skills and productive knowledge embodied in people."<sup>11</sup> The more human capital someone has, the more productive, *ceteris paribus*, he or she will be. Human capital is classified as either general or specific. Specific human capital raises a worker's productivity, but only with respect to a single firm. General human capital raises a worker's productivity for many jobs or firms.<sup>12</sup>

In Galanter and Palay's view, an attorney has four main types of human capital: (1) general intelligence and education; (2) legal skills gained through

7. *E.g.*, INGRID H. RIMA, LABOR MARKETS, WAGES, AND EMPLOYMENT 115 (1981).

8. Henry Hansmann, *The Ownership of Enterprise* 58 (July 1994) (unpublished manuscript, on file with author).

9. Edward P. Lazear & Sherwin Rosen, *Rank-Order Tournaments as Optimum Labor Contracts*, 89 J. POL. ECON. 841, 841-42 (1981); Barry J. Nalebuff & Joseph E. Stiglitz, *Prizes and Incentives: Towards a General Theory of Compensation and Competition*, 14 BELL J. ECON. 21, 21-22 (1983).

10. K.H. Hennings, *Capital as a Factor of Production*, 1 THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS 327, 329 (John Eatwell et al. eds., 1987).

11. Sherwin Rosen, *Human Capital*, 2 THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS, *supra* note 10, at 681, 682.

12. GARY S. BECKER, HUMAN CAPITAL 33-34, 40 (3d ed. 1993).

education and experience; (3) professional reputation; and (4) client relationships.<sup>13</sup> The level of human capital varies from lawyer to lawyer. Some lawyers have a surplus of human capital; others do not have enough. Those lacking in human capital can be seen as having "surplus labor"—they cannot on their own generate sufficient business to keep busy. An attorney with *excess* human capital, on the other hand, will have too many potential clients to handle by him or herself, because that attorney's labor is limited to what one person can do. When an attorney with excess human capital cannot accomplish all that he or she could without time constraints, some of the attorney's human capital languishes unused. Such a lawyer would benefit if it were possible to rent this surplus human capital to attorneys with surplus labor.<sup>14</sup>

While, ordinarily, simple market transactions (i.e., contracts) are sufficient to govern the lending of most assets from one party to another, this is not true for human capital. The unique nature of the asset and of the investments necessary to transfer it means that it is hard to substitute another "surplus labor" attorney once a transaction is undertaken;<sup>15</sup> that is, it would be costly to familiarize a new attorney with a half-completed project. Additionally, it would be difficult or impossible to specify adequately all of the terms and conditions that might be necessary as circumstances change during a project-length contract. This would leave an attorney hired under such a contract relatively unsupervised, which would put the reputation and client relationships of the lawyer with excess human capital at risk.<sup>16</sup>

Given these problems with project-length labor contracts, attorneys with excess human capital will instead enter into long-term employment relationships with attorneys lacking adequate human capital. This is the genesis of the law firm. Although governing the employer/employee (or, as it is commonly termed in the legal profession, partner/associate) relationship is less costly than engaging in a series of project-length contracts, Galanter and Palay suggest that monitoring the actions of associates will still be "difficult and costly."<sup>17</sup> Among the problems that arise in the supervision of the partner/associate relationship is that an associate could leave before the firm receives adequate return on its investment in associate training and client development. The associate might even be able to lure away clients upon departure. An associate also might "shirk"; that is, not work as hard as is necessary or expected. Although deferred payment (e.g., bonuses after set time periods) might help solve the problems of premature leaving and client stealing, it would not alleviate shirking. While payment based on worker

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13. GALANTER & PALAY, *TOURNAMENT*, *supra* note 2, at 89–90.

14. *Id.* at 90–92. Not all human capital can be shared (e.g., innate intelligence, intuition), but much can be (e.g., knowledge of what strategy will be most effective, client relationships). *Id.* at 91–92.

15. *Id.* at 94–95.

16. *Id.*

17. *Id.* at 96.

productivity ordinarily provides adequate incentive to work hard, Galanter and Palay assert that it is hard to evaluate, or monitor, how hard attorneys are working; therefore, payment based on productivity cannot alleviate associate shirking in law firms. Instead, according to Galanter and Palay, firms adopt a “promotion-to-partner tournament.”<sup>18</sup>

The “tournament” provides a deferred bonus that gives associates an incentive to stay with the firm *and* to work hard. The tournament among a firm’s associates operates, according to Galanter and Palay, in this manner: A limited but fixed percentage of associates will, after a set time period, be promoted to partner and receive a “superbonus.”<sup>19</sup> This superbonus consists of the security, prestige, and large income<sup>20</sup> that partnership confers. The firm will pick the winners of the tournament based on their human-capital development (since partners need to have excess human capital to share with associates who have surplus labor) and on the quality and quantity of their work product. The firm’s adherence to its promise to promote is easily monitored by associates.<sup>21</sup> Thus, the firm solves the problem created by its inability to monitor associate output effectively, and by its need to recover its investment in associate training, by creating a promotion-to-partner tournament. This tournament motivates associates to work hard and to remain with the firm.

## II. THE FAILURE OF TOURNAMENT THEORY AS AN EXPLANATORY MODEL OF LAW FIRM STRUCTURE

While tournament theory offers an intriguing explanation for associate career patterns in large law firms, Galanter and Palay invoke the theory without fully explaining it and demonstrating its applicability to law firms. This Part examines the economic model of tournament theory and ascertains whether it applies to law firms. It finds that while promotion from associate to partner bears a superficial similarity to the promotion among executives that was the impetus for the development of tournament theory, tournament theory cannot credibly be extended to explain law firm structure. This Part then explains that, contrary to the predictions of tournament theory, law firms do not exhibit a multitiered tournament among partners. It further argues that not all associates are motivated by the prospect of partnership as Galanter and

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18. *Id.* at 99–100.

19. *Id.* at 100.

20. Law firm partners share the firm’s profits. A number of systems are utilized to divide the profits among partners. These range from productivity-based to seniority-based. 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, 340 n.46, 341 (1985).

21. GALANTER & PALAY, TOURNAMENT, *supra* note 2, at 100–02. Galanter and Palay go on to explain how the tournament, although devised to solve the monitoring problem, actually creates a mechanism whereby a firm grows exponentially. *Id.* at 102–08. The issue of firm growth, however, does not concern us here; this Note focuses solely on the structure of associate career patterns.

Palay suggest. Moreover, it demonstrates how a tournament would be unstable in the face of economic changes outside of a particular law firm and presents empirical evidence that law firms are not utilizing a tournament with a fixed promotion rate to motivate associates.

A. *The Economic Model of Tournaments and Its (Non-)Applicability to Law Firms*

Galanter and Palay rely on the economic tournament model elaborated by James Malcomson,<sup>22</sup> who in turn built upon the work of Lorne Carmichael.<sup>23</sup> Carmichael developed a promotion model that is based upon the high cost of monitoring employees. This model explains why firms might pay workers based on their seniority rather than on their marginal product. Firms need workers to develop specific human capital in order for the firm to function efficiently. After an initial period of training, the worker is aware of his or her job satisfaction and the firm is aware of the worker's productivity. This information is asymmetric, however.<sup>24</sup> It is very costly for the firm to learn the worker's job satisfaction and for the worker to ascertain his or her productivity.<sup>25</sup>

Once the worker has achieved seniority, he or she is more productive because of the firm-specific human capital he or she has developed through experience. Therefore, it will be inefficient if too many workers leave after the initial training period (i.e., if there is too much "turnover"). A solution might be for the firm to pay more to workers during the second period of their employment (that is, after the initial training period), thereby giving workers incentive to stay with the firm during their period of higher productivity. Nevertheless, if the firm commits itself to paying more in the second period it will have too great an incentive to fire workers after the first period to save costs. Carmichael asserts that a better solution would be for the firm to institute a seniority system, in which a trained worker is promoted into the higher-wage position if he or she is the senior trained worker when a high-wage position becomes available (as through a high-wage worker's retirement). Carmichael demonstrates that, in the face of firm-specific human capital and

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22. *Id.* at 100 n.45; James M. Malcomson, *Work Incentives, Hierarchy, and Internal Labor Markets*, 92 J. POL. ECON. 486 (1984).

23. Lorne Carmichael, *Firm-Specific Human Capital and Promotion Ladders*, 14 BELL J. ECON. 251, 251-52 (1983).

24. "Asymmetric information" is a term used to describe situations in which two or more transacting parties have different information. This can lead to inefficiencies in, or even the absence of, contracting. A familiar example is the used car market, where buyers will only have information on average quality, while sellers will have more specific information about their cars' quality. A seller with an above average car will thus be unable to obtain its true value on the market. See George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488, 489-90 (1970).

25. Carmichael, *supra* note 23, at 251-52.

workers' inability to know their true productivity, such a seniority system will lead to an efficient level of turnover.<sup>26</sup>

Carmichael's use of seniority systems provided a foundation for James Malcomson to develop a model of tournaments. Malcomson's model assumes that the output of a particular worker cannot be determined precisely. Instead, a supervisor must make a subjective evaluation of worker productivity. The information that the supervisor collects is asymmetric in the sense that the worker cannot verify the validity of the supervisor's determination. In this situation, if workers are paid based on their (subjectively evaluated) output, their performance will be suboptimal because of the uncertainty as to whether they will be paid more for additional effort (because of error in the supervisor's assessment). In other words, the workers will react to imprecise measuring by working less diligently. Both the workers and the employer, however, would be better off if the workers were paid accurately for their efforts and worked more.<sup>27</sup>

Malcomson suggests that in such a situation a firm should react by offering a contract according to which, after a period of evaluation, a fixed percentage of workers will receive the higher wage during their next period of employment.<sup>28</sup> This promise is easily verifiable by the workers. Furthermore, the firm will grant the higher wage in the second period to the most productive employees in order to create the greatest incentive for workers to be productive.<sup>29</sup>

Malcomson's model might be applied to law firms, as in *Tournament of Lawyers*, if being made partner were equivalent to receiving the higher wage during the second period.<sup>30</sup> The first period of employment might be seen as the period during which attorneys serve as associates.<sup>31</sup> Yet the crucial

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26. *Id.* at 252, 255-57.

