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# THE PRICE OF LAW: HOW THE MARKET FOR LAWYERS DISTORTS THE JUSTICE SYSTEM

Gillian K. Hadfield\*

- Q. How many lawyers does it take to screw in a light bulb?  
A. How many can you afford?<sup>1</sup>

## I. INTRODUCTION

Bill Clinton's legal bills in connection with the Lewinsky scandal topped \$10 million;<sup>2</sup> the bill for Ken Starr's investigation of the President exceeded \$50 million.<sup>3</sup> The cost to the eight families portrayed in the bestseller *A Civil Action* for their tort suit against a manufacturing company accused of dumping hazardous chemicals into the water supply was \$4.8 million (paid from a settlement of about \$8 million); the cost for the defense exceeded \$7 million.<sup>4</sup> Lawyers who represented the three states in the nationwide suit by state attorneys general against tobacco companies to recoup smoking-related health care costs were awarded \$8.2 billion in legal fees, averaging in some cases

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\* Professor, Faculty of Law, University of Toronto. J.D., Ph.D. (Economics), Stanford. — Ed. I have benefited enormously from conversations about this work with numerous colleagues. I am particularly grateful to Ken Arrow, Kyle Bagwell, Bruce Chapman, Ron Daniels, Kevin Davis, Bill Eskridge, John Ferejohn, Marc Galanter, Vic Goldberg, Jeff Gordon, Jack Heinz, Frank Mathewson, Bob Mnookin, Mayo Moran, Deborah Rhode, and Michael Trebilcock for extensive and generous comments and discussions, and to Columbia Law School, Cornell Law School, Stanford Law School, the Hoover Institute, the American Bar Foundation, and the University of Toronto and Osgoode Hall for providing me with an opportunity to discuss this work with a wide range of researchers in the legal profession while the paper was in preparation. This paper could not have been completed without the opportunity provided by Columbia Law School, the Olin Foundation, and the Connaught Foundation in offering me leave time as Columbia's Senior Fellow in Law and Economics in the Fall of 1998, and as Connaught Fellow at the University of Toronto in the Spring of 1999. This research was also generously supported by the Wright Foundation and the Center for the Study of State and Market at the University of Toronto. Finally, I am grateful to Hari Viswanathan and David Thomson for research assistance.

1. *Lawyer Jokes* (visited Nov. 1, 1999) <<http://www.kinseylaw.com/JOKES/Jokes.html#anochor772866>>.

2. See Katherine Q. Seelye, *Financial Holdings Stay Steady for Clinton but Legal Fees Soar*, N.Y. TIMES, May 18, 1999, at A18.

3. See Editorial, *An Unmourned Death*, L.A. TIMES, Feb. 25, 1999, at B8.

4. See JONATHAN HARR, *A CIVIL ACTION* 453-54 (1995).

over half a billion dollars per lawyer.<sup>5</sup> Total revenues to legal service providers in the U.S. now reach over \$125 billion annually, having grown at a rate that far outstrips the growth in the economy generally in the past few decades.<sup>6</sup>

These astronomical and seemingly exceptional figures betray a more widespread reality: legal process has become extraordinarily expensive, for all matters. The legal fees for a Canadian judge successfully suing a satirical magazine for \$75,000 in damages were \$20,000; the magazine's fees \$40,000.<sup>7</sup> Fees for a personal injury action by a young model who miscarried at four months and suffered a facial scar due to a slip in a grocery store were \$11.7 million of a \$30 million damage award; disbursements for costs and expenses alone topped \$750,000.<sup>8</sup> Divorce litigation routinely costs those few who can afford it hundreds of thousands of dollars; for most litigants, it commands what wealth they do have.<sup>9</sup>

Why *do* lawyers cost so much? Surprisingly, we have few insights into this basic question. Conventional popular culture has one suggestion: lawyers are an avaricious lot who will bleed you dry.<sup>10</sup> Conventional economics has another: legal training is expensive.<sup>11</sup> And conventional professional wisdom has another: lawyers enjoy a state-granted monopoly over which they control entry for the purposes of protecting the public. None of these is particularly compelling. While each seems to hold some grain of truth, each also raises more questions than it answers. How is it that the profession has come to be dominated by vice? Why is law so complicated that legal training is so expensive? Is the public better off with inexpensive low quality legal advice or high quality legal advice it cannot afford?

The profession has long been both uneasy and defensive about its relationship to the market. Concerns about the commercialization of

5. See Barry Meier, *Lawyers in Early Tobacco Suits to Get \$8 Billion*, N.Y. TIMES, Dec. 12, 1998, at A1. The settlement with Florida was \$13 billion; across the nation the total was \$206 billion.

6. See Richard H. Sander & E. Douglass Williams, *Why Are There So Many Lawyers? Perspectives on a Turbulent Market*, 14 L. AND SOC. INQUIRY 431 (1989).

7. See A. McIlroy, "Franked!," GLOBE AND MAIL, May 22, 1999, at D1.

8. See Karen M. Zuckerman, *Contingent Fee for All*, TEX. LAW., 1998 SALARY & BILLING SURVEY (Apr. 6, 1998) <<http://www.texlaw.com/special/salbill/040698r.htm>>.

9. See *Virginia's No-Fault Divorce Reform Bill* (visited Nov. 1, 1999) <<http://patriot.net/~crouch/artj/tvshow.html>> (comments of John Crouch, Executive Director of Americans for Divorce Reform).

