# PLSC 476: Empirical Legal Studies

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# ABA Model Rule 5.4

Rule 5.4:

a. A lawyer or law firm shall not share legal fees with a nonlawyer,...

b. A lawyer shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law.

c. A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.

d. A lawyer shall not practice with or in the form of a professional corporation or association authorized to practice law for a profit, if:

    1. a nonlawyer owns any interest therein...;
    2. a nonlawyer is a corporate director or officer thereof or occupies the position of similar responsibility in any form of association other than a corporation; or
    3. a nonlawyer has the right to direct or control the professional judgment of a lawyer.

# What This Means...

**"(L)egal services must be provided by a law firm that is owned, managed, and financed exclusively by lawyers."**[1]

- Every member of management must be a lawyer
  - Includes the CEO, CFO, CIO, CTO, etc.
  - Operates at *all* levels (firm, office, practice group, etc.)
- Every individual who invests in the firm must be a lawyer
  - No "outside" investors.
  - No venture capital, etc.
  - No corporate ownership.
  - No publicly-held law firms.

→ **All law firms are organized as partnerships (or vereins...), and**
→ **Partnership is valuable.**

[1] Hadfield, Gillian, and Deborah Rhode. 2016. "How to Regulate Legal Services to Promote Access, Innovation, and the Quality of Lawyering." 67 *Hastings Law Journal*, p. 1193.

# Partners and Partnership

Two-Tier System:

- Associates
- (Equity) Partners

Three-Tier System:

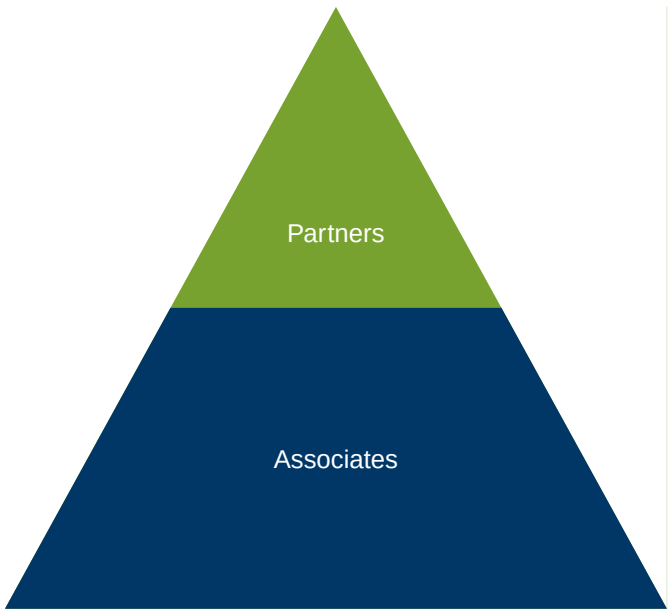
- Associates
- Non-Equity Partners
- Equity Partners

In general, there are more associates and non-equity partners than equity partners...

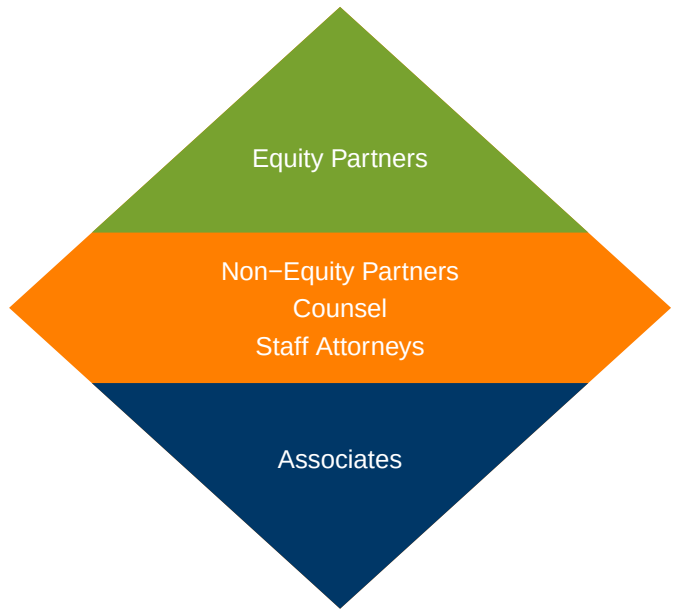
$$\text{Leverage} = \frac{N_{\text{Associates}} + N_{\text{Non-Equity Partners}}}{N_{\text{Equity Partners}}}$$

# Law Firm Models

Pyramid Model




Diamond Model



# Pyramids and Diamonds

Classic Pyramid: Skadden Arps:

- $N_{\text{Equity Partners}} = 383$
- $N_{\text{Non-Equity Partners}} = 0$
- $N_{\text{Associates}} = 1271$
- Leverage $= 3.32$

