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Four Big Pictures Trends to Watch in a Roiling Market

Benjamin H. Barton

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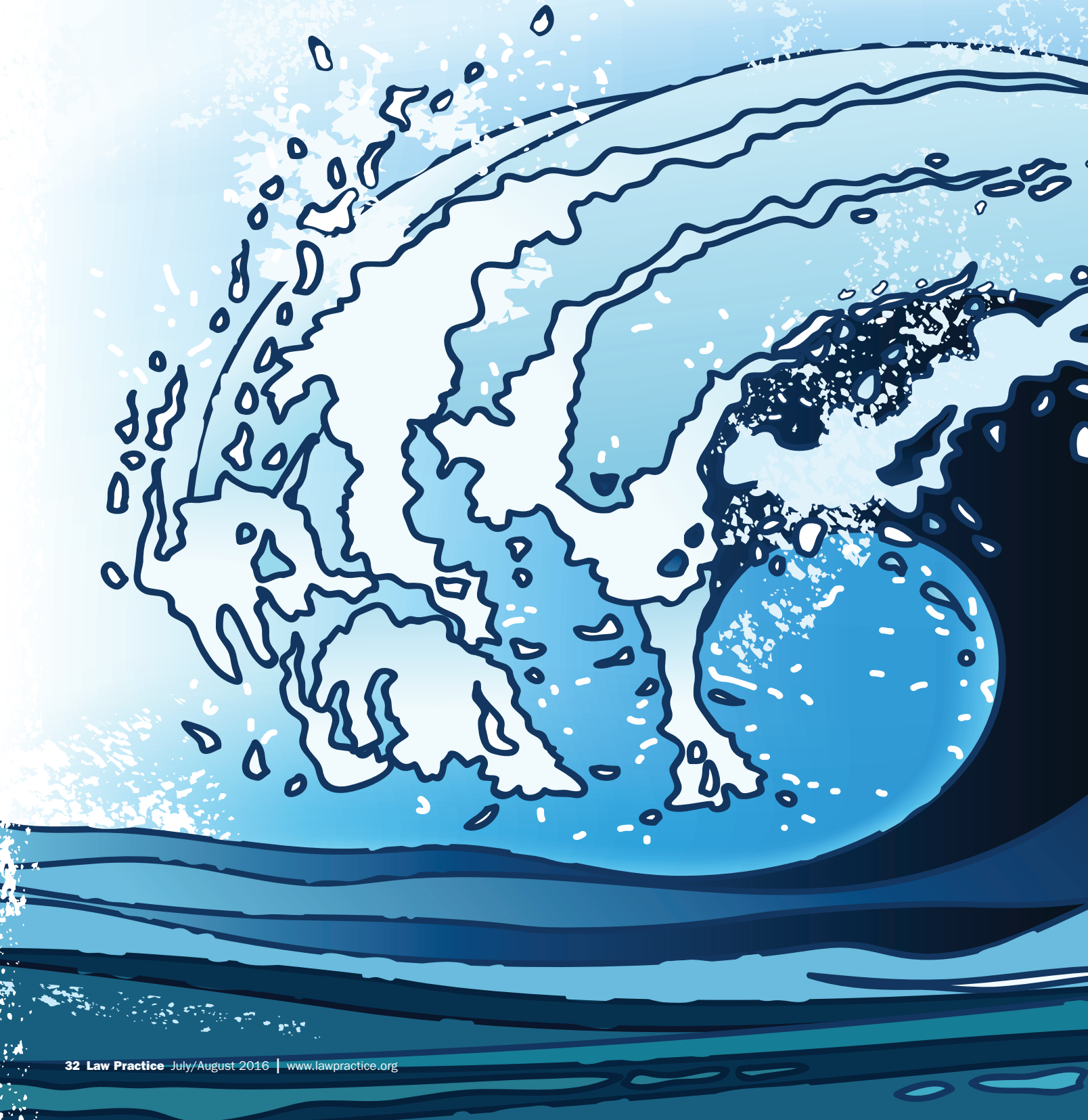
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FOUR BIG PICTURE TRENDS TO WATCH IN A