10. Q. "What is the difference between a lawyer and a leech?" A. "A leech will let go and drop off when its victim dies." *Canonical List of Lawyer Humor (Court Jester)* (last modified Mar. 2, 1995) <[http://www-personal.usyd.edu.au/~atan/jokes/canonical\\_lawyer.html](http://www-personal.usyd.edu.au/~atan/jokes/canonical_lawyer.html)>. For a scholarly treatment of lawyer humor, see Marc Galanter, *The Faces of Mistrust: The Image of Lawyers in Public Opinion, Jokes, and Political Discourse*, 66 U. CIN. L. REV. 805 (1998).

11. See Sherwin Rosen, *The Market for Lawyers*, 35 J.L. & ECON. 215 (1992).

law practice date back almost as far as the profession itself,<sup>12</sup> and certainly characterize the modern bar. The profession is entrusted with guardianship of the justice system, and so imbued with the qualities of public service, but it also primarily distributes its goods via commercial, private markets. This dual role causes internal conflict in the profession. The American Bar Association's ("ABA") 1986 Commission on Professionalism, for example, saw the fundamental question of professionalism to be, "Has our profession abandoned principle for profit, professionalism for commercialism?"<sup>13</sup>

The relative inattention to the basic question of the economic causes of the high cost of legal services may, paradoxically, be precisely attributable to the fact that the relationship between the lawyers and the market is at the heart of modern conceptions of professionalism. As defined by the ABA's Commission on the Profession, for example, the attributes of a "profession" are primarily found in its relation to the market:

The profession receives special privileges from the state.

Its practice requires substantial intellectual training.

Clients must trust the professional because their lack of training prevents them from evaluating his or her work.

The client's trust presupposes that the practitioner's self-interest is overbalanced by devotion to serving both the client's interest and the public good.

The profession is self-regulating.<sup>14</sup>

By making the relationship between legal practice and the market constitutive of the "profession," definitions such as these cast that relationship as a matter of professional ethics, not economics. Seen in this light, the high cost of legal services is a problem of virtue, not incentives: the very concept of professionalism requires that a disregard of economic incentives be a moral duty for the professional. Lawyers charge high fees only to the extent that they fail at their professional obligation to the public interest. Conversely, fees charged by ethical attorneys are not "high."

The claim of "professionalism" in the relationship between the practice of law and the market is actually a series of linked normative claims derived from the basic fact of legal complexity. Law requires substantial intellectual training. It is therefore in the public interest that law be practiced only by those with such training. Only those with training can judge the capacity of others to practice and the qual-

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12. See Robert M. Gordon, *The Independence of Lawyers*, 68 B.U. L. REV. 1 (1988).

13. COMMISSION ON PROFESSIONALISM, ABA, IN THE SPIRIT OF PUBLIC SERVICE: A BLUEPRINT FOR THE REKINDLING OF LAWYER PROFESSIONALISM 1 (1986).

14. *Id.* at 3.

ity of practice delivered to clients, and therefore entry into practice and regulation of practice is delegated to those with training. Set apart from the control of both the state and the market, the obligation then falls to the profession not to take advantage of the absence of external controls: to put public and client interest ahead of self-interest. The profession is first conceptualized and then justified as a practice apart from the market economy.

But the practice of law is not apart from the economy. The concept of a profession may set the practice apart as a normative ideal, but the structuring of the profession is still the structuring of a market. As the question, "Has the profession abandoned principle for profit?" suggests, it is not at all evident that practitioners, even highly ethical professionals, resist market incentives in any systematic way. The question then is, if practitioners are behaving as market actors, what kind of market is this? Is it competitive, in the sense that its prices reflect costs and competitive returns to an efficient use of resources such as training and human capital? Or are there systematic features of this market that lead to noncompetitive prices or that otherwise raise the cost of legal services to levels that should trigger concern?

In this Article, I explore the economics of the market for lawyers and demonstrate its various noncompetitive features. Lawyers in fact face a string of powerful market incentives to charge fees above those that would emerge in a competitive market. As is typical of noncompetitive markets, the legal market results in prices being determined by the value placed on them by consumers, not the cost of providing the service. The allocation of lawyers' efforts are thereby skewed to those who place high monetary value on legal services and are able to pay these large sums: generally, commercial clients. The most troubling feature of these market incentives is not merely that the fees lawyers charge are high. It is that they are high because the market is fundamentally characterized by a bidding competition between commercial actors and individuals for access to scarce legal resources. This is a competition commercial actors (more generally, organizations drawing on aggregations of wealth) overwhelmingly win because of the great disparity in resources between commercial/organizational entities and individuals. Legal fees are high precisely because legal resources are, as a result of free market forces, pulled disproportionately into the commercial sphere, and individuals are largely priced out of the market. Only those individuals with claims on the resources of commercial entities (i.e., tort damages for injuries caused by corporate actors or products) and access to contingency fee arrangements can compete for legal services.

The distribution of legal services produced by the market for lawyers is thus quite disturbing: organized as a self-regulating profession with guardianship of the public justice system, a system that lies at the heart of democratic social structure, the profession is propelled by

market forces to devote itself disproportionately to the management of the economic relationships of commerce and not the management of just relations among individuals and the state.

In Part II, I sketch an empirical overview of the profession, focusing on the data demonstrating a sharp cleavage in the profession between lawyers serving corporate clients and those serving individual clients, and a disproportionate allocation of lawyers to the corporate sphere. In Part III, I catalogue the imperfections in the market for lawyers that lead the market to substantial departures from competitive price and allocation. Based on this catalogue, I identify the three basic elements supporting the structure of the market for lawyers. These are: the complexity of law, the monopoly the state has over coercive dispute resolution, and the unified nature of the profession. Each of these elements suggests an approach to policy reform to improve the accessibility of the justice system, and the analysis as a whole raises deep philosophical questions about the nature of law and legal reasoning. In Part IV, I briefly suggest some of the questions and solutions we need to explore to bring the legal system better into line with our aspirations for justice.