27. Malcomson, *supra* note 22, at 487, 492-93.

28. *Id.* at 487, 492-95.

29. *Id.* at 487-88, 493. Malcomson demonstrates mathematically that the promotion system is preferable to traditional performance-based pay given difficulties in monitoring worker output. *Id.* at 498-99, 502-06.

Paying the more productive workers the higher wage will also increase the firm's likelihood of being able to retain its most productive employees. Carmichael, *supra* note 23, at 252, 255-57. Note that the firm will not have an incentive to underreport workers' efforts: A fixed percentage of workers must be paid the higher wage regardless of absolute effort levels. Only relative effort matters. Malcomson, *supra* note 22, at 493.

30. This would generally be true. Depending on the firm's profitability and its method of dividing profits among partners, however, a new partner's income might actually dip *below* that of a senior associate. *See, e.g.,* D.M. Osborne, *Latham Sheds Its Skin*, AM. LAW., June 1993, at 62, 66. Nonetheless, the discounted present value of the new partner's future income stream would rise when he or she became partner (otherwise, such a partnership offer would not be accepted).

31. One benefit of Malcomson's model is that it does not mandate any particular action with respect to those workers who are not tournament winners. This is appealing as a model of law firm structure in light of the fluid nature of law firms' treatment of associates not promoted to partner. Gilson and Mnookin posited an "up or out" system as the traditional norm and attempted to explain recent moves towards the incorporation of "permanent associate" and "senior attorney" positions within firms. Ronald J. Gilson & Robert H. Mnookin, *Coming of Age in a Corporate Law Firm: The Economics of Associate Career*

motivating factor in Malcomson's, and in Galanter and Palay's, model is asymmetric information. In Galanter and Palay's explanation of law firm structure, the firm cannot cheaply and accurately verify associate productivity, and the associates cannot count on the accuracy of the firm's subjective evaluations. This monitoring problem, and nothing else, motivates the firm's adoption of a tournament. In the absence of monitoring difficulties, the firm would adopt a traditional compensation scheme, paying workers based on their productivity.<sup>32</sup> The absence of the monitoring problem in law firms makes Malcomson's model inapplicable in that context.

Although the idea that monitoring associate output is particularly difficult and costly has some support, it is unconvincing when fully analyzed. Armen Alchian and Harold Demsetz, in an article on the monitoring costs of the principal-agent relationship,<sup>33</sup> suggest that attorneys are costly to monitor because team production makes it difficult to measure an individual associate's output.<sup>34</sup> At the same time, attorney inputs are difficult to measure because much of a lawyer's effort occurs only in his or her mind.<sup>35</sup> This view has been adopted by many commentators on the organization of law firms. These authors, however, do not examine or test the monitoring cost hypothesis. Instead, they merely adopt it uncritically.<sup>36</sup>

The view that attorneys are difficult to monitor breaks down under closer analysis. First, it is not difficult to evaluate attorney work product. For associates in large corporate law firms, output often consists of documents written by a single attorney.<sup>37</sup> Therefore, even when a team of lawyers is working on a case, it is not particularly difficult to keep track of the output of

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*Patterns*, 41 STAN. L. REV. 567 (1989). Others have argued persuasively, however, that the up or out system was never completely dominant, and that its relative prominence was more a phenomenon of the 1960's and 1970's than a fixed "norm" of large law firms. GALANTER & PALAY, TOURNAMENT, *supra* note 2, at 28-29, 100 n.46. Still more recently, it appears as if the move towards utilizing a tier of permanent associates is on the wane. Amy Stevens, *Lawyer with Six Years of Experience, Top Credentials, Seeks Job, Any Job at All*, WALL ST. J., July 22, 1994, at B1 ("When the recession hit the law in the late '80s, several major firms experimented with 'staff attorneys' and other career nonpartner positions. But for the most part, firms have abandoned the alternate tracks in favor of the old-fashioned 'up or out' policy . . ."). A model, like Malcomson's, that requires neither permanent associates nor an up or out policy is therefore appealing. It leaves to secondary factors the determination of what happens to associates who do not make partner. This is preferable to reaching a fixed result from within the model, because such a result would not be able to account for changing patterns among real-world law firms.

32. See *supra* notes 17-18 and accompanying text.

33. Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972).

34. See *id.* at 780, 786.

35. *Id.* at 786.

36. See, e.g., Michael C. Jensen & William H. Meckling, *Rights and Production Functions: An Application to Labor-Managed Firms and Codetermination*, 52 J. BUS. 469, 502 (1979); Samuelson, *supra* note 3, at 647; Stephen David Silberman, *The Market, the Firm and Delivery of Legal Services* 111, 113-14 (1975) (unpublished Ph.D. dissertation, Yale University). Even Malcomson cites Alchian and Demsetz in his article on tournament theory. Malcomson, *supra* note 22, at 487.

37. Hansmann, *supra* note 8, at 58.



individual attorneys.<sup>38</sup> Moreover, monitoring the quality of such output is not usually a *cost* to the firm; instead, it is customary for a partner to read and revise the written work of associates. This work (and the partner's expertise in reviewing the final product) is expected by clients, who pay the partner's customary hourly fee<sup>39</sup> for such work.<sup>40</sup> Thus the monitoring of associate output goes along with a partner's billable work at little additional cost.

Perhaps even more important, it is not difficult or costly to monitor how assiduously associates are working. The firm tracks associates' hours carefully for billing purposes.<sup>41</sup> It is relatively costless for the firm to aggregate this information and utilize it in evaluating an associate for pay or promotion purposes.<sup>42</sup> While some have claimed that it is impossible to evaluate the "quality" of a billable hour,<sup>43</sup> it is in fact customary practice for partners to review bills and "write off" associate time that appears excessive.<sup>44</sup> Since partners have enough experience to estimate the range of time a task should take they could give associates credit only for hours worked that are actually billed to the client.<sup>45</sup>

The use of billable hours to monitor associates' work should also be effective because it does not create any asymmetries of information between

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38. *Id.* See generally Jeanne Q. Svihart et al., *Evaluating New Lawyers*, in *YOUR NEW LAWYER* 210 (Michael K. Magness & Carolyn M. Wehmann eds., 2d ed. 1992) (describing how to monitor and evaluate associates).

39. Law firms typically charge a higher hourly rate for partners than for associates. See, e.g., Osborne, *supra* note 30, at 64; Judy Sarasohn, *Client Pressure Holds Down Fees*, *LEGAL TIMES*, Nov. 22, 1993, at 13, 14.

40. See RICHARD N. FEFERMAN, *BUILDING YOUR FIRM WITH ASSOCIATES* 55 (1988) (discussing billing clients for partner time devoted to "associate supervision").

41. Law firms typically bill clients by the hour for attorney work. "Hourly rates are still the most common way of charging clients . . ." Sarasohn, *supra* note 39, at 14; see also *Law Firms Still Wary of Alternative Billing*, *LEGAL INTELLIGENCER*, May 4, 1993, at 5.

42. See Fred S. McChesney, *Team Production, Monitoring, and Profit Sharing in Law Firms: An Alternative Hypothesis*, 11 *J. LEGAL STUD.* 379, 383 (1982); see also Gilson & Mnookin, *supra* note 20, at 372 ("The great majority of law firms use detailed time records buttressed by close personal observation to identify malingerers."). Ever-ingenious associates might be able to subvert "close personal observation," however. *From Last to First*, *AM. LAW.*, Oct. 1992, at 68 (quoting Weil, Gotshal & Manges associate regarding practice of associates leaving "their office lights on and papers strewn on their desks to make it appear they are working late").

It should also be noted that a firm should be able to observe and take into account short-term productivity dips that are attributable to personal matters rather than to shirking. Gilson & Mnookin, *supra* note 20, at 373. Even if such matters were costly for the firm to monitor, it would be in the associate's own interest to inform the firm of such excuses for lower productivity. See ROBERT MICHAEL GREENE, *MAKING PARTNER: A GUIDE FOR LAW FIRM ASSOCIATES* 65 (1992).

43. See, e.g., Silberman, *supra* note 36, at 114 ("[Time records] offer no evidence of quality . . ."); see also Alchian & Demsetz, *supra* note 33, at 786 (discussing difficulties inherent in monitoring lawyers' use of billable time).

44. See, e.g., EDWARD POLL, *ATTORNEY AND LAW FIRM GUIDE TO THE BUSINESS OF LAW* 84 (1994); Donald S. Akins et al., *Compensation and Benefits*, in *YOUR NEW LAWYER*, *supra* note 38, at 223, 228; Steven Brill, *1987: Bye, Bye, Finley, Kumble*, *AM. LAW.*, Sept. 1994, at 35, 37.

45. Note that a partner has no particular incentive to question an associate's billable hours so long as the client does not object to paying for them. The possibility for tacit collusion between partners and associates to charge at the high end of the reasonable range thus exists. Such collusion is, however, subject to the client's ability to exit the relationship or to decline to be a repeat customer of the firm.

the associates and the firm. Associates typically receive monthly compilations of their billable hours.<sup>46</sup> If the firm does not provide such information, it is easy for associates to make a copy of their timesheets before turning them in to partners or to the billing department.<sup>47</sup>

An empirical study that sought to test the Alchian and Demsetz theory provides further support that an explanation of law firm structure should not be predicated upon difficulties in monitoring associate output. Arleen Leibowitz and Robert Tollison investigated the relationship between firm size and monitoring costs.<sup>48</sup> They rejected the idea that attorney work was difficult to monitor (finding it obvious that lawyer shirking could be controlled by monitoring billable hours), and instead chose to focus on whether firm size affected the ability to monitor and control expenditures on "operating expenses and payroll."<sup>49</sup>

Indeed, it is ironic that Alchian and Demsetz single out law (and other professional) firms as presenting difficult monitoring problems.<sup>50</sup> In reality, it is enormous firms such as industrial corporations where some workers specialize in "supervisory or managerial tasks," that present the greatest challenges to measuring worker output and inputs.<sup>51</sup> In service firms, in contrast, each worker produces work that is, typically, billed directly to the client.