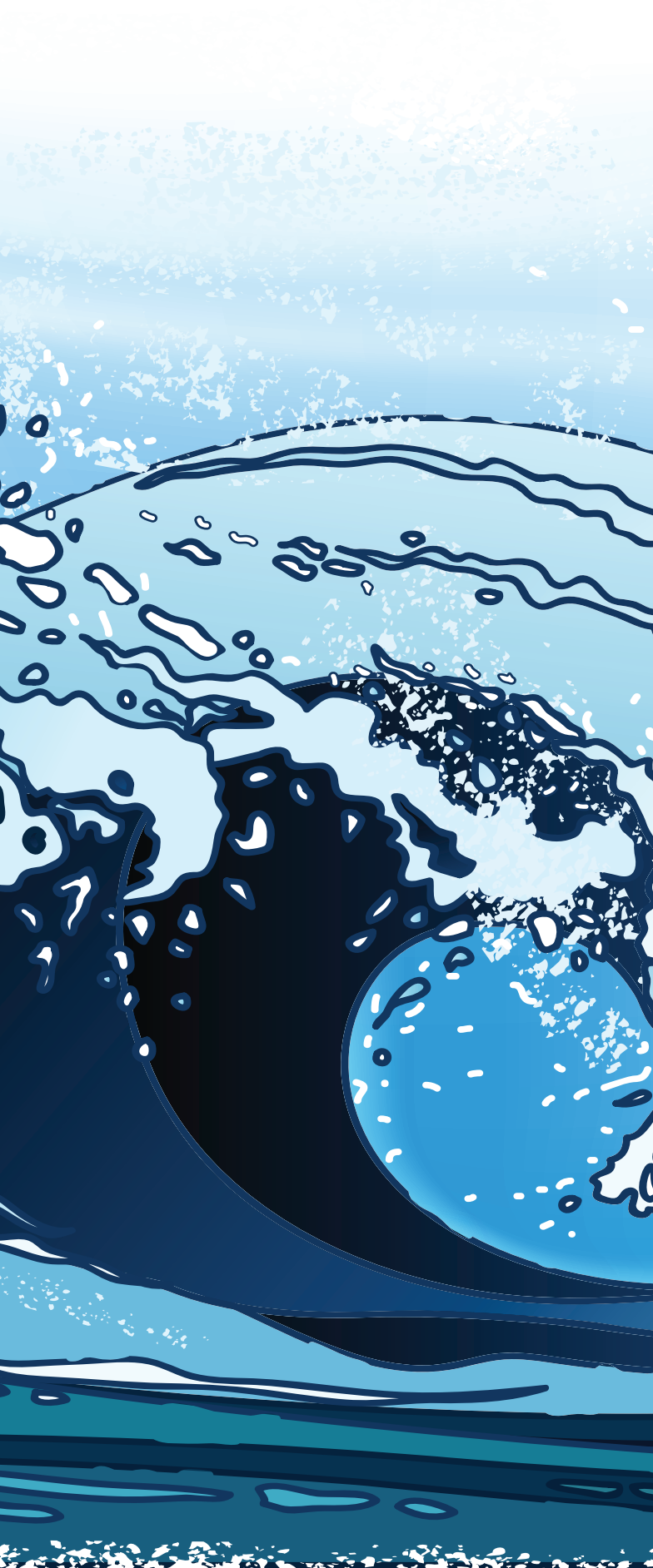


ROLLING MARKET

**Crisis is just another
word for opportunity.**

By Benjamin Barton





THE

every year my colleague Glenn Reynolds and I teach a seminar called Images of the Law. In the class we watch movies about lawyers and then discuss them. We mix up the offerings but always show two classics: *The Paper Chase* and *The Verdict*. *The Verdict* is the single greatest movie about American lawyers and courts, and I relish the opportunity to see it again and again. *The Paper Chase* is an extremely annoying movie about a misguided group of whiny first-year law students. I have seen it so many times that I now dread rewatching it. But every year it is the students' absolute favorite. Why? Because they identify so closely with the story, setting and the characters, despite the fact that it depicts law school in the 1970s. Law school has changed that little over the years. The courtroom scenes in *The Verdict* are the same, very recognizable to modern audiences.

Sure, today's law school classroom is less cruel and features more laptops, and a modern courtroom has computers for the clerks and lawyers, but the basic courtroom and classroom experience are still very much the same today as they were 50 or even a 100 years ago. Yet we are living through the greatest period of legal change since the Great Depression—and maybe since the Industrial Revolution. The traditional practice of law is facing interlocking challenges from technology, globalization, nonlawyers and outsourcing. In this article I track four recent trends.

NEW PROBLEMS FOR CORPORATE LAWYERS; OLD PROBLEMS FOR SOLOS AND SMALL FIRMS

Since 1967 the Internal Revenue Service (IRS) has gathered, aggregated and published two sets of anonymous lawyer tax returns: lawyers who filed partnership returns and lawyers who filed as sole practitioners or proprietors. Because tax filings lag and it takes time to scrub and produce the data, we are on a

slight time lag. Figure 1 runs from 1967 to 2013.

The data come with some caveats. I use the partnership line as a rough proxy for corporate law and the solo line as a rough proxy for small-firm and solo practice, but there are reasons why the data is not a perfect measure of those markets. The IRS sole practitioner incomes include anyone who worked full time as a lawyer, but it also includes lawyers just starting out and others winding down their practices, so those numbers may be a little low.

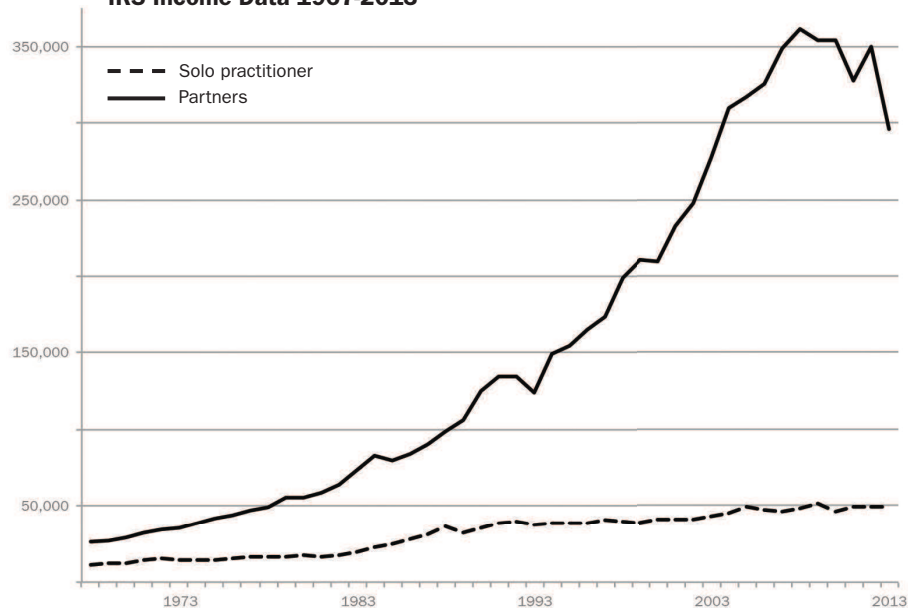
Likewise, the partnership income measure does not include professional corporations, so some BigLaw lawyers are excluded. It also includes every lawyer that filed as a partner, which mixes up Wall Street partnerships with small, Main Street partnerships. Most small partnerships have more in common with solo practitioners than BigLaw.