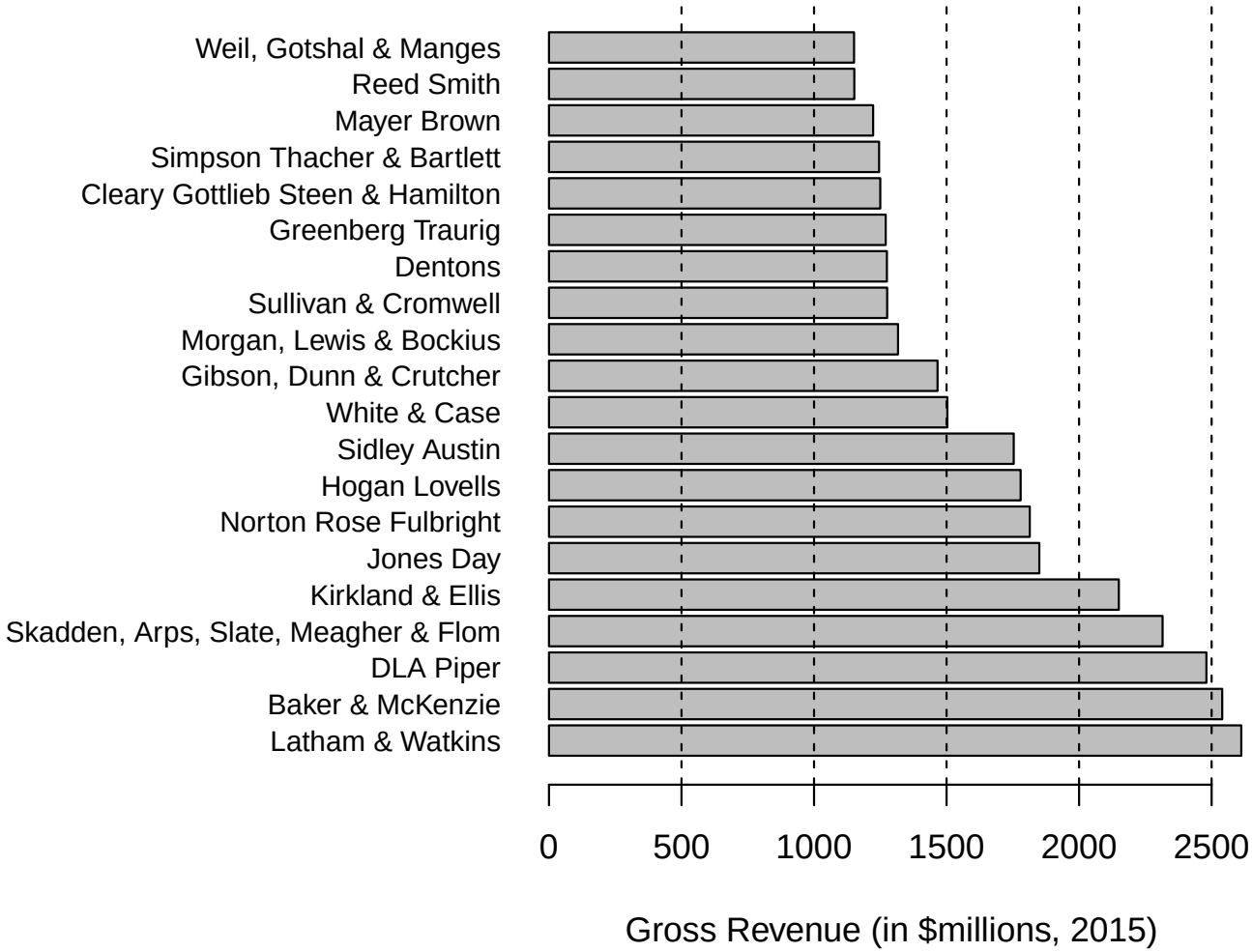
Classic Diamond: Lewis Brisbois:

- $N_{\text{Equity Partners}} = 103$
- $N_{\text{Non-Equity Partners}} = 454$
- $N_{\text{Associates}} = 334$
- Leverage $= 7.65$