Because associates can be easily monitored, it is implausible to rely, as do Galanter and Palay, upon the Malcomson model of tournament theory, which

46. Telephone Interview with William James, Esq., Blanc, Williams, Johnston & Kronstadt (Jan. 10, 1995).

47. Even if large law firms were to shift to "value billing" for all of their tasks, partners could continue to monitor the quality of associate work product. *See supra* notes 8–40 and accompanying text. The term "value billing" refers to a variety of non-hourly billing methods, such as contingency fees or flat rates for a given task. Paul D. Roy & Alan P. Levine, *In-House Counsel Reject Value-Billing*, NAT'L L.J., Nov. 20, 1989, at S2. Additionally, firms could keep an internal hours-monitoring system in place at little cost, *see* ROBERT J. ARNDT, *MANAGING FOR PROFIT: IMPROVING OR MAINTAINING YOUR BOTTOM LINE* 66 (1991), and to the extent that associates work with different attorneys on different teams in a given year, the average output of an associate's teams could be used as a proxy for that associate's marginal output.

48. Arleen Leibowitz & Robert Tollison, *Free Riding, Shirking, and Team Production in Legal Partnerships*, 18 *ECON. INQUIRY* 380 (1980).

49. *Id.* at 386. Although Leibowitz and Tollison found that, as firms expand beyond five partners, monitoring expenses increase, *id.* at 388, this result does not provide support for a tournament theory of law firm structure driven by the problems of monitoring costs. The fact that a large law firm might experience difficulties in preventing partners from hiring extra support staff or purchasing expensive office machinery does not suggest that it will adopt a tournament among its associates in order to motivate them to work harder. Additionally, an expense-monitoring explanation of law firm structure suffers from two serious weaknesses of its own. First, the existence and success of large law firms suggest that factors besides expense monitoring must be important. Leibowitz and Tollison concede as much. *Id.* at 381, 382–83, 390 (discussing existence of factors that make large firm size possible in spite of fact that expense-monitoring costs increase with firm size). Second, in reality, expenses play a relatively insignificant role in law firm management and profitability. JOHN G. IEZZI, *RESULTS-ORIENTED FINANCIAL MANAGEMENT: A GUIDE TO SUCCESSFUL LAW FIRM PERFORMANCE* 6, 16 (1993); ARNDT, *supra* note 47, at 77.

50. Alchian & Demsetz, *supra* note 33, at 786.

51. Hansmann, *supra* note 8, at 58; *see* McChesney, *supra* note 42, at 383. Alchian and Demsetz's proposed solution in the face of high monitoring costs is worker profit sharing. Alchian & Demsetz, *supra* note 33, at 786. Most large industrial corporations are investor-owned, however, with shareholders receiving residual profits. For reasons why this investor-owned structure might be preferable for large industrial corporations while professional firms are typically employee-owned, *see* Hansmann, *supra* note 8, chs. 5–7.

is based on the especially high costs of monitoring worker output, in order to explain law firm structure. Put simply, Malcomson's tournament model is inapplicable to the law firm, because attorneys are not difficult to monitor.<sup>52</sup>

### B. *The Missing Tournament Among Law Firm Partners*

Another factor limiting the applicability of tournament theory to law firms is the theory's prediction that partners would participate in a series of tournaments throughout their careers.<sup>53</sup> If the costs of monitoring attorneys are high enough to require a tournament among associates to keep them motivated to work, partners would require a similar motivation, necessitating another (or perhaps several) tournaments at the partnership level.

Not even Galanter and Palay argue that law firm partners compete in a tournament in which only a fixed percentage are "promoted."<sup>54</sup> Yet under their theory partners not engaged in a tournament would work inefficiently.<sup>55</sup>

52. While Galanter and Palay relied upon Malcomson, other models of tournaments exist in the economics literature. None, however, is applicable to law firms. Nalebuff and Stiglitz present one alternative model, but neither of their two underlying assumptions applies to law firms. One of their assumptions is that firms have difficulty monitoring worker input. Nalebuff & Stiglitz, *supra* note 9, at 23-24. The other is that firms experience economic shocks from outside forces that affect the productivity of all of the firm's workers and are observable by them, but are unobservable to the firm. *Id.* Such shocks would not seem to be a part of the economics of law firms. The common shocks that hit a law firm (e.g., a slowdown in corporate work) are every bit as observable to the partners as to the associates. See, e.g., Thom Weidlich & Marian Raab, *Jobs in the Law: Changing Picture*, NAT'L L.J., Aug. 15, 1994, at A1 (detailing easily observable "ebb and flow of demand for different kinds of expertise").

Theodore Bergstrom proposed a tournament-like model, not based on monitoring difficulties, in which workers are allocated between job categories. Theodore Bergstrom, *Soldiers of Fortune?*, in 2 EQUILIBRIUM ANALYSIS: ESSAYS IN HONOR OF KENNETH J. ARROW 57 (Walter P. Heller et al. eds., 1986). Bergstrom demonstrates that in most situations it would be more efficient to use a random lottery system to divide workers, at equal pay, into "farmers" and "soldiers" than to pay a higher wage to soldiers in order to attract enough workers into that job category. (His model assumes that at equal wages all workers prefer to be farmers.) *Id.* at 58-59. While Bergstrom's model is interesting and counterintuitive, it is not applicable to law firms. Law firms are not faced with the problem of paying certain workers a higher wage to perform a less desirable job; instead they pose the question of why a fraction of lower-paid workers with less desirable jobs move into higher-paid, more desirable positions. For an interesting "restatement of Bergstrom with a different interpretation," see Brendan O'Flaherty & Aloysius Siow, *Promotion Lotteries*, 7 J.L. ECON. & ORGANIZATION 401, 403-08 (1991).

53. Michael A. Leeds, *Rank-Order Tournaments and Worker Incentives*, 16 ATLANTIC ECON. J. 74, 77 (1988) ("Proper incentives are possible in the context of tournaments only if they are continuously repeated.").

54. See generally GALANTER & PALAY, *TOURNAMENT*, *supra* note 2. For ease of exposition, we will continue to speak about the law firm as composed of partners and associates. Some firms, for example Kirkland & Ellis and Hopkins & Sutter (both headquartered in Chicago), choose certain associates to become nonequity partners after six to seven years and then choose only some of the nonequity partners to become full partners after another two to three years. Telephone Interview with Mike Foradas, Esq., Recruiting Chairman, Kirkland & Ellis (Jan. 20, 1995); Telephone Interview with Nancy A. Villano, Legal Recruiting Coordinator, Hopkins & Sutter (Jan. 20, 1995); see NATIONAL ASS'N FOR LAW PLACEMENT, DIRECTORY OF LEGAL EMPLOYERS 596, 602 (1994) [hereinafter NALP DIRECTORY]. One could analyze this as two successive tournaments. The key point of the argument in the text above, however, is that even at these firms an attorney might still spend the preponderance of his or her career as a full partner not participating in a tournament.

55. See Malcomson, *supra* note 22, at 494 (discussing how one tournament leaves workers unmotivated during their post-tournament employment).

Partners do share in the firm's profits, so the harder a partner works the higher the firm's profits and thus that partner's profits. However, this work incentive is seriously diluted by the large number of partners. That is, while each partner directly enjoys the fruits of slacking off, some of the cost (reduced profitability) is foisted onto the other partners (to the extent that profits are shared apart from productivity and/or to the extent that the partner is not "caught" shirking).<sup>56</sup>

One might argue that partners could be sufficiently motivated by "firm culture." In other words, by the time attorneys become partners, they have been socialized (by working hard as an associate, in law school, and indeed to get into law school) to work hard even without much of an economic incentive.<sup>57</sup> Yet this explanation is unsatisfying because under tournament theory the associateship period is not one of gentle socialization to the firm, but rather one of hard work created by the incentive to make partner. It would thus be unpersuasive to argue that the tournament selects out those young attorneys with a "natural" work ethic who can then be entrusted with a relatively non-incentivized partnership. The tournament actually makes all associates work hard; that is its function.

Tournament theory, then, predicts too much about law firms. Firms are not organized as an endless series of tournaments; we must therefore question the extent to which the structure of even associates' careers may be seen as a tournament.

### C. *Tournaments: Problems of Participation*

An additional problem with applying tournament theory to law firms is that many associates may not be participating in a "tournament." Galanter and Palay assume that all associates are participating in the tournament for partnership.<sup>58</sup> To motivate hard work by associates, tournament theory relies upon the incentive created by associates' desire to make partner. However, many associates may not take the chance of making partner into account in deciding whether to work for a firm, or in deciding how hard to work once they are there.<sup>59</sup> Associates may accept a job with a firm to acquire certain

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56. Leibowitz & Tollison, *supra* note 48, at 381; McChesney, *supra* note 42, at 381.

57. Gilson & Mnookin, *supra* note 20, at 375, 378-79.

58. GALANTER & PALAY, TOURNAMENT, *supra* note 2, at 102 n.49 ("The expected value of an associate's compensation depends upon his money wage, his chance of becoming a partner, and, if offered, the value of a partnership share.").

59. "Associates came for training, contacts, and the allure of the Paul, Weiss name on their resumes. They did not come, they say now, for partnership. No one . . . will admit to starting at Paul, Weiss with the goal of making partner eight years later." Alison Frankel, *What Ever Happened to the Class of '83?*, AM. LAW., Oct. 1993, at 53, 55. This article details the career paths of the associates who joined the firm in 1983.