## II. EMPIRICAL EVIDENCE

### A. *The Cost of Lawyers and Legal Services*

Average hourly rates for lawyers in the U.S. in 1998 were \$180; large-firm partners averaged \$250 an hour with the top ten percent earning over \$385 an hour. The average lawyer billed over 7 hours a day.<sup>15</sup> At these rates, and including expenses which are billed separately (such as the cost of experts, paralegals, filing fees, court costs, transcript fees, photocopying, postage, long distance, and fax charges), any legal matter can cost tens of thousands of dollars in a matter of days. One experienced litigator estimates that it costs a minimum of \$100,000 to litigate a straightforward business claim.

For large corporations, the explosion in legal bills has led to a variety of efforts to contain costs: expanded in-house corporate counsel (approximately 10% of the profession is in-house), professional legal

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15. See Altman Weil, Inc., *The 1998 Survey of Law Firm Economics* (visited Nov. 1, 1999) <[http://www.altmanweil.com/publications/surveys/slfe/Section\\_01.htm](http://www.altmanweil.com/publications/surveys/slfe/Section_01.htm)>. Some caution is in order in interpreting this data. The sample, while large (over 10,000 lawyers and 400 firms), is based on Altman Weil, Inc.'s clients and contacts. Altman Weil is a large consultant to law firms. These clients, while they include small offices, are probably not representative of the smaller general practice or solo practitioner office serving individual clients. Anecdotal data from such firms suggest that rates of \$150 are standard. See *About Our Fees at Wolfe Legal Services, Ltd.* (visited Nov. 1, 1999) <<http://www.wolfelaw.com/fees.htm>>.

bill auditors to monitor for fraudulent billing or over-billing,<sup>16</sup> market-supplied software that mines a company's or industry's old legal bills to determine benchmarks for assessing incoming legal bills or establishing flat-fee agreements, unbundling services so that more standardized services, such as legal research, are contracted out, and awarding one firm a flat-fee contract to perform, for example, all the personal injury defense work that a large corporation has.<sup>17</sup>

While these innovations have pressured large corporate law firms to increase efficiency, it remains true that hourly rates in corporate firms have continued to increase at between 3.6 to 7.3% per year in the later 1990s.<sup>18</sup> More importantly, the costs of legal services, particularly from the perspective of the noncommercial client (for whom most of these techniques are unavailable and unworkable), are still phenomenal. One new cost-control technique is task-based billing, the rates for which speak volumes: the cost of a case evaluation and initial complaint is \$6,000 if the stakes are under \$150,000, \$12,000 if they are over \$2 million; the cost of a motion for summary judgment \$18,000 and \$40,000, respectively. (Figure 1 reproduces a sample task-based fee schedule.)<sup>19</sup>

FIGURE 1: LITIGATION FLAT FEE SCHEDULE

Task	Size of Case			
	Under \$150,000	\$150,000 to \$500,000	\$500,000 to \$2 Million	Over \$2 Million
Case Evaluation and Initial Complaint	6,000	8,000	10,000	12,000
Answer	3,000	4,000	5,000	6,000
Written Discovery Requests	900	1,200	1,500	1,800
Response to Written Discovery	1,200	1,800	2,400	3,600
Discovery Motion	2,250	2,900	3,750	4,500
Agreed Protective Order	600	800	1,000	1,200
Personal Jurisdiction	6,000	8,000	10,000	12,000
Venue Motion	6,000	8,000	10,000	12,000
Motion for Continuance	450	600	750	1,000

16. One study found that 92% of lawyers either intentionally padded their bills or knew lawyers who did. See Stephen M. Voltz, *Litigation Cost Control Resource Center* (visited Nov. 1, 1999) <<http://www.legalfees.com>>. A frequent form of overbilling is double-billing: billing two or more clients for the same work if both require it be done. Legal bill auditors estimate that 5% to 10% of bills include fraudulent charges. Overbilling and fraud have been uncovered at leading law firms in the past several years. See *id.*

17. This was done by Chrysler in recent years. See Dan Shingler, *Reminger Flat-Fee Billing Attracts Big-Time Clients*, CRAIN'S CLEV. BUS., Oct. 16, 1995, at A2.

18. See *Hourly Billing Rates*, TEX. LAW., 1999 SALARY AND BILLING SURVEY (Apr. 6, 1998) <<http://www.texlaw.com/special/salbill/032999aa.htm>>.

19. See Voltz, *supra* note 16. In 1995 the ABA, in consultation with in-house corporate attorneys and large corporate law firms, established a standardized approach to task definition and published the Uniform Task-Based Management System: Litigation Code Set. Canadian firms are following suit.