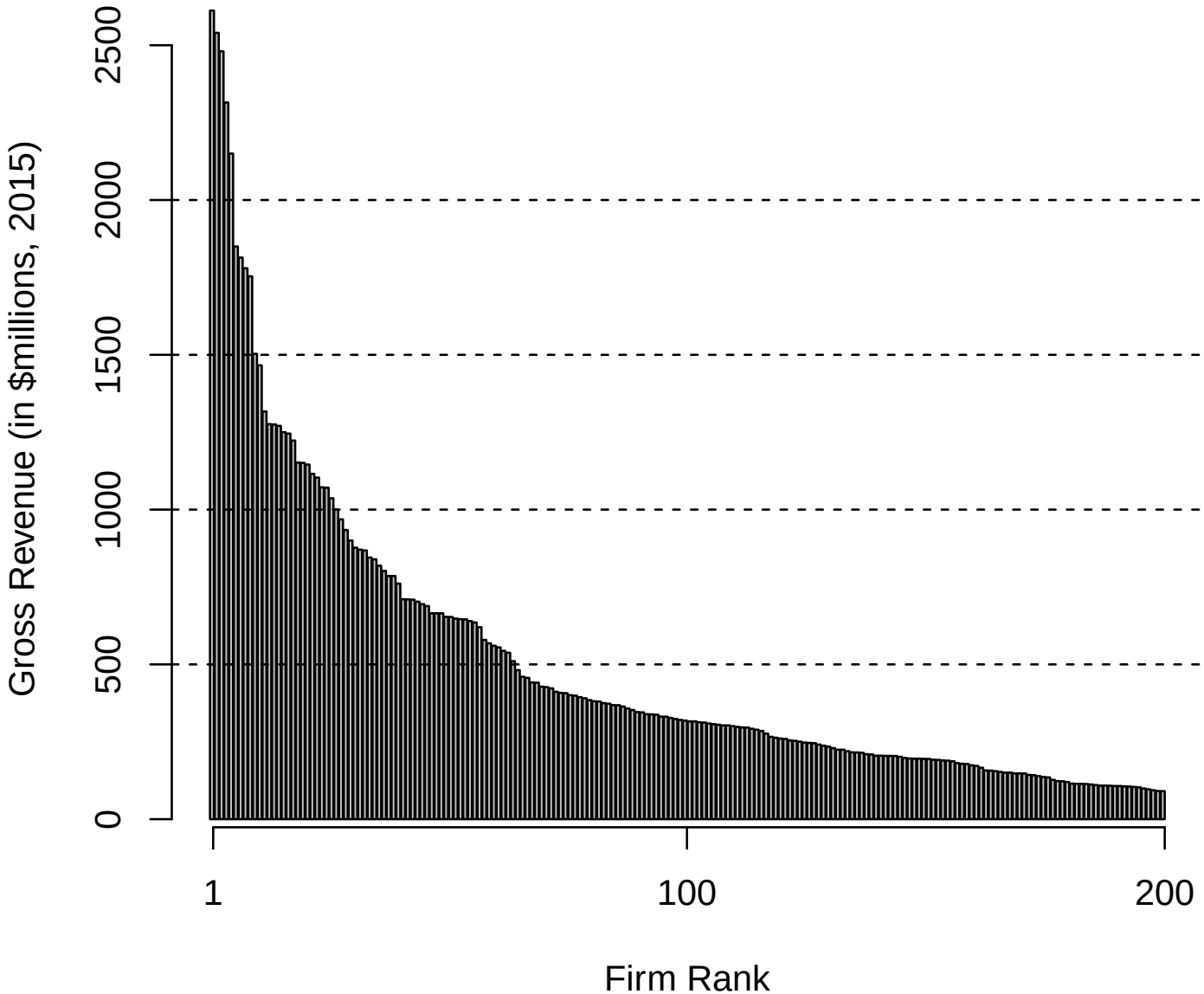
# Some Data: The "AmLaw 200"

- Annual data collected by *The American Lawyer*
- The 200 largest law firms in the U.S., as measured by gross revenue
- Began in the 1990s...
- Information includes:
  - Gross revenue + revenue per lawyer (RPL)
  - Profits and Profits per (equity) Partner (PPP)
  - Number of equity and non-equity partners, and associates
  - Leverage
  - Average compensation
- Here: Focus on one recent year (2015)...

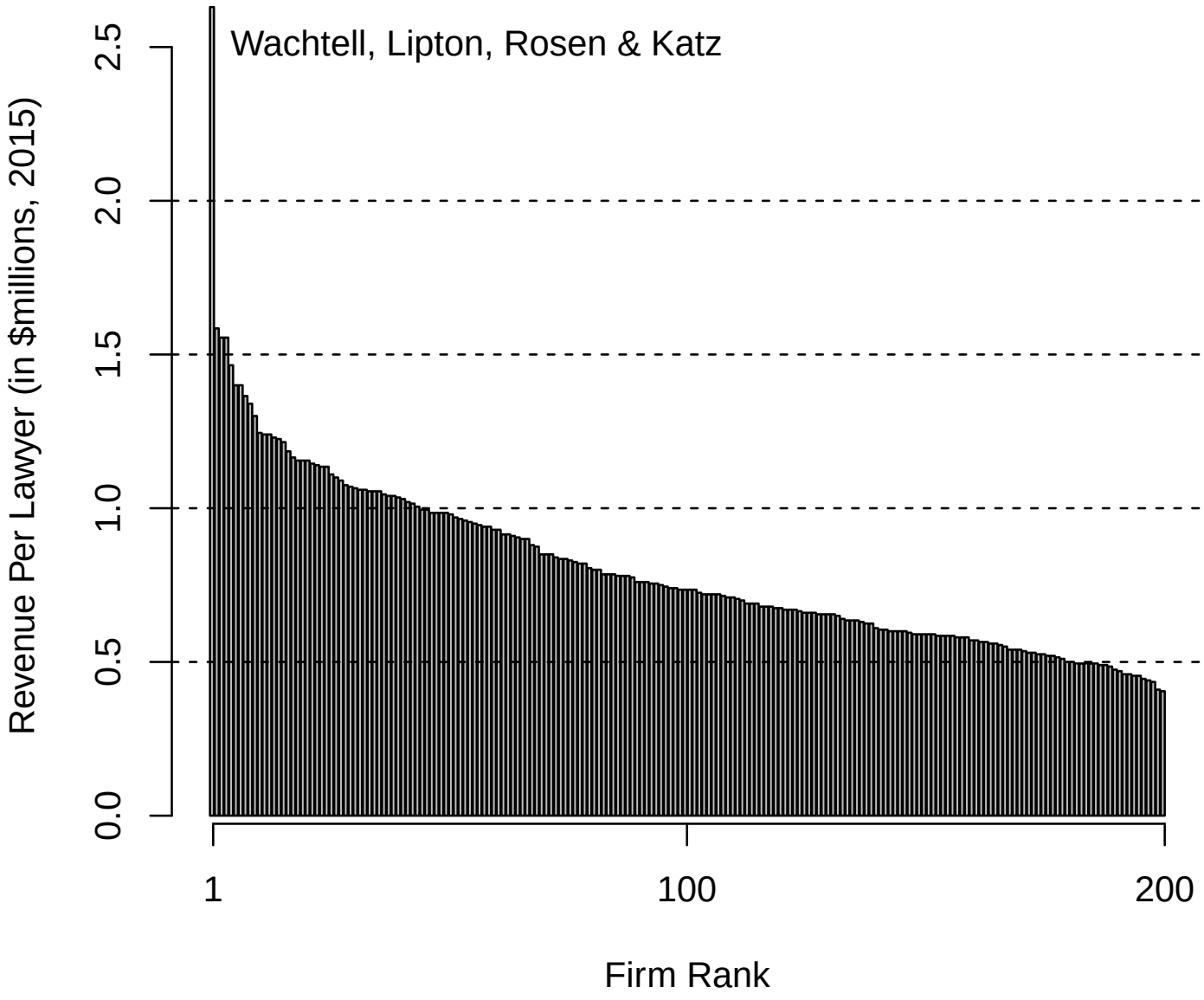
# The 20 Biggest Law Firms (by Revenue, 2015)