Most of the associates who left in [1986 and 1987], however, had gotten what they expected from Paul, Weiss: hard work, long hours, and a lot of experience. They flocked out in 1986 and

skills, intending to move on well before attaining partnership.<sup>60</sup> Additionally, as long as the salary offered by a large firm is higher than the salary that could be earned in another job,<sup>61</sup> law school graduates with a particularly strong desire for a high wage will choose the law firm job, even absent *any* imputed compensation from the chance to become a partner. Recent graduates might seek out the highest available wage, taking less account of the “labor leisure tradeoff”<sup>62</sup> than would most workers,<sup>63</sup> for at least two reasons. First, they tend to be younger and have fewer time commitments (e.g., children)<sup>64</sup> than most of the workforce. Second, they may be burdened with debt.<sup>65</sup> Tournament theory thus fails to capture the real motivations of many new law firm associates.

#### D. *Tournaments: The Destabilizing Effects of Outside Economic Forces*

An additional important point ignored by Galanter and Palay’s model, and by most of the economics literature, is that associates’ careers within a firm do not occur against a stable economic background outside the firm.<sup>66</sup> As the

1987 because they wanted to spend the rest of their careers differently. “Everyone knew very few people stayed for the long haul.”

*Id.* at 56 (quoting former associate).

60. “These young lawyers are using the firm as a general training ground, and the probability of making partner does not matter to them.” Arleen Leibowitz & Robert Tollison, *Earning and Learning in Law Firms*, 7 J. LEGAL STUD. 65, 73 (1978). “[S]ome . . . recruits are not interested in long-term careers with [the firm they go to work for]. Instead, they seek postgraduate skills training to become competent lawyers, and they know that the private corporate law firm is the best place to acquire that training.” JOEL F. HENNING, *MAXIMIZING LAW FIRM PROFITABILITY: HIRING, TRAINING AND DEVELOPING PRODUCTIVE LAWYERS* 3-1 (1993); see also Laurie Anne Albright, *An Analysis of the Practice of Corporate Law from a Critical Theory Perspective* 44 (1991) (unpublished Ph.D. dissertation, University of San Francisco) (reporting that some attorneys join large firms for skills training; others hope to work on large *pro bono* cases). A full discussion of the human capital development aspects of the employment relationship between law firms and associates may be found in Section C of Part III.

61. In most cases, salaries at large law firms exceed those at other jobs open to law school graduates. Thus, in Chicago most large law firms pay first-year associates \$70,000. The Legal Department of the First National Bank of Chicago pays \$60,000 to beginning attorneys. The Department of Law of the City of Chicago pays new attorneys \$34,428 per year. New hires at the Chicago Field Office of the Internal Revenue Service earn \$35,048. NALP DIRECTORY, *supra* note 54, at 44, 65, 589, 596-97.

62. Another way of stating this is that, given their debts, the relatively high wage available at large law firms leads to the substitution effect (high wage means leisure more costly  $\implies$  consume less of it) dominating the income effect (income up  $\implies$  purchase more of all goods, including leisure).

63. “Production or nonsupervisory workers on nonfarm payrolls” have worked, on average, just under 35 hours per week during recent years. Bureau of Labor Statistics, U.S. Dep’t of Labor, *Current Labor Statistics*, MONTHLY LAB. REV., Dec. 1993, at 75, 100.

64. See Jennifer A. Kingson, *Women in the Law Say Path Is Limited by “Mommy Track”*, N.Y. TIMES, Aug. 8, 1988, at A1, A15 (discussing family commitments arising after birth of children that lead some associates to abandon partnership quest).

65. See Judy Klemesrud, *Women in the Law: Many Are Getting Out*, N.Y. TIMES, Aug. 9, 1985, at A14 (describing attorneys who, burdened by debt, joined large law firms but are now leaving due to firms’ heavy time demands).

66. *But cf.* Christopher Ferrall, *Promotion & Incentives in Partnerships: Theory & Evidence* 4, 22 (Queen’s Univ. (Canada) Discussion Paper No. 808, 1991) (noting that prospect of making partner becomes meaningless once associate can get job (“lateral out” in parlance of legal profession) with another entity that offers higher overall expected utility).

attractiveness of the other job opportunities available to associates outside of their current law firm fluctuates, the incentives provided by a tournament also change dramatically. A certain percentage chance of making partner looks more attractive when lateral opportunities are scarce, and less attractive when high-paying outside jobs are readily available. Because associates are attentive to their market value outside the firm,<sup>67</sup> an inflexible tournament structure with a fixed percentage of associates making partner is actually unstable.

Another way the outside market can affect firm structure is if outside opportunities differ systematically over the span of an associate's career. For example, if an associate's lateral opportunities decrease significantly after a certain number of years in practice, many junior associates might be expected to leave large firms early out of fear that otherwise it would soon be too late.<sup>68</sup> Associates who start thinking this way are effectively outside of any "tournament." This situation, with limited lateral opportunities for senior associates, seems to be characteristic of the current economic climate.<sup>69</sup>

Additional instability is introduced by the fact that firms also hire associates laterally.<sup>70</sup> Some lateral associates make partner, further complicating the fortunes of the associate cohorts hired out of law school.<sup>71</sup> Oddly, Galanter and Palay document the trend towards increased lateral hiring,<sup>72</sup> but fail to incorporate it into their model.

Just as associates take account of the job market outside their firms in making career decisions, partnership is not necessarily the career culmination suggested by tournament theory. While it is still common for partners to spend their careers with the firm where they make partner, or perhaps to move to another law firm, some partners may value partnership because it sends an important signal of their accomplishment and dedication, and allows them to obtain a high-level position in a nonlegal job enterprise.<sup>73</sup> While partners leave large firms for other opportunities,<sup>74</sup> this "market signaling" aspect of

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67. Commenting on his decision to lateral out into investment banking, one Paul, Weiss associate stated, "I felt overworked and underpaid relative to my clients." Frankel, *supra* note 59, at 55-56.

68. See, e.g., *id.* at 56-58 ("In 1986 and 1987, with headhunters calling regularly to remind associates that their marketability would plummet if they waited too long to move, 13 of the lawyers who started in 1983 left the firm. . . . As [an] associate got more senior, attractive lateral moves seemed to get scarcer and scarcer.")

69. Stevens, *supra* note 31, at B1. According to a legal recruiter, sixth-year associates "might as well be dead . . . . They might as well go back to school and start all over again. They'd have a much better time finding a job." *Id.*

70. E.g., Margaret Cronin Fisk, *Lateral Hires*, NAT'L L.J., Nov. 14, 1994, at A18.

71. In large law firms, "associates often consider the addition of lateral-entry associates as an obstacle to their progression to partnership." Akins et al., *supra* note 44, at 226.

72. GALANTER & PALAY, *TOURNAMENT*, *supra* note 2, at 54-55.

73. See A. MICHAEL SPENCE, *MARKET SIGNALING: INFORMATIONAL TRANSFER IN HIRING AND RELATED SCREENING PROCESSES* 14-30, 76-87 (1974). Note that, according to Spence, the fact that making partner increases one's job opportunities need not imply that partnership is actually an indication of superior future job performance. See *id.* at 25.

74. E.g., Stephen G. Hirsch, *Orrick Partner Leaves for Brobeck*, RECORDER, Nov. 5, 1991, at 16; Martha Middleton, *Ex-Managing Partner Set To Depart Isham*, NAT'L L.J., Nov. 30, 1987, at 2 (describing partner leaving firm to pursue "unspecified business interests"); Susan Orenstein, *Corporate Partner Leaves*

partnership may be especially useful in offering a better explanation than do Galanter and Palay of the continued existence of high-quality specialty firms with "a commitment to remain small."<sup>75</sup> Galanter and Palay describe such "boutique" firms as offering limited partnership opportunities to their associates, who are instead compensated with more "collegiality" than is available at a large firm.<sup>76</sup> In fact, boutiques may be able to remain small yet offer good partnership opportunities if their reputation is such that partners can and do leave for what they perceive as even better opportunities. This seems to be the case for at least some prominent boutiques.<sup>77</sup>

#### E. *Empirical Evidence Against the Use of Tournaments by Law Firms*

In Galanter and Palay's model, and in tournament theory in general, the firm promises that a fixed percentage of each year's associate class will be promoted to partner. The associates monitor the firm's fidelity to this commitment.<sup>78</sup> Galanter and Palay purport to find a stable percentage of associates being promoted to partner in various firms from 1950 to 1986. However, Galanter and Palay calculate firms' yearly promotion percentage by determining "the net increase in the size of the partnership as a percentage of all associates at the firm in a given year."<sup>79</sup> This is the wrong statistic to examine. Tournament theory would predict that a fixed percentage of each incoming class would make partner. Galanter and Palay's statistic ignores the incoming associates who have lateraled out of the firm, and includes in the calculation associates from other classes. It therefore does not calculate the probability of associates from a given cohort making partner, and so proves nothing about a stable promotion rate.<sup>80</sup>

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*Pettit for In-House Post*, RECORDER, Jan. 3, 1994, at 3; Susan Orenstein, *Wilson, Sonsini Tax Partner Joins Treasury Department*, RECORDER, Nov. 23, 1993, at 4.

75. GALANTER & PALAY, TOURNAMENT, *supra* note 2, at 126; Galanter & Palay, *Big Get Bigger*, *supra* note 2, at 791-92.

76. GALANTER & PALAY, TOURNAMENT, *supra* note 2, at 126; *see* Galanter & Palay, *Big Get Bigger*, *supra* note 2, at 791-92.

77. For example, at Stutman, Treister & Glatt, a bankruptcy boutique, one partner recently departed for investment banking, another to become chief financial officer of a large corporation, and a third to government. The departure of three partners in a boutique with only seven associates allows a promotion rate in excess of that of large firms while still permitting the boutique to maintain its small size. Telephone Interview with K. John Shaffer, Esq., Stutman, Treister & Glatt (Jan. 3, 1995).

On partnership prospects at boutiques, *see* Akins et al., *supra* note 44, at 226 ("Many new lawyers join a small office primarily for the opportunity to become a partner after only a few years . . ."); *Five Hot Boutiques: How a Strategic Focus Drives Their Success*, AM. LAW., Sept. 1993 (Special Pullout Report), at 10 (boutique with very short partnership track), 19 (associates attracted to boutique from large firms because of "'realistic' shot at partnership"), 29 (at boutique, "odds of making partner are certainly more favorable than in the large firms"), 33 ("Controlling its growth . . . has not stopped [boutique] from making new partners.").