The IRS has collected this data in the same manner for 46 years, so it offers a unique longitudinal view into lawyer incomes. Filing taxpayers are subject to perjury or other prosecution for falsification, so the data is more reliable than U.S. Census or Bureau of Labor statistics (BLS).

If we graph partners against solo practitioners since 1967, we see the figures reflected in **Figure 1**.

First, life has been hard for solo practitioners for a long time. Figure 1 is not adjusted for inflation; it is the real income reported by the IRS every year. The solo practitioner line looks almost flat, which means that, adjusted for inflation, these lawyers have actually lost ground. In 1967 solo practitioners earned \$75,676 in 2013 dollars. In 2013 the average solo practitioner earned \$49,088, a decline of 35 percent in real dollar terms. If you choose a more recent earnings peak in 1988, solo practitioners earned \$71,783.44 in 2013 dollars that year, so earnings have declined 32 percent in 25 years.

Figure 1
IRS Income Data 1967-2013



Second, the average solo practitioner earns a very meager living in comparison to societal expectations for lawyers. When the average income is \$49,000, that means lots of American lawyers earned less than that in 2013. Some may have earned a lot less. A 2009 Alabama Bar Association survey found that almost a quarter of their members earned under \$25,000 a year.

The IRS data is not from a small sample of American lawyers. In 2013 the IRS collected 342,911 tax returns from solo practitioners. The ABA counted 1,268,011 licensed American lawyers in 2013, so the count covers more than a quarter of the lawyers in America.

Third, the gap between Main Street lawyers and BigLaw has grown substantially since 1967. In 1967 partners earned a little more than twice as much as a solo practitioner. If you went to law school hoping to work in corporate law and ended up in a small firm you earned less, but it was not as if you had fallen out of the upper class and landed in the working class. At the largest differential

In 1967 solo practitioners earned \$75,676 in 2013 dollars. In 2013 the average solo practitioner earned \$49,088, a decline of 35 percent in real dollar terms.

Figure 2
Juris Doctors Awarded by ABA Law Schools

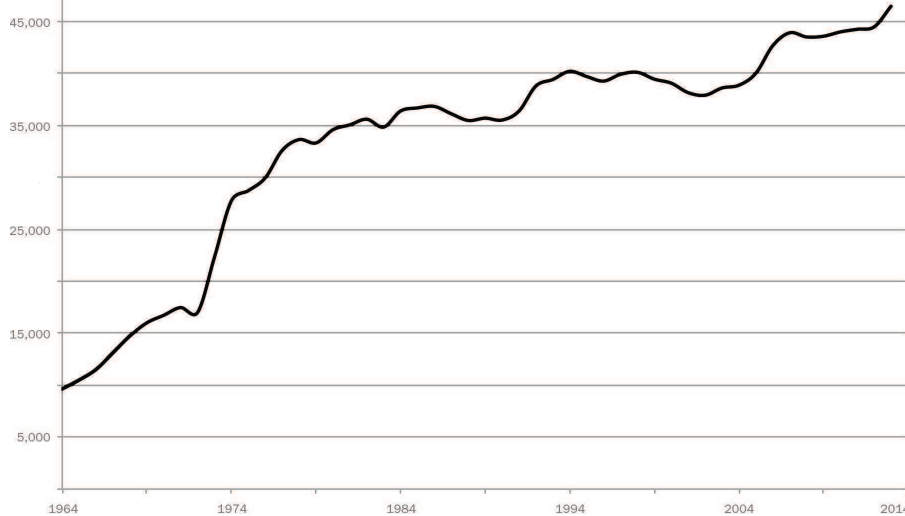
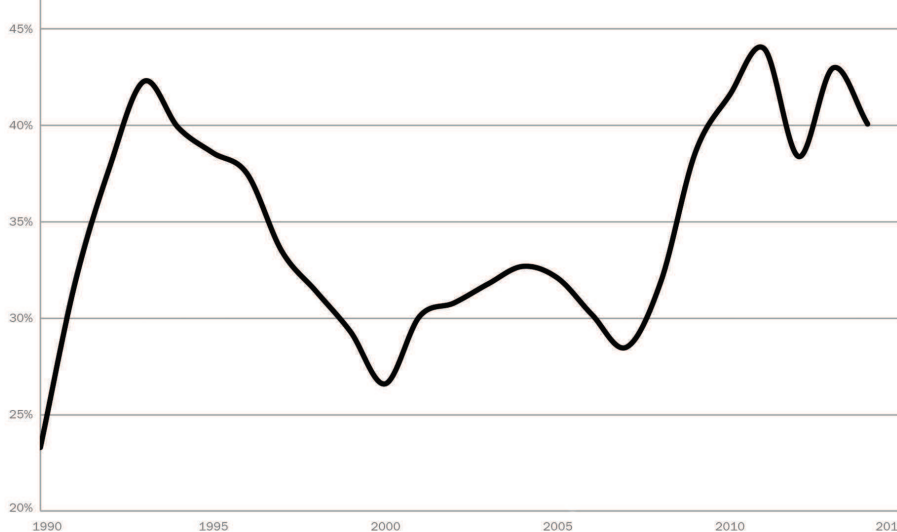