Task	Size of Case			
	Under \$150,000	\$150,000 to \$500,000	\$500,000 to \$2 Million	Over \$2 Million
Arbitration Motion	6,000	8,000	10,000	12,000
Deposition Prep and Notice	450	600	750	1,000
Response to Subpoena	300	400	500	600
Summary Judgment	18,000	24,000	30,000	40,000
Scheduling Order	600	800	1,000	1,200
Pretrial Order	4,500	6,000	7,500	9,000
Status Conference	600	800	1,000	1,200
Monthly Budget/Strategy Conference	450	600	750	900
Witness List	450	600	750	900
Exhibit List	450	600	750	900
Trial Brief	6,000	8,000	10,000	12,000
Jury Charge	3,000	4,000	5,000	6,000
Drafting Findings/Rulings	3,000	4,000	5,000	6,000
Supplemental Discovery	1,500	2,000	2,500	3,000
Motion to Disqualify	6,000	8,000	10,000	12,000
Temporary Restraining Order	6,000	8,000	10,000	12,000
Preliminary Injunction	7,500	10,000	12,500	15,000
Attachment	3,000	4,000	5,000	6,000
Preparing Draft Orders	300	400	500	600
Preparing Judgment	600	800	1,000	1,200
Third Party Subpoena	450	600	750	900
Motion to Withdraw	450	600	750	900
Notice of Removal	750	1,000	1,250	1,500
Motion to Remand	2,250	3,000	3,750	4,500
Motion to Amend	1,500	2,000	2,500	3,000
EEOC/MCAD Response	6,000	8,000	10,000	12,000
Motion to Sever or Consolidate	1,500	2,000	2,500	3,000
Motion to Bifurcate	1,500	2,000	2,500	3,000
Motion in Limine	6,000	8,000	10,000	12,000
Motion for Directed Verdict	2,250	3,000	3,750	4,500
Notice of Appeal	300	400	500	600
JNOV Motion	6,000	8,000	10,000	12,000
Motion for New Trial	4,500	6,000	7,500	9,000
Appeal Brief	22,500	30,000	37,500	45,000
Coordinate Expert's Report	2,250	3,000	3,750	4,500
Conduct Deposition	3,000	4,000	5,000	6,000
Defend Deposition	1,500	2,000	2,500	3,000
Mediation	2,250	3,000	3,750	4,500
Witness Interview	600	800	1,000	1,200
Audit Response (per matter)	150	200	250	300
Settlement Documents	1,500	2,000	2,500	3,000
Review Client Documents	1,500	2,000	2,500	3,000
Review Opponent's	1,500	2,000	2,500	3,000
Pretrial Conference	450	600	750	900
Trial (per partner per day)			2,000	
Trial preparation (per partner per day)			2,000	

If the stakes are monetary, the legal process is not worth the expense unless potential awards — and the resources available for an award — can cover these extraordinary costs. If the stakes are non-

monetary — as they are in many cases involving individuals — legal process must be either foregone or paid for with whatever wealth the individual has. In Canada, the average individual who has contact with a lawyer has one instance of contact; approximately 1/3 never have contact with a lawyer. A 1994 ABA survey found that 61% of moderate income respondents with legal problems had no interaction with the justice system.<sup>20</sup> In 1990 in the U.S., 52% of families obtained their divorces without lawyers, and in 88% of litigated family law cases — generally the most frequent type of claim in courts<sup>21</sup> — at least one party was unrepresented or defaulted.<sup>22</sup> It is not unusual for those with little or no choice but to participate in legal process — those in disputes involving children, accused of crimes, seeking protection from violence, or named as civil defendants — to be impoverished by legal fees and/or forced to default. Only routine legal work seems affordable: \$100 for a simple will, \$350 for an uncontested divorce, \$425 for an individual bankruptcy.<sup>23</sup>

Free or subsidized services — legal aid, public interest, pro bono, and publicly provided legal services — account for a tiny fraction of legal effort. Approximately 10% of lawyers work in government. In the U.S. in 1988, however, only 1% of lawyers were working as legal aid lawyers *or* public defenders. The revenues of legal aid societies are less than 1% of the total revenues to legal services nationwide, in both the U.S. and Canada. The total funding to public interest firms in the U.S., at its peak, was less than one-half of one percent of total revenues: \$35 to 50 million.<sup>24</sup> Only about 10% of U.S. lawyers participate in bar-run pro bono programs. A 1985 ABA study showed that only 20% of U.S. lawyers donated more than 1 hour a week (50 hours/year) to pro bono work; in the early 70s, a peak time for social activism, the average among the 2/3rds of lawyers who did any pro bono work was 27 hours per year (30 minutes a week).<sup>25</sup> The self-

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20. See ROY W. REESE & CAROLYN A. ELDRED, ABA, *LEGAL NEEDS AMONG LOW-INCOME AND MODERATE-INCOME HOUSEHOLDS: SUMMARY OF FINDINGS FROM THE COMPREHENSIVE LEGAL NEEDS STUDY* (1994).

21. See Ministry of the Attorney General Ontario Canada, *Court Statistics Annual Report: Fiscal Year 1997/1998 2-6* (Toronto: Ministry of Attorney General Program Development Branch, 1998).

22. See STANDING COMMITTEE ON THE DELIVERY OF LEGAL SERVICES, ABA, *RESPONDING TO THE NEEDS OF THE SELF-REPRESENTED DIVORCE LITIGANT* (1994).

23. See Legg Law Firm, L.L.C., *Fee Schedule: Service Fees* (visited Nov. 1, 1999) <<http://www.legglaw.com>>.

24. See RICHARD L. ABEL, *AMERICAN LAWYERS* (1989); KAREN WINNER, *DIVORCED FROM JUSTICE: THE ABUSE OF WOMEN AND CHILDREN BY DIVORCE LAWYERS AND JUDGES* (1996).