78. *See supra* text accompanying note 21.

79. GALANTER & PALAY, TOURNAMENT, *supra* note 2, at 103.

80. While Galanter and Palay acknowledge some difficulties with their statistic, they nevertheless argue for its accuracy. *Id.*

Considering the appropriate data—the percentage of a given incoming class that makes partner—one finds that firms do *not* have a fixed promotion rate. Instead, the percentage of each cohort that makes partner varies dramatically, as shown by the data in Table 1 on the percentage of ten incoming classes that made partner at the New York offices of eighteen large New York-based law firms. Since these data do not include lateral hires, at either the associate or partner level, they present only the percentage of each incoming associate class that actually made partner—a percentage that Galanter and Palay assert to be stable for each firm. The appendix presents the actual size of the incoming classes, and the number of associates who made partner.

	'78	'79	'80	'81	'82	'83	'84	'85	'86	'87
Cadwalader	9	6	24	0	9	9	—	—	—	—
Cleary, Gottlieb	—	—	—	24	21	17	6	14	—	—
Cravath	—	—	—	8	0	11	9	0	2	—
Davis, Polk	—	—	—	—	5	19	2	2	5	3
Debevoise & Plimpton	—	—	—	14	0	21	10	8	3	—
Dewey, Ballantine	—	—	—	21	4	9	8	0	0	—
Fried, Frank	—	—	—	13	12	14	19	10	8	—
Kaye, Scholer	—	—	14	6	3	0	7	3	—	—
Milbank, Tweed	—	—	—	25	43	7	8	0	0	—
Paul, Weiss	—	7	8	13	22	10	12	—	—	—
Shearman & Sterling	—	—	12	9	18	16	6	—	—	—
Simpson, Thacher	—	16	11	19	18	11	13	—	—	—
Skadden, Arps	—	31	25	17	6	7	5	—	—	—
Stroock & Stroock	—	—	14	15	19	18	14	23	—	—
Sullivan & Cromwell	—	—	—	12	22	28	18	8	4	—
Wachtell, Lipton	—	—	—	—	63	22	56	17	50	80
Weil, Gotshal	—	—	—	67	28	34	18	19	18	—
White & Case	—	—	26	43	21	25	27	10	—	—

TABLE 1. *Percentage of Entering Associates Making Partner, by Year Associates Joined Firm*<sup>81</sup>

Table 1 demonstrates that firms do not promote a fixed percentage of each incoming class to partnership. Furthermore, there is no evidence (nor is it at

81. OFFICE OF CAREER SERVS., HARVARD LAW SCH., EMPLOYER DIRECTORY 517, 522, 526, 530, 532, 534, 539, 552, 567, 581, 596, 599, 601, 604-05, 610, 612-13 (1994).



all credible) that Milbank, Tweed, Hadley & McCloy informed the class of 1983 that less than one-sixth as many would be promoted to partner as compared to the class of 1982, or that Davis, Polk & Wardwell informed the class of 1983 that nearly four times as many were promised partnership as compared to the previous cohort. Even less dramatic swings in the promotion rate would have a large effect on compensation in the tournament model. A change in the promotion rate from 20% to 10% would cut the value a new associate assigns to the potential "superbonus" in half. Galanter and Palay's prediction of a stable promotion rate cannot be salvaged by asserting that, if the rate is not fixed per year, there is an average rate over a period of a few years. Table 1's data demonstrate, for example, that the Skadden, Arps, Slate, Meagher & Flom associates entering during 1979–1981 made partner at a dramatically higher rate than the classes entering during 1982–1985. Again, there is no evidence that associates were informed of such changes at the time they were hired.<sup>82</sup> Other firms show similar instabilities. Tournament theory cannot account for these unstable promotion rates and, in fact, this instability precludes the application of tournament theory to law firms.

### III. THE PRODUCTION-IMPERATIVE MODEL

This Note has demonstrated that tournament theory is a weak foundation upon which to base an understanding of associate career patterns. In particular, because associates are so easily monitored, the tournament model relied upon by Galanter and Palay is inapplicable. Moreover, tournament theory predicts features that are not present in law firms (an endless series of tournaments and the promotion of a fixed percentage of each incoming class to partnership), fails to account for the fact that many associates are not seeking partnership, and ignores the important influence of changes in the job market outside the law firm being analyzed. The real causes of the observed structure of law firms must be sought elsewhere. This Part proposes an alternative explanation for the structure of law firms. The production-imperative model developed in this Part focuses on a law firm's need to organize around the demands of its work, so as to function efficiently in the competitive market for legal services. It argues that law firm associates are seeking monetary compensation and human capital development rather than relying on the firm's promise to elevate a fixed percentage of associates to partnership.

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82. Even a random series of numbers will have a "fixed" 10-year average. To be monitorable, the promotion rate should be stable year-to-year, as predicted by Galanter and Palay. In addition, varying the promotion rate around some "average" value would reduce the expected utility of an associate's compensation package, assuming associates are risk averse. *See infra* note 124.

### A. *Legal Work and Its Impact on Law Firm Structure*

Large firm associate career structure is motivated largely by the requirements of the work performed by corporate law firms. In the competitive environment in which these firms operate,<sup>83</sup> work must be performed in a manner that holds down costs so that a firm can accomplish tasks at a market rate. The type of work undertaken is thus a major determinant of the ratio of associates to partners within the firm and between departments.

This dictating of firm structure by market and production demands can best be understood by disaggregating the firm into its constituent departments. While attorneys from different departments sometimes work together, each department faces a different demand for its output, and has different requirements for performing its work.<sup>84</sup> A large corporate matter (e.g., a securities offering or a merger) or a large litigation matter requires a great deal of what can be termed "paperwork."<sup>85</sup> For a corporate matter these tasks include "due diligence" (examining the files and records of the business firms involved in the transaction<sup>86</sup>) and drafting and proofreading a variety of agreements.<sup>87</sup> For a litigation matter the paperwork includes document discovery<sup>88</sup> (reviewing documents to be sent to opposing counsel in response to discovery requests and removing privileged material, reviewing documents received pursuant to demands for the production of documents<sup>89</sup>) and

83. *E.g.*, ARNDT, *supra* note 47, at 4; FRANK BRENNAN, FOCUSING ON PROFITABILITY 3-4 (1994); NELSON, *supra* note 6, at 2. Two Supreme Court decisions have contributed to increased competition in the legal profession. In *Goldfarb v. Virginia State Bar*, 421 U.S. 773 (1975), the Court held that the "minimum-fee schedules" used by the legal profession to keep prices high violated the Sherman Act. In *Bates v. State Bar*, 433 U.S. 350 (1977), the Court held that a rule prohibiting lawyers from advertising violated the First Amendment. A line of cases since *Bates* has interpreted the boundaries of regulations on lawyer advertising. *See, e.g.*, *Ibanez v. Florida Dep't of Business & Professional Regulation*, 114 S. Ct. 2084 (1994) (rejecting Board of Accountancy's censure of attorney who advertised her credentials as Certified Public Accountant and Certified Financial Planner).

84. *See* NELSON, *supra* note 6, at 177 ("[T]asks vary by field of practice.").

85. "Paperwork" is used merely in a descriptive, not a pejorative, sense. *But see, e.g.*, KRONMAN, *supra* note 3, at 285 (noting that associates often perform "repetitive and ministerial tasks"); NELSON, *supra* note 6, at 9 ("[M]any associates are assigned to work they find unrewarding."); Steven Brill, *The New Leverage*, AM. LAW., July/Aug. 1993, at 5, 70 (describing many associate tasks as "grunt work" and "drone work").

86. *See* William D. Sherman, *The Due Diligence Defense*, in MECHANICS OF UNDERWRITING 1989, at 331, 351-57 (PLI Corp. Law & Practice Course Handbook Series No. 629, 1989) (giving "nonexhaustive" list of issues and tasks arising out of due diligence requirement).

87. Robert W. Gordon, *The Independence of Lawyers*, 68 B.U. L. REV. 1, 56 n.195 (1988) ("Much corporate work . . . is proofreading the boilerplate—mind-numbingly tedious, requiring intense concentration but no imagination."); *see, e.g.*, Klaus Eppler & Edward W. Scheuermann, *Drafting the Form 10-K*, in PREPARATION OF ANNUAL DISCLOSURE DOCUMENTS 1994, at 361 (PLI Corp. Law & Practice Course Handbook Series No. B-835, 1994); Arnold S. Jacobs, *Drafting Documents*, in ACCOUNTING FOR LAWYERS 1986, at 209 (PLI Corp. Law & Practice Course Handbook Series No. 526, 1986).

88. *See* FED. R. CIV. P. 26, 34.