Figure 3
Percentage of Law Graduates Unable to Find Full-time Work as a Lawyer



in 2008, partners earned seven and a half times what solos earned. And that is based on the lower IRS data for partnerships. In 2013 the average profits per partner at an Am Law 100 firm was \$1.47 million, more than 29 times what a solo practitioner earned that year.

Fourth, partners (like partners in Am Law 100 firms) saw strong growth between 1967 and 2008, outpacing inflation and the overall growth in the economy. Since 2008, not so much. The IRS partner cohort has seen a 25 percent decline in earnings between 2008 and 2013. These are the steepest declines since 1967, and they look even worse given that the rest of the economy has experienced a recovery and the Am Law 100 has actually shown slight gains in revenue and profits over the same period.

What does it mean if the largest law firms in America are growing slowly but the IRS measure of all partnerships has lost 25 percent? It means that firms outside of the Am Law 100 are really feeling the bite.

The takeaway? The press has acted as if the struggles for lawyers started in the Great Recession but solo practitioners have struggled for decades. Partners have started to catch up since 2008, and our bimodal profession (i.e., corporate law and everybody else) may be showing signs of collapsing back into more of a bell-shaped income distribution.

WHAT HAPPENED TO SOLO PRACTITIONERS?

There are a lot of answers to this question, but I will highlight two. First, law schools have graduated too many lawyers for too many years. This has resulted in a glut of lawyers fighting in an already saturated market, driving earnings down. **Figure 2** shows the growth in the number of JDs since 1964.

The market for lawyers has struggled since the 1990s and yet we added roughly another 10,000 JDs a year over that period. The largest growth was in the 1970s, but that growth was more rational: the market

for lawyers was relatively strong in those years. The recent growth? Less so.

But how do we know that there are too many JD holders for the market to bear? One clue is the National Association for Law Placement (NALP) data. Every year since 1990 NALP has gathered employment data from law schools. NALP separates these jobs into different categories, such as private practice or clerkships or jobs where JDs are preferred. Figure 3 separates out the law graduates who were unemployed, those who found work in nonlaw, JD-preferred, and those who started their own practice from those who found full-time employment in jobs that required a JD.

As **Figure 3** displays, a significant portion of law grads have had a hard time finding work as a lawyer for years. Since 1990 the percentage has always been above 25 percent and in post-recession years has hovered closer to 40 percent.

Has this trend continued into practice? Maybe these folks started slow but eventually found work. **Figure 4**, which is taken from Marc Gans' excellent article "Not a New Problem," lays out four different counts that suggest that is not the case. The top dark blue line measures a 40-year count of all of the ABA law school graduates in America over that time period. The next, red line graphs the ABA count of licensed American lawyers. The light blue line is the census count of lawyers. This measures the census estimate of the number of lawyers, which is based on asking people what they do for a living and then estimating over the entire population. The lowest line is from the BLS Occupational Outlook Handbook. That lowest number is generated from surveys of American businesses. All of the counts show a significant gap between the number of law graduates and the number of lawyers.

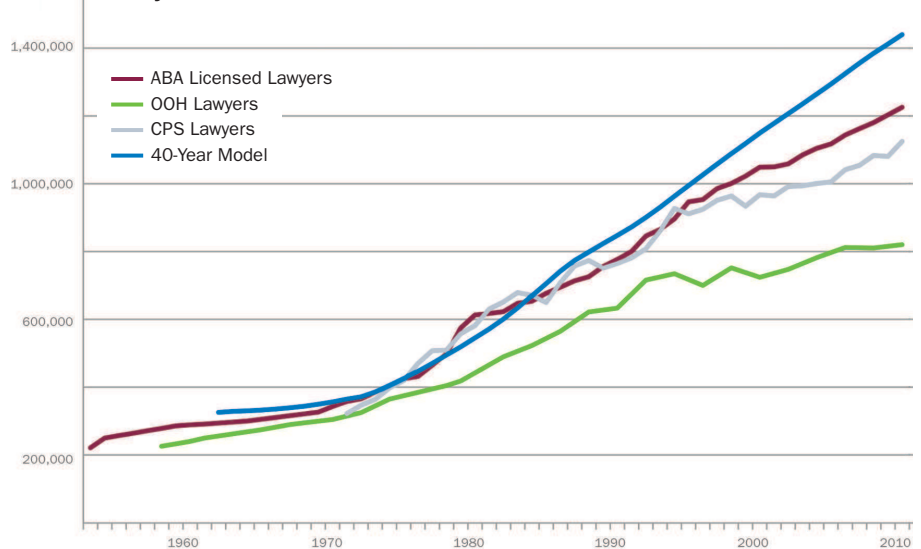
You can choose the lawyer count you prefer. The ABA count seems likely to be too high since there are many people who carry a license into retirement or a nonlaw job. Between the census count

and the BLS count, there is more room for disagreement. I tend to believe surveys of neutral third parties over those provided by individuals. Regardless, a large number of law school graduates—almost 40 percent by the BLS count—are not working as lawyers. I ran the same numbers for doctors and, unsurprisingly, there are fewer MD holders who are not working as doctors.