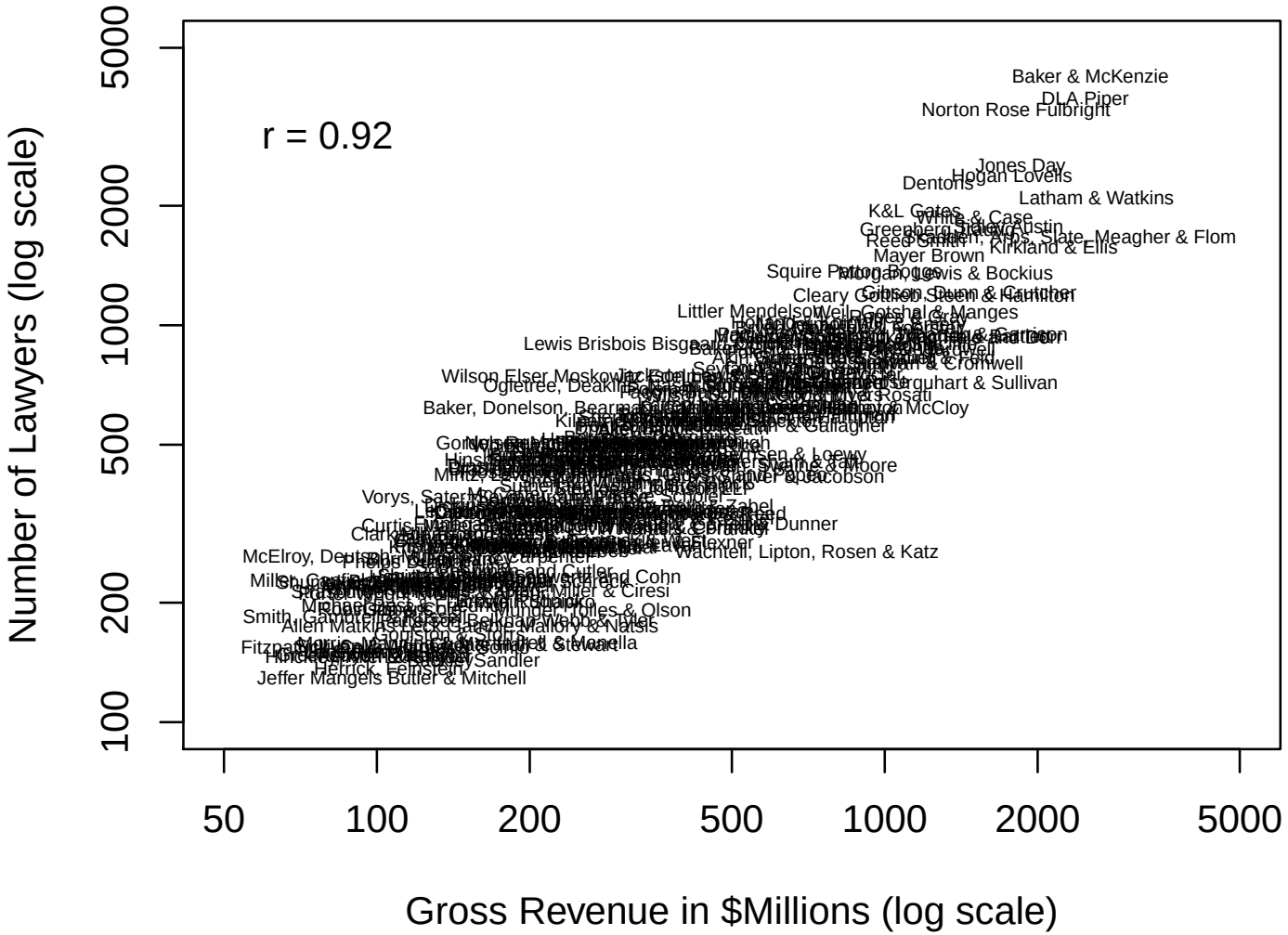
# Gross Revenue in the AmLaw 200 (2015)