25. See ABEL, *supra* note 24.

reported average for lawyers in Ontario is 20 hours per year; 75% reported 0 hours for 1998.<sup>26</sup>

### B. *The Allocation of Resources Across Business and Personal Clients*

The high average cost of legal services hides a deeper and even more troubling phenomenon: the overwhelmingly commercial focus of our legal system. The largest firms serve almost exclusively corporate clients. The most successful, influential, and creative lawyers predominantly (although not exclusively) serve corporate clients. The vast majority of elite law school graduates end up serving corporate clients. Commercial clients command a huge fraction of legal effort, effectively squeezing the interests of individuals, particularly their most precious and democratically vital interests, to the margins.

In their landmark study, *Chicago Lawyers*, Heinz and Laumann first documented in 1975 the striking degree of differentiation in the legal profession between those who serve business clients and those who serve personal clients.<sup>27</sup> From a survey of the Chicago bar, they concluded that the profession is divided into two hemispheres. The corporate<sup>28</sup> sphere is characterized by large firms populated by elite law school graduates who are well-connected and influential in the profession. These lawyers serve business clients on business matters and engage in complex transactions and litigation, work that is perceived (by those who do it as well as those who do not) as high prestige. They charge high hourly fees and enjoy high annual incomes.

The personal client segment of the market is characterized by solo practitioners or small general practice/slightly specialized firms serving personal clients on personal and small business matters. The work is of two predominant types. Most is routine, noncontested legal work such as house closings, noncontested divorces, simple wills and estate planning, simple incorporations, tenant evictions, and so on. Non-routine litigation work is predominantly personal injury litigation done on contingency basis; some litigation work is done on a significant hourly fee (sometimes as high as the fee charged in the large firm segment) for wealthier individuals in family law or, less frequently, other matters. Lawyers in this segment tend to be graduates of non-elite institutions, to be less well connected and influential in the pro-

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26. Unpublished statistics from the 1998 Member Information Form data collected from all practicing lawyers in Ontario by the Law Society of Upper Canada (regulatory body for Ontario).

27. JOHN P. HEINZ & EDWARD O. LAUMANN, *CHICAGO LAWYERS: THE SOCIAL STRUCTURE OF THE BAR* (1982).

28. I use the term "corporate" here and throughout the paper to mean any business interest, including partnerships.

fession, and earn lower incomes. Their work is perceived, by lawyers in both sectors, as lower prestige.<sup>29</sup>

In 1975 the term “hemisphere” was barely accurate: 53% of legal effort was devoted to the corporate sphere<sup>30</sup> and 40% to the personal sphere.<sup>31</sup> Of the personal sphere, just half — 21% of the total work done by the Chicago bar — was devoted to what Heinz and Laumann called “personal plight”: civil rights, family, immigration, employment, plaintiff personal injury, criminal defense, and so on. The remainder was small business and personal business work done for individuals: income tax, real estate, estate planning, and so on. These numbers were roughly the same as early estimates of the breakdown of legal effort in the U.S. as a whole.<sup>32</sup>

These 1975 numbers are striking enough, but when the Chicago study was redone in 1995 the numbers were downright alarming. The share of legal effort going to corporate clients increased to 61%. Total effort devoted to personal clients fell to 29%. The “personal plight” segment accounted for a mere 16% of total legal effort.<sup>33</sup>

The personal sector is increasingly marginalized within the profession. Income inequality in the profession has increased substantially over the last few decades. In this sector, incomes and fees have either remained stable or decreased slightly with a perceived glut of lawyers and un/underemployment. The business sector has become honeycombed by specialization; incomes and fees have increased over the past decades with a perceived shortage of lawyers. Law now has the highest income inequality of the professions.<sup>34</sup> Also over the last few decades, artificial barriers to entry such as restrictions on the number of law school places, advertising prohibitions, and bar-established fee schedules have disappeared or diminished substantially. Simultaneously the number of lawyers has risen dramatically, and firm size in the corporate sphere has exploded, while the fraction of legal resources devoted to the personal sphere — the theoretical core of the justice system as opposed to the legal system — has dwindled at a rapid rate.<sup>35</sup>

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29. See HEINZ & LAUMANN, *supra* note 27.

30. These figures include in “corporate” all organizational clients, including government. These latter client types are a small fraction.

31. The remainder is work for government, nonprofits, law schools, and so on.

32. See HEINZ & LAUMANN, *supra* note 27.

33. See John P. Heinz et al., *The Changing Character of Lawyers' Work: Chicago in 1975 and 1995*, 32 L. & SOC'Y REV. 751 (1998).

34. See Sander & Williams, *supra* note 6.

35. Marc Galanter has long emphasized the dominance of organizational clients in the legal system. See MARC GALANTER, *WHY THE HAVES COME OUT AHEAD* (1974); Marc Galanter, Planet of the AP's [Artificial Persons]: Reflections on the Scale of Law and its Users (Oct. 11, 1999) (unpublished manuscript, on file with author).

In the Part that follows, I examine the economic features of the market for lawyers in an effort to account for this striking picture of the justice system. With the empirical data on the makeup of the system and the allocation of lawyers across business and personal clients, across economic and personal matters, the question becomes not merely, why do lawyers earn so much, but rather, how did we end up with a system that looks like this?

### III. THE ECONOMICS OF THE MARKET FOR LAWYERS AND LEGAL SERVICES

As I have already suggested, the allocation of legal services to the commercial sector is due to the noncompetitive nature of the market, which places the emphasis on the wealth of clients rather than on the cost of services. In this Part, I catalogue six different features of the market for lawyers and legal services that can be expected to lead to high fees and hence the commercial orientation of law. All are structural attributes that cause the market to deviate from the conditions of perfect competition. It will be helpful, then, to begin with a brief summary of the idea of perfect competition and its importance to an economic analysis of the provision of legal services.