These data tell a lot about the market for solo practitioners and small firms. Over the last 20 years or so, we have been producing more JDs than there are good jobs. This has made solo practice grimly competitive. It has also driven a large percentage of JD holders out of practice altogether. When a law school graduate can earn more as an insurance adjuster or a manager at Chipotle than practicing law, the graduate will stick it out in solo practice for only so long.

But maybe these people have left the law for good reasons and are happier in their new jobs? When I present these figures to lawyers, judges or law professors, someone always asks me about their senator who has a law degree and is not working as a lawyer or their friend who is the CEO of a sporting goods chain. These folks are, indeed, probably pleased with their career trajectory. The *After*

Figure 4
Lawyer Estimations Over Time



the JD data, gathered by the ABA and the American Bar Foundation, however, suggests a different picture. The lawyers who are working in jobs that do not require a JD are the least satisfied with their employment and the most likely to be looking for another job. At current market rates these lawyers probably have paid upward of \$150,000 in tuition to get a job they might have been able to get without a law degree.

WHAT HAPPENED TO SOLOS, PART 2: COMPUTERIZED LEGAL SERVICES

The second pressure on solo practitioners and small firms is the rise of computerized legal services. LegalZoom was founded in 2001. Originally LegalZoom's business model was based around computerized legal forms. Some of the forms were just glorified versions of the forms that had been available in NOLO Press formbooks for years, but others were interactive forms. An interactive form program asks a user a series of questions and uses the answers to populate a legal document like a will or incorporation papers. More recently LegalZoom has joined Rocket Lawyer in selling both forms and legal services, often together and via a subscription model.

If you haven't visited LegalZoom or Rocket Lawyer, you really should. Just do a Google search for "online will" and the first two results are likely to be Rocket Lawyer and LegalZoom. The program will actually let you answer some or all of the questions for no charge, but you do have to pay to get the finished product. Prices for a will on LegalZoom start at \$69. A Rocket Lawyer basic will is free if you sign up for their legal services subscription.

LegalZoom and Rocket Lawyer claim they are not directly competing with lawyers because they are servicing clients who would not otherwise hire a lawyer or guiding clients into working with a lawyer from their network. The growth numbers for LegalZoom suggest otherwise.