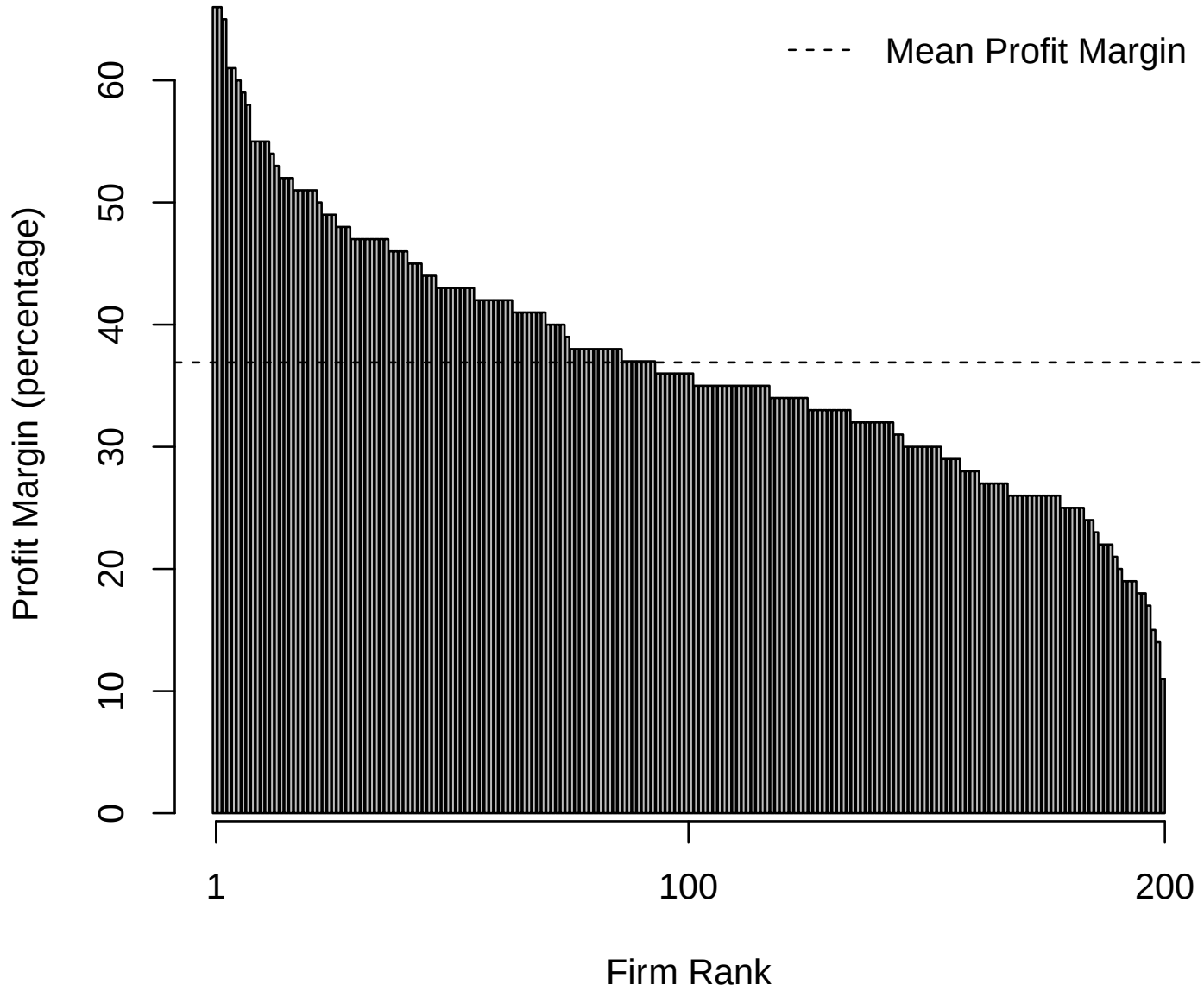
# Revenue Per Lawyer



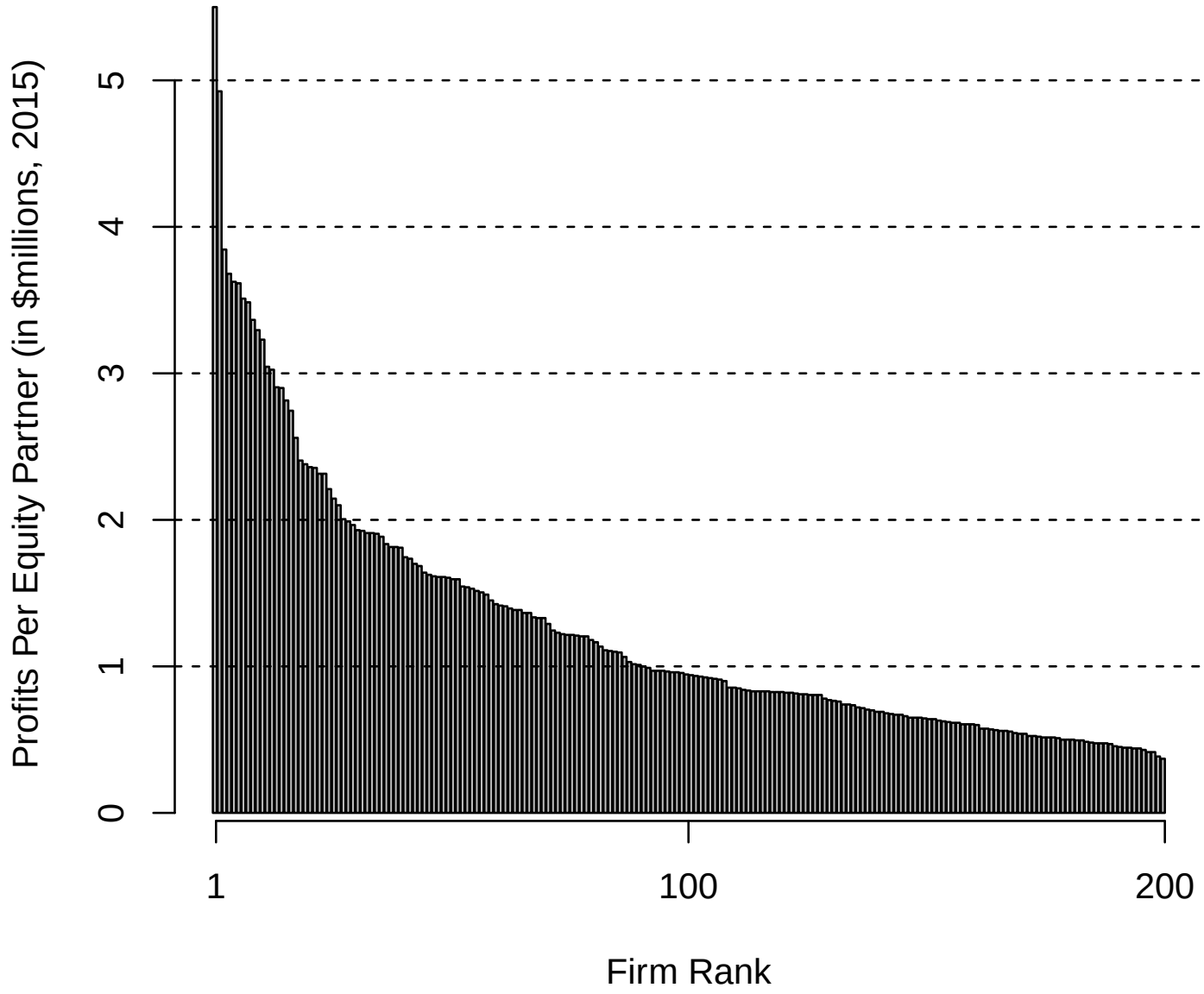
# Firm Size and Gross Revenue



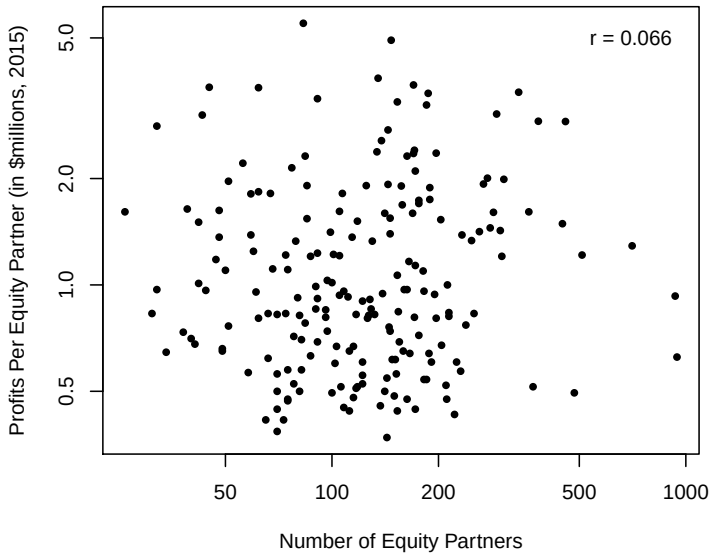