My objective is, in the first instance, to do a positive economic analysis of the determination of prices in the market for lawyers. Positive analysis, however, has immediate normative implications. The economic framework for analyzing the operation of markets is essentially comparative: we assess the extent to which the market deviates from the hypothetical benchmark of "perfect competition." The perfectly competitive market is one in which goods are distributed by sellers with no ability to influence market price to buyers with no ability to influence market price under conditions of full information. Price is equal to marginal cost, and output is the quantity demanded at that price.

The reason "perfectly competitive" markets are of interest is because the theorems of welfare economics demonstrate that such markets result in the maximization of consumer welfare: in a sense, prices are as low as they can be, and output is as high as it can be, given the technological constraints on production and the configuration of preferences across the economy. We may wish prices were lower or output higher, but this is the best we can do given the distribution and scarcity of resources. If there are unacceptable features of the resulting market price and output, recourse must be had to redistribution, rather than restructuring of the market to "squeeze" more from it. In terms of the market for legal services, if the market is perfectly competitive its high prices are a fact of economic life. If access to legal services is unacceptable under these prices, the solution is subsidization and/or public provision of services.

Markets that depart from the perfectly competitive benchmark, on the other hand, are markets that we cannot assume achieve the best we can do. Once we leave the terrain of the perfectly competitive market (or, more reasonably, the largely perfectly competitive market), we have to look more closely at the operation of the imperfect market and the possibility of intervention to correct market failures. If we can identify structural features responsible for market failures, we can examine possible ‘fixes.’ Hence the plan of the analysis in this Article is to catalogue the ways in which the market for legal services deviates from the perfectly competitive market, and then to examine what structural response we might make in order to improve the accessibility of legal services. I conclude this Part, then, with a discussion of the links between each of the market failures I catalogue and what I identify as the basic components of the market: a monopoly over coercive dispute resolution, the complexity of law, and the unified nature of the profession.

#### A. *Complexity: The Cost of Complex Reasoning and Process*

Lawyers are expensive, in the first instance, when what they do is complex and requires sophisticated and careful reasoning and the exercise of thoughtful judgment. Competence in law often requires extensive training.<sup>36</sup> As Sherwin Rosen has noted, this explanation for the high cost of legal services goes back to Adam Smith: “High wages in a profession are necessary to compensate an entrant when great expenses must be incurred for learning its trade.”<sup>37</sup>

This account of the high price of lawyers appears quite benign, the product of competitive market forces: price equals cost. And indeed the fact of legal complexity and the cost of legal training plainly are a basis for legal expense in many cases. There are a few pieces of the complexity argument that we need to examine more closely, however, in order to see the problem with a straightforward claim that the cost of lawyers is simply the result of competitive market mechanisms and hence, in a sense, just a fact of economic life.

To begin, it is important to remember that legal costs are (usually) the product of hourly legal fees and the number of hours a lawyer devotes to a matter. Even where lawyers charge flat or contingency fees, these fees generally average out over a portfolio of cases to a comparable rate per hour charged on a noncontingency basis.<sup>38</sup> Legal fees may be high then for one or both of two reasons: hourly rates are high

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36. This is not to say that there are not things that lawyers currently do that could be done as well, if not better, by individuals with less or different training.

37. Rosen, *supra* note 11, at 216.

38. See Herbert M. Kritzer, *The Wages of Risk: The Returns of Contingency Fee Legal Practice*, 47 DEPAUL L. REV. 267, 290-303 (1998).

and/or the number of hours devoted to a matter are high. Suppose the number of hours required by a matter was fixed by the principles of justice in the same way that we conceive the number of hours for a medical procedure to be largely fixed by biology.<sup>39</sup> With hours fixed by “necessity,” perfect competition in the market for lawyers would then lead to entry up to the point at which the hourly rate produced an income compensating lawyers for the investment in legal training.

But the hours required to resolve a legal matter are not fixed by abstract and immutable principles of justice. They are determined by procedures and reasoning requirements established and implemented by members of the profession (lawyers and judges and legislators) in an antagonistic, interactive process. From an economic point of view it then makes sense to ask whether the amount of time required to resolve a matter — essentially the complexity of the relevant law and procedure — is optimal: is the value obtained by an increase in complexity justified by the cost of increased lawyer time? This question has to be asked not only of a particular case,<sup>40</sup> but, more importantly, of the system as a whole.

By “complexity” I mean not only the intellectual subtlety of legal rules but also the mass of factors and contingencies which must or could be considered in determining legal strategies, arguments, and expectations. As the complexity of law and procedure increases, the total cost of resolving a matter goes up, and hence fewer disputes and claims (that is, fewer people) have access to law and lawyers. There is no reason to think, however, that even a perfectly competitive market for lawyers will result in the optimal level of complexity in the system as a whole.

Consider first the role of judges. Judges, both directly through their rulings on procedural matters (which, incidentally, are a high fraction of rulings)<sup>41</sup> and indirectly through their rulings on substantive law, play a dominant role in the evolution of complexity in procedure. Procedural rulings can obviously extend the time it takes to resolve a matter by allowing more extensive discovery, by granting latitude for lengthy filings or hearings, and so on. Less obviously, both procedural

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39. Medical experts, and critics, will no doubt want to object that the complexity of a procedure is also a function of technology and ideology, but my point is only to draw a clear reference point.

40. There is a growing literature on the economics of civil procedure which looks at this question in particular. See, e.g., Geoffrey P. Miller, *The Legal-Economic Analysis of Comparative Civil Procedure*, 45 AM. J. COMP. L. 905 (1997).