LegalZoom filed an S-1 form with the

Figure 5
ABA Accredited Law Schools

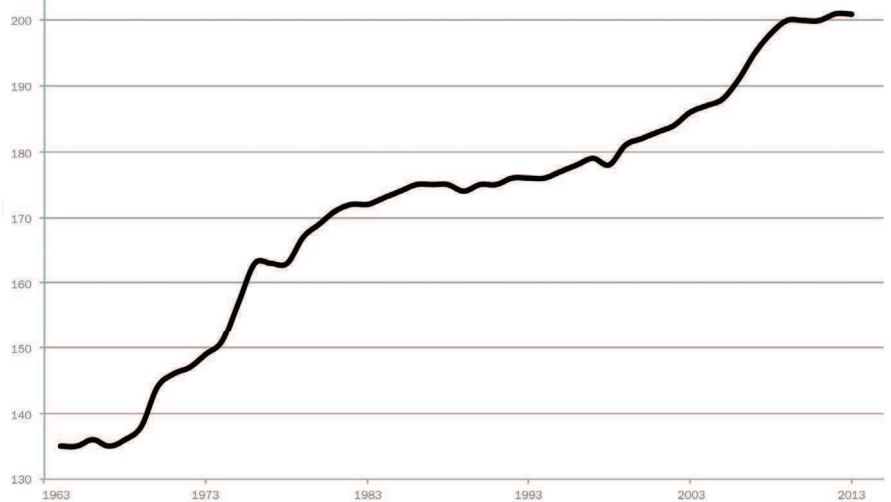


Figure 6
Average Tuition for ABA Accredited Law Schools

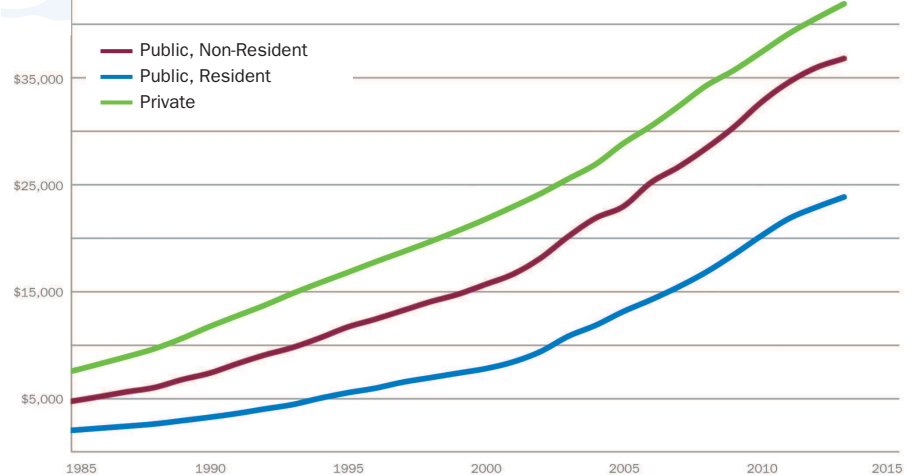
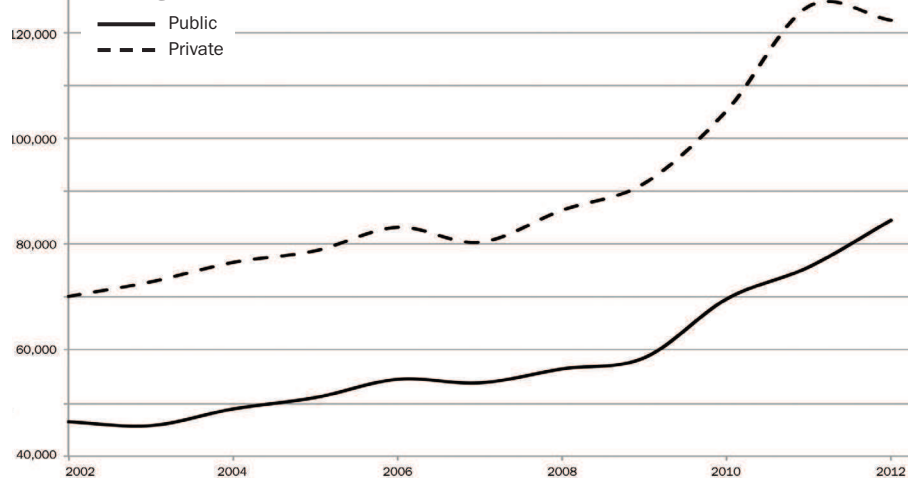


Figure 7
Average Law School Debt at Graduation 2002-2012



U.S. Securities and Exchange Commission in advance of a presumed initial public offering (IPO) in 2012. LegalZoom was later purchased by the private equity firm Permira and the IPO was shelved. Nevertheless, the S-1 form still contains the only widely available public data about LegalZoom or Rocket Lawyer. As one might expect pre-IPO, it tells a rosy tale of happy customers, growing revenues and future profits. LegalZoom claims it served approximately two million customers between 2001 and 2011. In one shocking statistic, LegalZoom claims that more than 20 percent of the new California limited liability company filings in 2011 were generated through LegalZoom. That is not a typo: one in five! Some of these LLCs probably would not have hired a lawyer in the past, but some of them surely would have. And remember that statistic is from 2011. It seems very unlikely that LegalZoom (or its archrival Rocket Lawyer) have grown less popular since 2011.

HOW WERE LAW SCHOOLS AFFECTED?

The market for Main Street lawyers, where the majority of American lawyers have always worked, has been very tough since at least the 1990s. Surely law schools adjusted to this reality? Hardly. Across the same period of time that a law degree became less valuable for many graduates, law schools relentlessly grew. The number of ABA-accredited law schools grew, the number of students and graduates grew, tuition rose, the number of administrators swelled and the student/faculty ratio shrunk.

Figure 5 shows the number of ABA-accredited American law schools.

There are now 202 fully accredited law schools, with another four provisionally accredited awaiting full accreditation.

More law schools means more law students and more law graduates. (Look back at Figure 2 if you are unconvinced.) The growth since 1990 is particularly egregious. Across a period where around a third of law school graduates could not

find work as a lawyer, law schools added roughly another 10,000 JDs a year.

These students have paid more in tuition as well, even in the current tough market for law schools. Bizarrely, law schools have continued to raise tuition above the rate of inflation, even amongst collapsing class sizes. **Figure 6** shows the average tuition

at law school between 1985 and 2013.

Some of these tuition hikes are offset by more aggressive scholarship offers. But scholarships have not stemmed the rising tide of student debt. **Figure 7** shows how much student indebtedness has risen just over the last years.

Figure 7 only runs through 2012,



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Figure 8
Total LSAT Takers

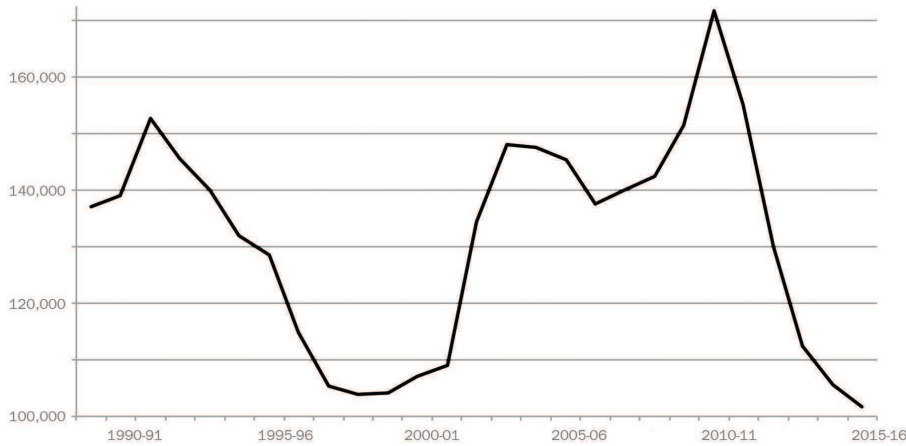
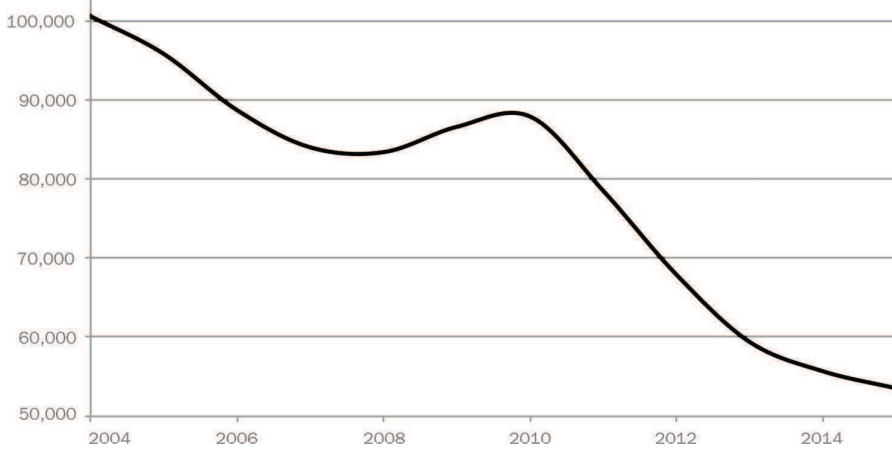