# Profit Margins

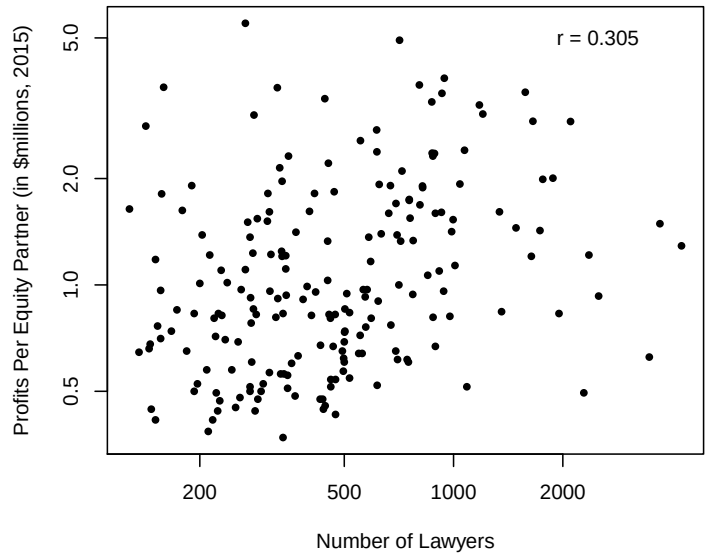


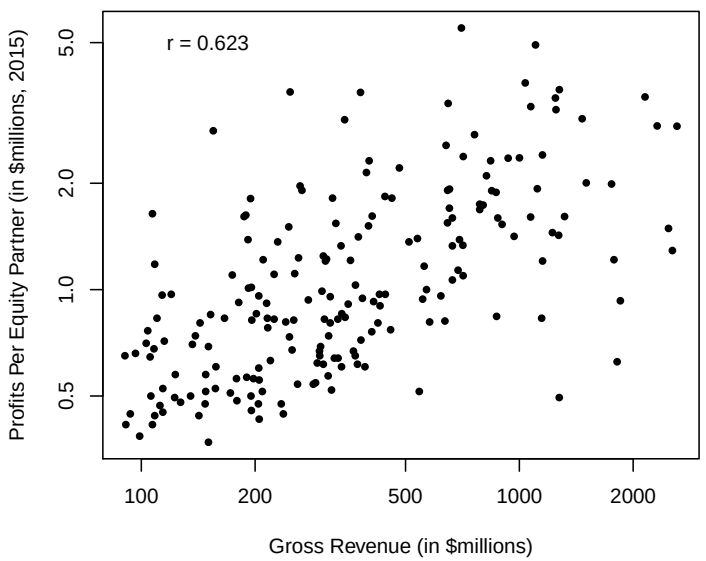
# Profits Per (Equity) Partner (PPP)