41. In one sample of filings in Ontario courts, almost one-third of matters were procedural in nature, seeking, for example, rulings on discovery or case scheduling. (Data on file with author).

and substantive rulings will over time tend, generically, to expand the specialized legal knowledge required to resolve a matter.<sup>42</sup>

This latter tendency is a result of the nature of legal reasoning. In any system of law committed to precedent, whether as a matter of principle or pragmatism, the art of legal reasoning and decision is the art of drawing out distinctions and similarities between cases. Brilliant lawyering is the art of drawing out and then persuading others of the salience of distinctions and/or similarities that were not previously recognized. This implies that there is a natural entropy to legal complexity.<sup>43</sup> As legal rules become increasingly refined in a given area, or unified across previously disparate bodies of law, more facts and/or more legal doctrines become relevant: research needs to go up, process needs to go up, and analysis needs to go up. All this takes time.

The relevant economic questions are: How do judges decide when and to what extent to increase the complexity (cost) of resolving legal issues? What incentives or considerations guide their decisions? Do their decisions make optimal tradeoffs between the benefits of complexity and the costs of complexity?

Probably not. From a strictly self-interest point of view, these assessments are made by individuals who, for the most part, do not bear the cost of the resulting procedure. Standard economic analysis would thus not predict optimal decisionmaking. Moreover, again drawing on standard economics, even if judges bore the cost of procedure for the decisions they make, because of precedent, these decisions have a public good and a public bad quality about them. The procedures established in a given case become part of the body of law available to all in the jurisdiction. The impact on others is not taken into account by a self-interested decisionmaker, and so optimal tradeoffs are not reached.

The standard economic model of pure self-interest is, however, not a particularly appealing model of judicial conduct. Individuals are capable of ethical conduct — resisting self-interest — and judicial legitimacy in society depends on there being some confidence that judges behave ethically, even if not perfectly so. But even the most highly ethical judge, the one who is a paragon of professionalism in the sense of looking only to public interest in judgment, will not make the opti-

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42. Striking evidence of this was found in the RAND Institute's evaluation of the impact of the Federal Civil Justice Reform Act's efforts to *reduce* the time and cost of federal procedure. The study found that establishing discovery controls *increased* the amount of legal effort required to resolve a matter. Lawyers now had to become familiar with the new "streamlined" procedures and prepare filings and strategy in relation to those procedures. JAMES S. KAKALIK ET AL., JUST, SPEEDY, AND INEXPENSIVE? AN EVALUATION OF JUDICIAL CASE MANAGEMENT UNDER THE CIVIL JUSTICE REFORM ACT 16-17, 26-27 (1996).

43. See Anthony D'Amato, *Legal Uncertainty*, 71 CAL. L. REV. 1 (1983).



mal tradeoff between the benefits and costs of complexity in substantive law and procedure.

The reason is precisely because of his or her commitment to professional ethics. These ethics, for judges in particular, require that decisions be based on legal rules and principles. When asked to rule on whether a given rule is best understood to apply or not to a given set of facts — to rule on the relevance of a distinction proffered by counsel — the ethical judge responds within the terms of the legal reasons at hand. Does due process require live testimony, or can testimony be given by videotape? What if the witness is a child? A victim of abuse? A great distance away? A president? Even if the cost of live testimony versus videotaped testimony is a legitimate legal consideration, it is rare that the *cost of the complexity of the distinctions introduced into the law generally* is taken into account. In many, many cases it would be seen as positively wrong for a judge to agree, for example, that justice requires the admission of videotaped evidence in particular circumstances and then, on the grounds of controlling the complexity of legal distinctions, to nonetheless exclude the evidence and consequently convict the defendant whose only defense is on videotape. It is the nature of our system of justice, which develops law for the jurisdiction generally through decisions that must be justified in a particular case, that individual considerations will systematically dominate the attention of the court. It is the very essence of our system of legal reasoning that the terms of decisionmaking are tuned to the assessment of whether these circumstances differ from those in some way, whether this legal rule applies in light of these *particular* facts. That this sensitivity to the differences between cases renders the law complex and hence more costly, and therefore less accessible to those not before the court, is a consideration that is, if not out of bounds, clearly subordinate.

It is even unlikely that judges could, with an enlarged sense of the tradeoffs between justice in a given case and justice for those who may never get their day in court because of the cost of participating in complex legal proceedings, determine the optimal tradeoff. Given the decentralized nature of judicial decisionmaking and the generally minute incremental effect of individual decisions, there would be little but abstract guessing to guide the judge who endeavoured to make the tradeoff. And even the most sophisticated statistician of a judge would be unlikely to get the tradeoff right: as I have explored elsewhere in connection with questioning the claim that the substantive rules of the common law evolve to efficiency,<sup>44</sup> the information constraints on judges make such decisionmaking impossible.<sup>45</sup>

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44. See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 493-99 (3d ed. 1986).

45. See Gillian K. Hadfield, *Bias in the Evolution of Legal Rules*, 80 *GEO. L.J.* 583 (1992).

Thus even the best, most ethical, judges are unlikely to produce a body of law that results in a level of complexity that, like the production of goods in a competitive market, optimally balances the costs and benefits of increasing the amount of lawyers' time necessary to resolve a legal matter.