Figure 9
Law School Applicants



because in 2013 the ABA changed their question. Instead of asking how much debt a student finished law school with, they asked how much the average student borrowed in a year of law school. For 2013 those numbers were \$32,289 for public law schools and \$44,094 for private law schools. If you multiply those numbers by three years of law school, you get \$96,867 for public law schools and \$132,282 for private law schools, so the trend toward rising indebtedness continues unabated.

When something becomes more expensive but also less valuable, sales tend to fall, and that is what has happened to law schools. Fewer people have been taking the LSAT, as noted in **Figure 8**.

Fewer LSAT takers means fewer applicants (see **Figure 9**).

And that translates to fewer matriculants, as depicted in **Figure 10**.

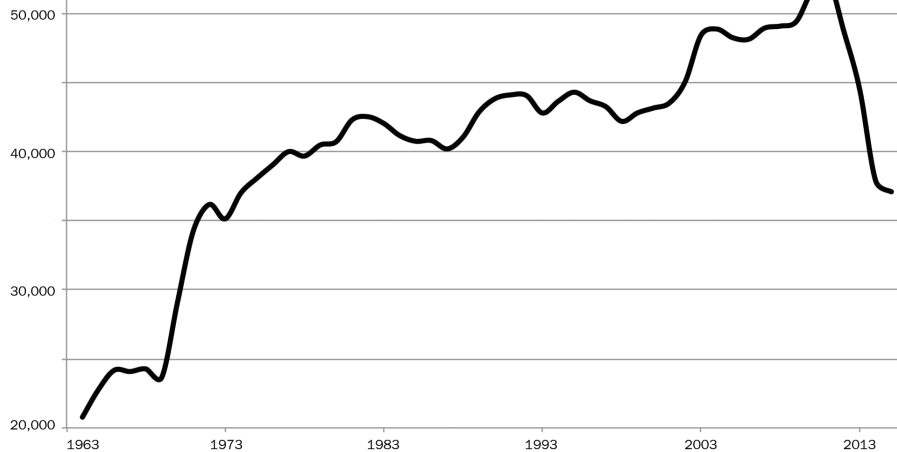
The most recent data on LSAT takers and applicants suggests that we may have reached bottom and are flattening out at a new normal, but we will know more in the fall. Even if we are at bottom, the new normal follows a precipitous decline and will mean much leaner times for law schools going forward.

As of yet no law schools have closed, although two have merged. That does not mean there has not been any bloodletting. By one count we have lost over 1,200 full-time faculty positions at ABA-accredited law schools just since 2010, more than 13 percent of American law professors.

Three recent data points—one from the top of the food chain and two from the bottom—show just how bad it has gotten. At the high end, consider the University of Minnesota Law School, U.S. News and World Report's 22nd ranked law school (and the sixth best public law school) and a school with a long tradition of excellence. Minnesota has seen its applicant pool shrink by 50 percent since 2010 and has shrunk its entering class from 260 to 176 across that period. Fewer students mean red ink. How much? An estimated \$12.5

A significant portion of law grads have had a hard time finding work as a lawyer for years. Since 1990 the percentage has always been above 25 percent and in post-recession years has hovered closer to 40 percent.

Figure 10
First Year Enrollment



million, just in 2012–15. Through support staff cuts, eliminating perks like free coffee, attrition through retirements and continued annual tuition hikes, the school hopes to be back in the black by 2019, after a total operating loss of \$16 million from 2012 forward.

If the 22nd ranked school in the country is losing \$16 million, what is the damage at the low end? Consider the Appalachian School of Law in Grundy, Virginia. Founded in 1994 as an economic development project in Appalachia, it has seen a 78-percent decline in first-year enrollment between 2011 and 2015 (from 145 to 32) and cut its full-time faculty in half. The Western Michigan University Cooley Law School has likewise seen a 57-percent cut in faculty. A number of law schools have also seen their bond ratings slashed.

Will we see mass law school closures? I think probably not. I think we will see struggling law schools take every available measure to keep the doors open, including letting anyone who applies matriculate, cutting faculty to the bone and raising tuition. It is actually very inexpensive to

run a skeleton law school staffed by a dean and mostly adjuncts. These law schools will, of course, face possible accreditation problems from the ABA. But the ABA has never disaccredited a fully accredited law school (though it has denied accreditation to applicants but never stripped accreditation once granted), so how long that process might take, and whether the ABA might be vulnerable in the inevitable lawsuits from disaccredited schools, are questions we may face in the near future.