89. *See* Gregory P. Joseph, *A Complete Guide to Deposition Practice*, PRAC. LITIGATOR, Jan. 1993, at 59, 60-62 (describing necessity for exhaustive document review in preparation for deposition); Richard A. Rosen, *Making Discovery Tools Work*, PRAC. LITIGATOR, Nov. 1992, at 51, 52, 57-58, 66, 69-70 (discussing document requests, document review, privilege, and interrogatories).

exhaustive legal research on the myriad issues involved in or potentially relevant to the dispute.<sup>90</sup>

A relatively smaller proportion of the work to be done by a large firm in a corporate transaction or litigation matter consists of client interaction and strategic, complex legal work. This includes synthesizing and applying legal research results to the facts at hand, using discovery for strategic advantage over the opponents in a litigation matter, ensuring that agreements or settlements successfully meet client objectives, and keeping clients apprised of developments.<sup>91</sup>

While the "paperwork" must be done correctly and with attention to detail, the demands in terms of skills and (especially) experience are not such that clients are willing to pay for this work to be done by partners charging a high hourly rate. While a partner would be able to perform all of the tasks by him or herself, the total bill to the client would need to reflect the lower "value added" by the partner when undertaking the "paperwork" tasks. Therefore, in order to maximize profits, the partner will personally handle the strategic work and will employ one or more associates to do the paperwork.<sup>92</sup> With this structure, the partner can keep busy all of the time while billing at a high rate.<sup>93</sup> At the same time, associates can effectively carry out the paperwork at a lower rate. To facilitate this work dynamic, large law firms' corporate and litigation departments must feature a fairly high ratio of associates to partners.<sup>94</sup> This ratio is typically referred to as "leverage."<sup>95</sup>

Production demands in non-paperwork intensive departments of a law firm would, on the other hand, dictate a different structure, requiring less leverage. Thus, for example, the tax departments of large firms generally display structures different from litigation and corporate departments due to their different production function. In tax litigation involving business clients, both the taxpayer and the Internal Revenue Service (IRS) typically stipulate the facts.<sup>96</sup> Without a factual dispute, tax litigation focuses on legal issues and on

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90. Barry D. Bayer, *A Top Ten List for Today's Litigator*, PA. L. WKLY., May 9, 1994, at S3 (discussing importance of legal research and document management).

91. See NELSON, *supra* note 6, at 180 ("[A]ssociates less frequently perform the more 'responsible' tasks of law practice . . . [P]artners and associates perform very different tasks."); Samuelson, *supra* note 3, at 648 ("[P]artners do not write research memoranda or draft interrogatories; they reserve their energies for complex issues of law and strategy.").

92. FEFERMAN, *supra* note 40, at 4 (discussing economic necessity of delegating work to associates); IEZZI, *supra* note 49, at 7 (asserting that work should "flow to the lowest level within the firm that can perform it satisfactorily"); James E. Brill, *People: The Law Firm's Major Asset*, in PREPARING FOR TOMORROW: SUCCESSFULLY INTEGRATING PEOPLE AND TECHNOLOGY FOR THE PROFITABLE PRACTICE OF LAW 95, 118 (1986) ("Partners should do only those legal tasks that no one else is qualified to do . . .").

93. Of course, this assumes that there are enough transactions or litigation matters in the firm to keep the partner busy with only high-level work. See *infra* text accompanying notes 110-11.

94. ARNDT, *supra* note 47, at 72.

95. ALTMAN & WEIL, INC., COMPENSATION PLANS FOR LAWYERS AND THEIR STAFFS 33 (1986); ARNDT, *supra* note 47, at 23-24, 71.

96. Lee A. Sheppard, *House Subcommittee Considers Extension of Fee Awards Provision*, TAX NOTES TODAY, Apr. 26, 1985, available in LEXIS, Taxana Library, TNT File, at \*2 (asserting that taxpayers

the application of the Tax Code, Treasury Regulations, and case law to the facts at hand.<sup>97</sup> Similarly, when the firm is handling a corporate transaction the tax attorneys typically function in a "service" role, offering input on how to structure the transaction so as to minimize adverse tax consequences. These tasks require a much lower proportion of "paperwork" than is typical of a matter undertaken by a corporate or litigation department.<sup>98</sup> The production-imperative model would thus expect to find a significantly lower level of leverage in the tax departments of large firms.<sup>99</sup>

The available evidence supports the hypothesis that leverage is higher in large firms' corporate and litigation departments than in their tax departments. For example, Paul, Weiss, Rifkind, Wharton & Garrison in New York City has 37 partners<sup>100</sup> and 84 associates<sup>101</sup> in its litigation department (an associate/partner ratio of 2.3). Its corporate department has 33 partners and 74 associates (a 2.2 ratio), and its tax department 11 partners and 14 associates (a 1.3 ratio).<sup>102</sup> Although Chicago firms are generally less leveraged than New York firms,<sup>103</sup> they also exhibit higher leverage in their corporate and litigation departments than in their tax department. Thus, Chicago's Kirkland & Ellis has 35 partners and 31 associates in its corporate department (a 0.89

stipulate facts "in most civil tax litigation"); Samuel B. Sterrett, *Tax Court Tactics*, PRAC. TAX LAW., Summer 1992, at 71, 73 ("The bedrock of litigation in the Tax Court is the stipulation of fact process.").

97. Sterrett, *supra* note 96, at 73 ("Discovery in the Tax Court is more limited than in the district courts or Claims Court."). Transfer pricing disputes are an exception; they typically involve huge numbers of documents being utilized in an essentially factual dispute. See *Chief Judge Says: Stop Squandering Court's Time on Vexatious Discovery Requests*, 1 TRANSFER PRICING REP. 265 (1992). See generally ELIZABETH KING, TRANSFER PRICING AND VALUATION IN CORPORATE TAXATION (1994).

98. See JOHN P. HEINZ & EDWARD O. LAUMANN, CHICAGO LAWYERS: THE SOCIAL STRUCTURE OF THE BAR 68 (rev. ed. 1994) (finding that professors and research specialists rate tax most intellectually challenging among 30 practice specialties in terms of its legal substance, and most rapidly changing). For an empirical investigation of this phenomenon, see *infra* note 108 and accompanying text.

99. See ARNDT, *supra* note 47, at 72.

100. NALP DIRECTORY, *supra* note 54, at 895. Here, "partners" also includes attorneys who are "of counsel." Many of these attorneys are semiretired partners. The Rodent, *The Legal Limbo of Of-Counsel Status*, CONN. L. TRIB., Jan. 23, 1995, at 39 (noting that "advantage of the traditional of-counsel category is that it allows lawyers to avoid full retirement"); see also GALANTER & PALAY, TOURNAMENT, *supra* note 2, at 140 ("It is no less 'accurate' to count . . . 'of counsel' than it is to exclude them.").

101. NALP DIRECTORY, *supra* note 54, at 895. "Associates" here refers to all attorneys who are neither partner nor of counsel.

102. *Id.*

103. The higher leverage ratios in New York, as contrasted with Chicago, appear to be due to differences in the nature of the work undertaken in those two cities. Deals in New York tend to involve larger amounts of money and litigations tend to be considered particularly important and/or complex. *Banks Fuel Rebound in M&A Work*, NAT'L L.J., Dec. 27, 1993, at S4 ("[T]he big deals seemed to gravitate to . . . New York firms."); Robert Weisman, *City Law Firm Has Carved Out Global Niche*, HARTFORD COURANT, July 24, 1993, at C1 (discussing prevalent practice of large businesses turning "to New York firms for their big national and international transactions"). These matters generate more "paperwork" because the greater the amounts at stake, the more issues that are worth investigating and negotiating. Moreover, with the client paying such high fees, there is even more of an impetus to ensure that no mistakes are made; thus more associates are required to investigate every last possibility. See Steven Brill, *Lopping Off a Third*, AM. LAW., June 1993, at 5, 81 (contrasting matters of "middling importance" with those requiring "top-dollar, full-court press"); Brill, *supra* note 85, at 65 (asserting that less leveraged firm does not "track down every detail unless it's important").

ratio), 47 partners and 48 associates in its litigation department (a 1.02 ratio), and 11 partners and 5 associates in its tax department (a 0.45 ratio).<sup>104</sup> Once again, the tax department has substantially lower leverage than the other two departments.

Other large firms display a similar pattern. Tables 2 and 3 show the leverage in the corporate, litigation, and tax departments for nineteen large firms in New York and Chicago.

	Corporate	Litigation	Tax
Cadwalader	2.0	1.6	0.6
Cravath	2.9	3.9	1.9
Davis, Polk	2.8	4.0	2.1
Fried, Frank	1.7	3.0	1.3
Milbank, Tweed	2.2	3.8	1.1
Paul, Weiss	2.2	2.3	1.3
Shearman & Sterling	2.7	3.2	1.3
Simpson, Thacher	2.5	3.2	1.7
Sullivan & Cromwell	2.6	2.7	2.1
Wachtell, Lipton <sup>105</sup>	1.0	0.8	0.3
Weil, Gotshal	2.4	3.2	1.4
White & Case	2.1	2.3	1.3

TABLE 2. Associate/Partner Ratios, by Department, New York<sup>106</sup>

104. NALP DIRECTORY, *supra* note 54, at 602.

105. The NALP Directory combines Wachtell, Lipton, Rosen & Katz's tax attorneys with its trust and estates attorneys. *Id.* at 919. The tax leverage reported above is based on information that one of six partners in the group splits his time roughly evenly between tax and trust and estates, as does one associate. Telephone Interview with former Wachtell, Lipton summer associate (Feb. 13, 1995). Note that leverage at Wachtell, Lipton is uncharacteristically low. Commentators applying tournament theory to law firms dismissed this leading firm as an "outlier." *See, e.g.,* Ferrall, *supra* note 66, at 14-15; *see also* Gilson & Mnookin, *supra* note 31, at 585 & n.50. Nevertheless, Wachtell, Lipton does exhibit substantially less leverage in its tax department than in its corporate or litigation departments.

106. NALP DIRECTORY, *supra* note 54, at 838, 843, 847, 855, 883, 895, 908, 911, 915, 920-21.

	Corporate	Litigation	Tax
Jenner & Block	0.7	1.1	.25
Katten Muchin <sup>107</sup>	1.0	1.1	.63
Kirkland & Ellis	0.9	1.0	.45
Mayer, Brown	1.3	0.9	.75
Sidley & Austin	1.0	1.0	.69
Sonnenschein, Nath	2.2	2.1	1.5
Winston & Strawn	1.0	1.4	1.3

TABLE 3. *Associate/Partner Ratios, by Department, Chicago*<sup>108</sup>

These statistics show that the production imperative has a substantial effect on law firms' leverage. Firms need to use associates, and hence gain leverage, in order to hold down costs and maximize per-partner profits. The amount of leverage used is dictated largely by the production requirements of the work undertaken by the firm, and thus leverage varies across departments depending on the nature of the work done in each department.