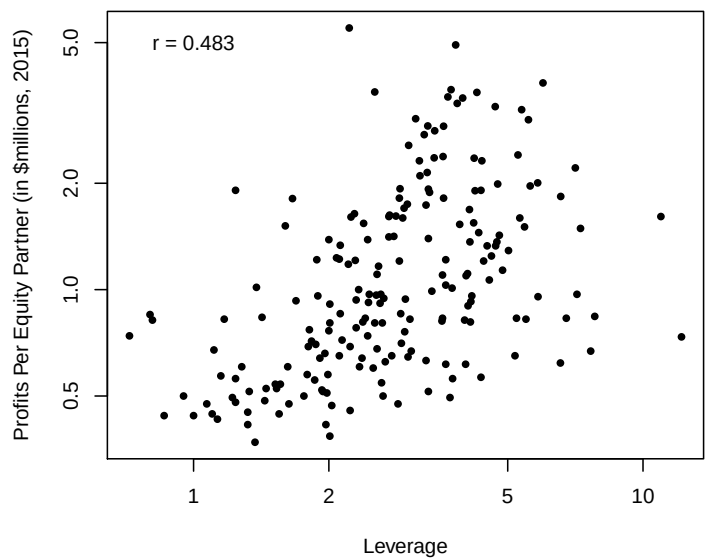


# What Correlates With PPP?

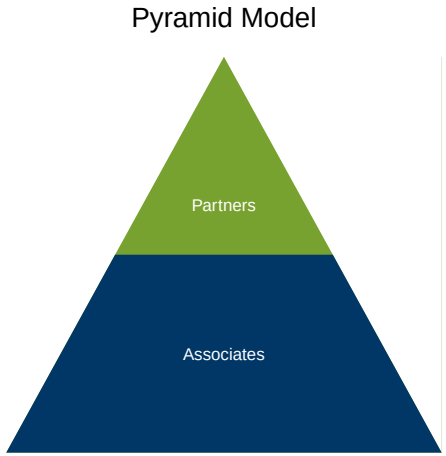


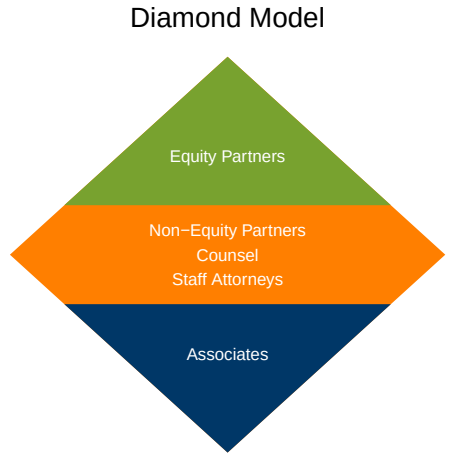



# Operationalizing Firm Type

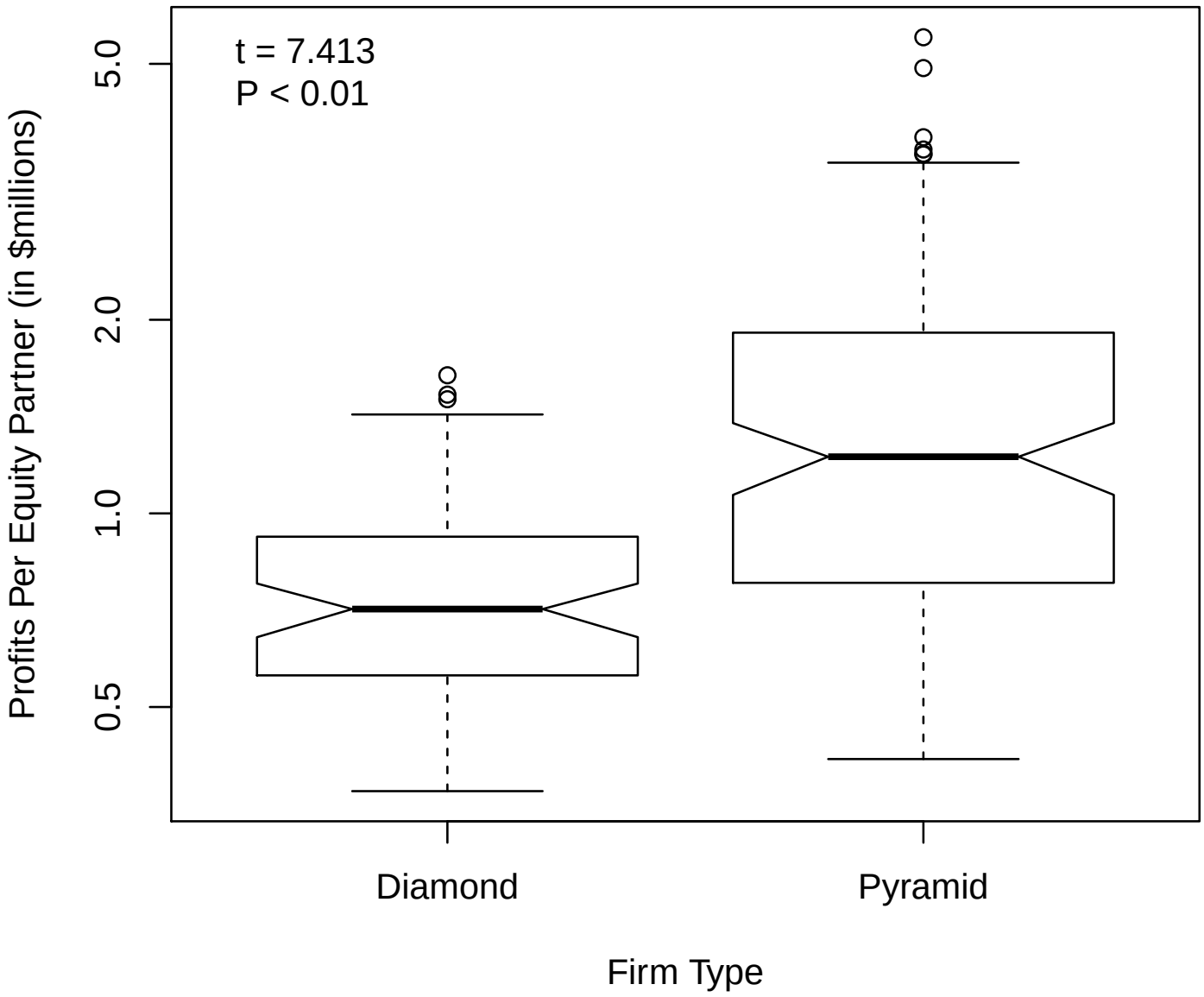



Criteria:

- $\frac{N_{\text{Non-Equity Partners}}}{N_{\text{Associates}}} < 0.5 \longrightarrow \text{Pyramid } (N = 130)$
- $\frac{N_{\text{Non-Equity Partners}}}{N_{\text{Associates}}} > 0.5 \longrightarrow \text{Diamond } (N = 70)$

# Profits Per Partner by Firm Type



# Models of Profits Per Partner

| | *Dependent variable: log(ProfitsPerEquityPartner)* | | |
|---|---|---|---|
| | All Firms | Pyramid Firms | Diamond Firms |
| Constant | $-7.307^{***}$ | $-7.452^{***}$ | $-5.731^{***}$ |
| | (0.623) | (0.707) | (1.288) |
| log(Gross Revenue) | $1.517^{***}$ | $1.524^{***}$ | $1.407^{***}$ |
| | (0.045) | (0.051) | (0.095) |
| log(Number of Lawyers) | $-1.467^{***}$ | $-1.475^{***}$ | $-1.365^{***}$ |
| | (0.048) | (0.054) | (0.101) |
| log(Leverage) | $0.318^{***}$ | $0.373^{***}$ | $0.222^{***}$ |
| | (0.029) | (0.036) | (0.043) |
| Diamond Firm | $-0.050^{*}$ | | |
| | (0.030) | | |
| Observations | 200 | 130 | 70 |
| $R^2$ | 0.913 | 0.916 | 0.820 |
| Adjusted $R^2$ | 0.911 | 0.914 | 0.811 |
| *Note:* | | $^{*}$p<0.1; $^{**}$p<0.05; $^{***}$p<0.01 | |

# The Business Side of Legal: Other Topics

- Practice Areas
- Specialization
- Location / Geographic Scope
- International Practice + Partnerships
- The "Billable Hour Model"
- $\rightarrow$ Incentives for Innovation