IS THERE ANY GOOD NEWS?

Yes. I think these changes are better for the country as a whole and, after a period of change, will work out better for lawyers as well. Why? Because when hidebound institutions like law schools or law firms break up, there are tremendous openings

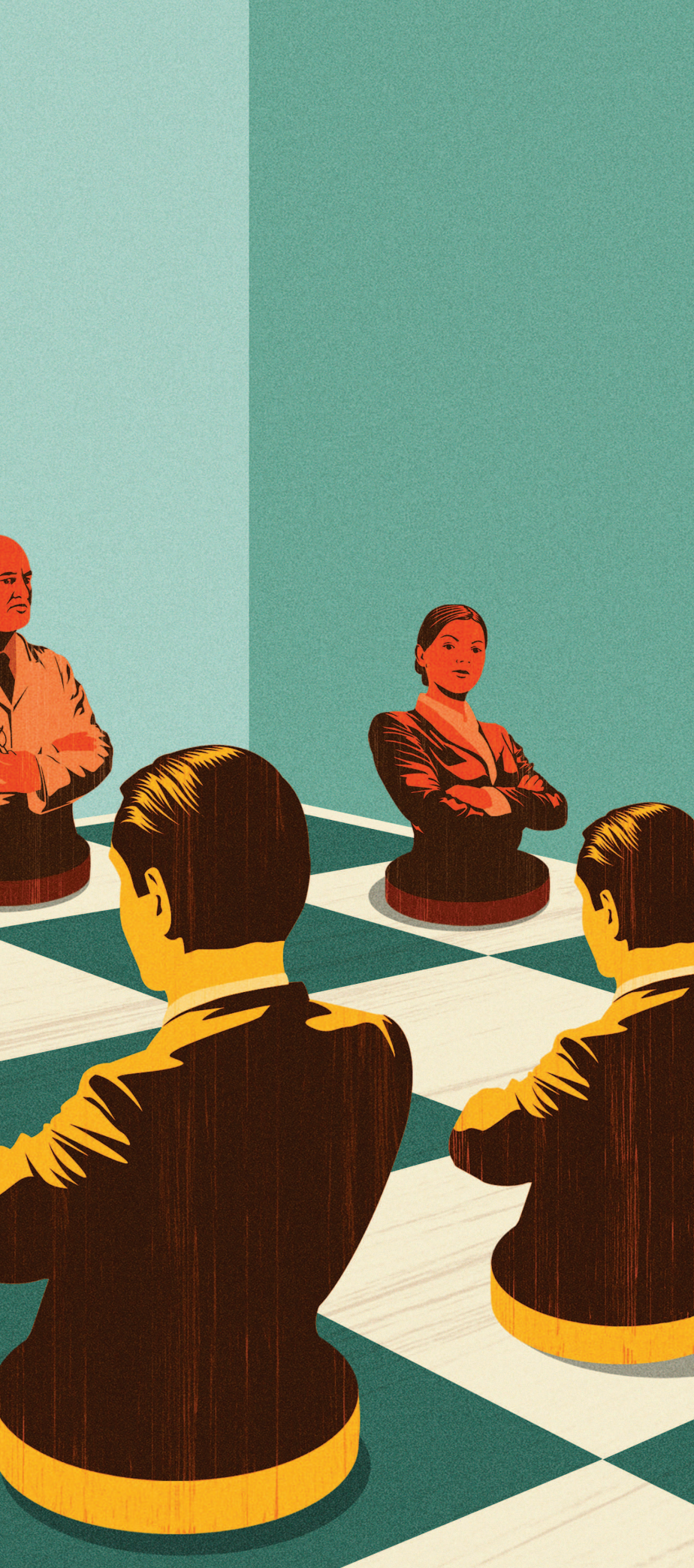
for the nimble and the entrepreneurial. I tell my students at the University of Tennessee that they are guaranteed less upon graduation than any law school class since the Great Depression. But they also have the good fortune to enter the market at a time of massive upheaval and change. Rather than just being slotted into a law firm or a government job depending upon their class rank, these students have the opportunity to blaze their own path. The bad news is these students will likely work in a bunch of different jobs over the course of their careers, with less job security than their parents had. But, on the flip side, these graduates will have many more opportunities to design their own job and to shift from place to place seeking the right fit. Crisis is just another word for opportunity. **LP**



Benjamin Barton is a professor at the University of Tennessee—Knoxville College of Law and the author of *Glass Half Full: The Decline and Rebirth of the Legal Profession* and *The Lawyer-Judge Bias in the American Legal System*. He has worked as an associate at a large law firm, clerked for a federal judge, represented the indigent for 12 years as a clinical law professor and now teaches torts and advocacy evidence. bbarton@utk.edu

THE DEBATE





Should Legal Technicians Practice Law?

WHEN THE STATE OF WASHINGTON approved a program of limited license legal technicians (LLTs) in 2012, it became the first state to license nonlawyers to practice law. To say the move was controversial would be an understatement. Proponents maintain that changes to traditional notions of law practice are essential to addressing a justice gap that has grown to crisis proportions. Critics contend LLTs will harm clients with inferior legal services and take much-needed work away from struggling lawyers. In the two pieces that follow, *Law Practice* presents both sides of the debate.