#### B. *The Production Imperative's Effect on Profits and Partnership*

The leverage induced by the firm's production requirements has important, even controlling, implications for firm profitability and associate careers. With, in most firms, one or more associates per partner, it is clear that not every associate could be promoted to partnership, unless the firm were to increase dramatically in size every seven to eight years.<sup>109</sup> Whether this would be possible would depend largely on market demand for legal services<sup>110</sup> and

107. The NALP Directory combines Katten Muchin & Zavis' Tax and Estate Planning Departments. *Id.* at 599. The tax leverage reported above is based on a figure of eight partners and five associates practicing tax law. Telephone Interview with Kelley Lynch, Legal Recruiting Manager, Katten Muchin & Zavis (Jan. 25, 1995).

108. NALP DIRECTORY, *supra* note 54, at 597, 602, 608, 622, 624, 629. As mentioned above, transfer pricing disputes are much more fact-intensive than other tax matters. *See supra* note 97. Thus, we would expect firms that litigate these disputes to have a higher associate/partner ratio in their tax departments. This seems to be the case at two of the leading firms practicing in the transfer pricing area, the Washington, D.C., offices of Dewey Ballantine and Baker & McKenzie. They have associate/partner ratios in their Washington, D.C., tax departments of 2.3 and 1.6, respectively. In Dewey Ballantine's New York office, which is not focused on transfer pricing litigation, the tax department's ratio is dramatically lower: 1.3. Similarly, Baker & McKenzie's Chicago tax department ratio is 0.61. NALP DIRECTORY, *supra* note 54, at 395, 414, 584, 850. This is additional evidence of the importance of firm production requirements in dictating leverage.

109. If the partnership track were, for example, eight years, and if the leverage ratio were 1.0, and every associate made partner, firm size after eight years would be double the previous size, minus any retiring partners. Because the average partner's tenure would be far longer than the average associate's, ARNDT, *supra* note 47, at 75, this would result in a growth rate of perhaps 75% per eight years.

110. *Id.* at 73 ("Practice growth allows a firm to continue to hire new associates and admit new partners."); *see* GALANTER & PALAY, TOURNAMENT, *supra* note 2, at 98 (conceding it is "unrealistic" to

the ability of the current partners to bring in business.<sup>111</sup> For those associates who did make partner, the cost to the firm of the "superbonus" (of higher current and future income conferred by partnership) would be offset by those attorneys' shift to performing higher value-added partner tasks.<sup>112</sup> Of course, not all associates would stay with the firm until the partnership decision was made; some would be lured away by other opportunities.<sup>113</sup>

Even if the firm could add enough business to promote all associates to partnership who stayed with the firm until the end of the partnership track, it would not be in the partners' best interest to make such across-the-board promotions. Some associates might make poor partners; because of the task differentiation between partner and associate, there is an imperfect correlation between success as an associate and success as a partner.<sup>114</sup> Therefore, the firm would not want to promote every attorney performing well as an associate to partner; it would instead take account of its prediction as to the future performance of the associate as a partner, and promote selectively according to that prediction. Furthermore, because partners share profits, they would not want to increase their ranks unless necessary to meet the production requirements of the firm. Therefore, subject to the firm's production requirements and its ability to attract new associates (a component of which may be the firm's partnership opportunities<sup>115</sup>), the firm would prefer to allow turnover, letting senior associates go<sup>116</sup> and hiring new, younger associates.

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ignore revenue constraints on firm growth).

111. McChesney, *supra* note 42, at 388–93 (proposing that because legal consumers lack full information, partners specialize in "promoting" firm by supplying information to potential clients).

112. See *supra* note 30 and text accompanying notes 21, 92. Associate compensation is a more muddled area. Some firms pay associates of a given class the same wage ("lockstep" compensation), while others provide performance-based bonuses. See, e.g., *Attorneys and Dollars*, NAT'L L.J., Aug. 1994, at 27, 28; John E. Morris, *How Do You Measure Up?*, AM. LAW., Sept. 1993, at 67, 69–73. Tournament theory cannot account for the payment of bonuses linked to productivity since it is based upon the inability to measure productivity. The production-imperative model can account for the diversity of payment schemes observed among large law firms. Some firms link compensation tightly to productivity. Others attenuate this link because they find that lockstep compensation improves associate morale and firm collegiality, see, e.g., Alison Frankel, *Debevoise Doesn't Budge*, AM. LAW., June 1993, at 76, 76, or because the firm can adequately control associate effort through informal pressures precisely because it is easy to monitor associates, David H. Maister, *Lockstep and the Power of Social Control*, AM. LAW., Sept. 1994, at 48, 48–49; Morris, *supra*, at 74. Also note that not all of an associate's compensation is in monetary form—some is in increased human capital, see *infra* text accompanying note 134, and some is in the strength of partner recommendations or help finding another job if the associate leaves the firm. Gilson & Mnookin, *supra* note 31, at 582–84 (discussing partners "facilitating outplacement of associates"). These nonmonetary components of compensation could vary based on an associate's productivity even if wages were lockstep.

113. See *supra* text accompanying notes 66–68.

114. Cf. ARNDT, *supra* note 47, at 75 (stating that in admitting new partners, firms should give attention to maintaining "an appropriate blend of finders, minders, grinders, and binders"); McChesney, *supra* note 42, at 391.

115. E.g., GALANTER & PALAY, TOURNAMENT, *supra* note 2, at 100.

116. Or, depending upon the state of the outside job market and the salary differential between new and senior associates, the firm might retain some attorneys as "permanent associates." See *supra* note 31.

This decision to replace a more experienced associate with a younger one implies that a pyramid structure, in which there are more junior than senior associates, is efficient for the firm. Some commentators, including Galanter and Palay, have claimed that law firms must keep associates for a period of years before profiting from them; that is, it takes a certain amount of time before firms can "fully amortize[] [their] investments" in the associates.<sup>117</sup> This argument is flawed, however. The pyramid structure is efficient for firms precisely because the partners profit from *all* of their associates, including the most junior.<sup>118</sup> In fact, Galanter and Palay's idea that associates must be kept for several years for the firm to turn a profit on them is at odds with Galanter and Palay's reliance on tournament theory, which would predict that, if low-level associates were unprofitable, they would not be hired by large law firms.<sup>119</sup>

Overall, then, a firm's decision to elevate associates to partner will be at least partially haphazard (at least from the perspective of the associates).<sup>120</sup> When a firm does make promotions, it will be in its best interest to choose the "best" associates for partnership.<sup>121</sup> However, the number of associates that the firm promotes will depend upon the current partners' ability to bring in new business and thus create a demand within the firm for new partnership tasks (as well as new associate tasks).<sup>122</sup> This, in turn, will usually depend heavily on market demand for a particular department's services.<sup>123</sup>

117. GALANTER & PALAY, TOURNAMENT, *supra* note 2, at 99. Galanter and Palay cite to Gilson and Mnookin, who suggest that associates become profitable only after having worked for the firm for some time. Gilson & Mnookin, *supra* note 31, at 574 n.26.

118. See, e.g., NELSON, *supra* note 6, at 77 (detailing how firms make profit on all associates); Brill, *supra* note 85, at 5, 65 (noting that law firms make profits on associates "after 1,200–1,400 hours (depending on overhead costs)"); James F. Fitzpatrick, *Legal Future Shock: The Role of Large Law Firms by the End of the Century*, 64 IND. L.J. 461, 464 (1989) ("Law firms work on the Marxist theory of surplus value . . . . A young associate will bill 2,000 hours, which will bring in \$200,000 of gross revenue to the firm. That associate's salary might be \$60–70,000 a year."); Stevens, *supra* note 31, at B1 ("Firms generally make their biggest profits off young, salaried associates, who work long hours and bill at high rates.").

119. Instead, there would first be a tournament in which recent graduates worked in other organizations (perhaps smaller firms, corporations, the government, or much less profitable large firms), and the "winners" would be hired away by the large law firms after the young attorneys had gained the experience and skills necessary for profitability. See Lazear & Rosen, *supra* note 9, at 861 (discussing tiers of tournaments, with lower-level firms specializing in "running contests among young workers—the minor leagues"). Note that the large firms would be partially subsidizing the wages of the younger attorneys. The potential for receiving an offer from one of the larger firms would be compensation to the new attorneys. Thus young lawyers would settle for lower wages in their first jobs than they would if they lacked the chance to "move up."

120. See *supra* p. 1922 tbl. 1, which documents the wide variation in partnership rates between different classes of a firm's associates.

121. See *supra* note 29 and accompanying text.

122. See *supra* note 111 and accompanying text.

123. Thus, lower leverage in a firm's tax department does not imply that it will necessarily be easier for tax associates to make partner. Partnership prospects will be dependent on the *growth* of each department and on the fluctuations in demand for different specialties. See *supra* note 110; cf. Weidlich & Raab, *supra* note 52 (discussing changes in demand for specialties).

This analysis seems to be borne out by the statistics reported above. Firms with higher leverage do not always offer a lower promotion rate than firms with lower leverage. For example, Cadwalader,



### C. *The Supply Side: Human Capital Development for Associates*

Why, then, will associates come to work at large law firms when their partnership chances are haphazard, even more uncertain than the tournament model would predict?<sup>124</sup> A law firm is no "Field of Dreams." If you build it, they *won't* necessarily come.<sup>125</sup> The answer lies in the human capital—including legal skills, professional reputation, and client relationships—that associates accrue while working at a law firm. This gain occurs especially rapidly during the first few years of work, and is a benefit received by all associates—those with an eye on partnership as well as those intending to move on to other pursuits.<sup>126</sup>

Again, Galanter and Palay mischaracterize this aspect of associate career patterns in their attempt to squeeze law firms into the tournament theory model. They assert that the firm pays for associates' investment in human capital and therefore fears the premature loss of associates.<sup>127</sup> It is true that a firm must pay for firm-specific human capital<sup>128</sup> and that, when the firm makes such investments, it must take care that associates do not leave the firm too early.<sup>129</sup> However, associates in large law firms are not developing primarily *firm-specific* human capital. Instead, particularly during their first few years with a firm, associates are gaining mostly *general* human capital—"real world" legal skills and experience.<sup>130</sup> Furthermore, the associates, not the firm, bear the cost of general skills training.<sup>131</sup> They do so by accepting a

Wickersham's leverage is on the low end for New York firms and Sullivan & Cromwell's leverage is on the high end. See *supra* p. 1922 tbl. 1. Yet Sullivan & Cromwell's promotion rate has been somewhat higher than Cadwalader, Wickersham's. Sullivan & Cromwell's overall promotion rate for associates joining the firm during 1981–1986 was 14%, and its rate for 1981–1983 was 19%. Cadwalader, Wickersham's promotion rate for 1978–1983 associates was 10%, and its rate for those joining the firm during 1981–1983 was only 6%. See *infra* p. 1934 app.

124. Lawyers tend to be cautious about risks. Not only are most individuals risk averse, but this tendency is even more pronounced in those with a high level of human capital, because human capital is difficult or impossible to diversify. Gilson & Mnookin, *supra* note 31, at 575; Gilson & Mnookin, *supra* note 20, at 325.

125. Cf. FIELD OF DREAMS (Universal Pictures 1989). See generally Charles Yablon, *On the Contribution of Baseball to American Legal Theory*, 104 YALE L.J. 227 (1994).

126. See *supra* notes 58–65 and accompanying text.

127. GALANTER & PALAY, TOURNAMENT, *supra* note 2, at 99; see *supra* note 18 and accompanying text. Galanter and Palay are not alone in interpreting associates as investing heavily in firm-specific human capital. E.g., Gilson & Mnookin, *supra* note 31, at 572–73, 577–78; Gilson & Mnookin, *supra* note 20, at 354–55. Carmichael assumed firm-specific human capital in his development of a seniority promotion system, *supra* text accompanying note 23, but this constraint was dropped by Malcomson in his tournament model.

128. BECKER, *supra* note 12, at 41–42.

129. In a more sophisticated model, however, firms would share both training costs and the returns from training with associates; this sharing would both help reduce turnover by giving workers a higher wage once trained and reduce the supply of job applicants by making them bear some of the training costs. *Id.* at 43–44. This option is not considered by Galanter and Palay.

130. See *infra* note 134 and accompanying text.

131. Training costs include the lost revenue from time that partners spend training associates. While partner supervision of associates is billable, see *supra* note 40, partner training of associates itself is not. See FEFERMAN, *supra* note 40, at 55–56.

lower salary than they would if their jobs did not impart to them increased general human capital.<sup>132</sup> The training that associates receive, in addition to their salaries, shows that associates are not “exploited” by their firms.<sup>133</sup>

The legal skills that large-firm associates develop are applicable in a variety of other job settings. Unlike administrative and managerial employees in large bureaucratic organizations, lawyers provide services directly to clients, rather than to the firm. This gives them “highly transferable” skills—*general human capital*—that can be employed in a variety of other settings.<sup>134</sup> For example, many U.S. Attorneys hire only lawyers with some (frequently large-firm) post-law school work experience.<sup>135</sup> Similarly, most corporate legal departments hire attorneys with some law firm experience, rather than hiring directly out of law schools: They prefer to hire lawyers with the experience and perspective gained by working as an associate in a law firm.<sup>136</sup> The transferability of skills that these examples demonstrate confirms that young attorneys are developing general human capital in law firms.

Thus, because a large law firm is such a good training ground for young attorneys, it can attract more associates than it would if it offered the same wage and partnership chance, but no boost to associates’ general human capital. The attention to detail, stamina, and application of legal skills to real-

132. BECKER, *supra* note 12, at 35; Carmichael, *supra* note 23, at 257; Leibowitz & Tollison, *supra* note 60, at 68. The firm has an incentive to provide this training because the reduction in wages is greater than the cost of the training. Similarly, the associates prefer to gain the training “on the job” rather than through additional schooling because the training and work are complementary (i.e., the skills are gained more easily from problems arising out of the work than they would be in school). BECKER, *supra* note 12, at 34 n.3, 51.

133. Leibowitz & Tollison, *supra* note 60, at 73. The large number of law firms (of all sizes) that compete for associates, coupled with other opportunities in government and corporations, is an additional reason to conclude that associates are not exploited. *See id.* at 65–66.

134. Hansmann, *supra* note 8, at 60; *see* Leibowitz & Tollison, *supra* note 60, at 69 (“[F]irms initially provide general training.”). Gilson and Mnookin largely concede this point in the second of their two articles on law firm organization, but raise a new argument. They state that “the skills associates acquire during their apprenticeship . . . appear to be general human capital [but] the information asymmetry between the firm and alternative employers in evaluating the quality of the general human capital acquired . . . transforms this general human capital into firm-specific human capital.” Gilson & Mnookin, *supra* note 31, at 581 n.41. Again, however, this argument is weak, especially given the comparison to a “manager in a large industrial firm” whose tasks are much more difficult to monitor (and hence whose reputation is much more ill-defined). Hansmann, *supra* note 8, at 287 n.31.

Gilson and Mnookin also argue that not making partner may be such a bad sign in the labor market that it will turn even general human capital into firm-specific human capital. Gilson & Mnookin, *supra* note 31, at 577. In other words, the turned-down associate will be particularly unmarketable. Not making partner is not such a huge burden, however, at a large, prestigious firm where few associates are elevated. At Paul, Weiss, for example, many associates felt that not making partner did not carry a stigma. *See* Frankel, *supra* note 59, at 58.

135. *E.g.*, Government Questionnaire, National Association for Law Placement, United States Attorney’s Office, Southern District of New York (May 3, 1994) (on file with author) (indicating no entry-level but 40 experienced attorneys hired during 1993); Letter from United States Attorney, Southern District of New York, to Career Development Office, Yale Law School (n.d.) (on file with author) (“[T]he Office requires applicants to have had approximately two years of experience beyond law school.”).

136. Donald S. Brooks, *Training and Development in a Corporate Law Department*, in SECTION OF ECONOMICS OF LAW PRACTICE, AM. BAR ASS’N, RECRUITING, TRAINING AND COMPENSATING ATTORNEY STAFF 7, 7 (1986).

world fact patterns fostered even by associate "paperwork" make valuable market commodities.<sup>137</sup> It is the prospect of gaining this general human capital, rather than the prospect of triumphing in a "tournament," that attracts most associates to large law firms.

#### IV. CONCLUSION

Law firms are not structured around a tournament, but by the requirements of the work the firms perform. Contrary to tournament theory's predictions, law firms do not hire groups of associates, promising that a fixed percentage will be elevated to partnership. Instead, firms hire as many associates as can be kept busy over the long term, because each new associate is a source of additional profits for the firm's partners. The work requirements of the firm's various departments dictate the number of associates that can be employed. The firm is able to prevent associate shirking because both the quality of attorney work product and the effort exerted by associates are easily monitored.

Associates are attracted to large firms because the salaries available are higher than for other options, and because those who are interested are offered a chance at partnership (subject, as associates are aware, to the firm's need for new partner-level work). Moreover, all associates gain experience and develop skills that increase their general human capital. Many associates leave after a few years to employ these skills in another job.

The relationship between a large corporate law firm and its associates is thus a fluid one. Many associates are "using" the firm as a training ground and do not intend to remain for long. Others intend to try to achieve partnership and then make a career with the firm. Yet all associates are sensitive to a wide variety of factors when making decisions about their futures. These include how their partnership chances are affected by the firm's financial stability and ability to generate new business, by the prospects of the associate's particular practice area, and by lateral hiring of new partners and/or associates. Associates are also sensitive to their marketability outside the firm. It is the interplay of these factors, rather than the fight to emerge triumphant in a tournament, that determines the structure of the law firm and the texture of the associates' careers.

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137. See HENNING, *supra* note 60, at 3-1 ("[T]he private corporate law firm is the best place to acquire [postgraduate skills training].").

APPENDIX: NUMBER OF ENTERING ASSOCIATES PER YEAR/  
NUMBER WHO MADE PARTNER

	'78	'79	'80	'81	'82	'83	'84	'85	'86	'87
Cadwalader	11/1	17/1	17/4	14/0	11/1	11/1	—	—	—	—
Cleary, Gottlieb	—	—	—	25/6	24/5	18/3	18/1	29/4	—	—
Cravath	—	—	—	39/3	28/0	38/4	53/5	48/0	55/1	—
Davis, Polk	—	—	—	—	43/2	48/9	44/1	47/1	56/3	64/2
Debevoise & Plimpton	—	—	—	21/3	36/0	19/4	21/2	25/2	32/1	—
Dewey, Ballantine	—	—	—	24/5	25/1	23/2	25/2	15/0	17/0	—
Fried, Frank	—	—	—	16/2	26/3	21/3	16/3	21/2	26/2	—
Kaye, Scholer	—	—	28/4	31/2	32/1	26/0	28/2	32/1	—	—
Milbank, Tweed	—	—	—	16/4	21/9	29/2	26/2	33/0	27/0	—
Paul, Weiss	—	27/2	26/2	32/4	27/6	31/3	42/5	—	—	—
Shearman & Sterling	—	—	41/5	43/4	33/6	32/5	47/3	—	—	—
Simpson, Thacher	—	25/4	36/4	31/6	40/7	36/4	45/6	—	—	—
Skadden, Arps	—	16/5	20/5	24/4	31/2	15/1	20/1	—	—	—
Stroock & Stroock	—	—	14/2	20/3	21/4	22/4	22/3	13/3	—	—
Sullivan & Cromwell	—	—	—	42/5	37/8	29/8	44/8	59/5	47/2	—
Wachtell, Lipton	—	—	—	—	8/5	9/2	9/5	6/1	2/1	5/4
Weil, Gotshal	—	—	—	21/14	32/9	35/12	38/7	43/8	50/9	—
White & Case	—	—	23/6	23/10	28/6	28/7	22/6	29/3	—	—

*Source:* OFFICE OF CAREER SERVS., HARVARD LAW SCH.,  
EMPLOYER DIRECTORY (1994).