When we move to consider the role of individual lawyers in the determination of how much time is necessary, the prospects for optimal complexity become even more dismal. Lawyers face much stronger incentives than do judges to behave in accordance with the standard economic model of self-interest. Undoubtedly there are lawyers who drag out the time devoted to a matter.<sup>46</sup> More important than such deliberate bill-padding, however, is again the fact that the ethical lawyer will disregard the impact of particular arguments or strategies on the complexity and hence the cost of law as a whole. Commitment to zealous advocacy will indeed demand, or can at least be understood to demand, that the lawyer disregard such considerations. It does not hurt, of course, that ethically sanctioned willful blindness is profitable.

For all these reasons then, even if the rate of return on the investment in legal training is determined by a perfectly competitive market, as economists such as Rosen suggest, we cannot conclude that the cost of lawyers is just the competitively determined cost of complex law. The complexity of law, and hence both the amount of time devoted to a matter and the extent of legal training required, is the product of a host of factors that disregard the costs and benefits of complexity for law as a whole.

We can think of the above impact of complexity on the cost of legal services as a direct effect: complexity raises costs because it increases the amount of legal effort necessary to resolve a dispute or claim. In the rest of this list of factors that lead to high legal fees, I move on to the indirect effects of complexity.

### B. *Credence Goods: The Role of Uncertainty*

Economists refer to a good as a credence good if it is provided by an expert who also determines the buyer's needs.<sup>47</sup> Buyers of credence goods are unable to assess how much of the good or service they need; nor can they assess whether or not the service was performed or how well. This puts buyers at risk of opportunistic behavior on the part of sellers: they may be sold too much of a service or billed for services not performed or performed poorly. Theoretical work on markets for credence goods predicts that markets for credence goods may be characterized by fraud (billing for unnecessary services or

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46. See Voltz, *supra* note 16.

47. See, e.g., Michael A. Darby & Edi Karni, *Free Competition and the Optimal Amount of Fraud*, 16 J.L. & ECON. 67, 68 (1973).

services not performed) and a price mark-up over cost.<sup>48</sup> Empirical work supports these predictions: in one study of automobile repair shops, for example, it was found that 90% of testers were recommended unnecessary repairs.<sup>49</sup>

Legal services are credence goods. The sheer complexity of law makes it difficult for clients to judge the service they are receiving. This much is well understood by the profession, as the ABA definition from the 1986 Commission on Professionalism<sup>50</sup> makes plain. Professional ethics recognizes that as a consequence of the inability of clients to judge lawyers' performance, lawyers are obligated to act on the basis of their clients' interests and not their own. Whether ethical constraints in fact substantially constrain lawyers from responding to the incentive to misrepresent the need for services or the quality or quantity of services performed is another matter. The low regard in which lawyers are popularly held suggests that many people do not believe lawyers are above fraudulent behavior: "Q. How can you tell when a lawyer is lying? A. His lips are moving."<sup>51</sup> That the free market results in some such behavior is evidenced more concretely by the fact that clients are willing to spend money on the services of another lawyer to review legal bills. In-house corporate counsel oversee the cost-effectiveness of time spent by outside lawyers on a corporation's legal matters. There are also independent "watchdog" services available in the market to assess legal bills on an as-needed basis.

The real problem for the market for legal services comes not, however, from a failure of professional ethics to constrain fraudulent billing, but rather from the failure of professional ethics even to reach the deeper credence characteristic of legal services. Law is not merely complex. It is so complex that it is also highly ambiguous and unpredictable. The necessity and quality of legal services are not merely difficult for nonexperts to judge; they are also difficult for experts, *even the expert providing the service*, to judge. This magnifies the credence problem dramatically.

The complexity of law reflects the amorphous and multi-faceted nature of human conflict and conflict resolution. Law is sensitive to context and to the multiple factors that must be weighed in reaching a decision on a case. Law is a result of human judgment and communi-

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48. See Asher Wolinsky, *Competition in Markets for Credence Goods*, 151 J. INSTITUTIONAL & THEORETICAL ECON. 117 (1995); see also Winand Emons, *Credence and Fraudulent Experts*, 28 RAND J. ECON. 107 (1997) (showing existence of nonfraudulent equilibria under certain conditions).

49. See Gregory A. Patterson, *Sears's Brennan Accepts Blame for Auto Flap*, WALL ST. J., June 23, 1992, at B1; see also Ernest Holsendolph, *Faulty Car Repairs Found Widespread*, N.Y. TIMES, May 8, 1979, at A1 (citing U.S. Department of Transportation study finding 53% of service charges were for unnecessary repairs).

50. See *supra* note 13 and accompanying text.

51. *Canonical List of Lawyer Humor (Court Jester)*, *supra* note 10.

cation, processes that are subject to influence by a multitude of considerations — idiosyncrasies, past experience, personal values, time, cognitive biases and limitations, politics, and so on. The process of resolving anything other than a routine legal matter involves many cumulative effects resulting from a cascade of judgments, large and small — what evidence to produce, how to craft pleadings or contractual language, what tone of voice to adopt in testimony or argument or negotiation, how cooperative or combative to be in response to other parties, how quickly to push for a decision, how much to spend on research or outside experts, and so on.

As a result of this sensitivity to detail and differences, law is also highly unpredictable. This makes it extremely difficult for anyone, including other lawyers, to judge whether the time spent on a case was honestly and carefully determined — whether the work performed on a case was the result of care and skill. It is also difficult to systematically study the effectiveness of legal services. Outcomes are ambiguous: did the project succeed because the contract was well negotiated and drafted, or in spite of the contract? Did the plaintiff win because of the lawyering or in spite of it? What particular lawyering decisions did, and did not, contribute to the outcome? Legal malpractice standards reflect this: lawyers will be held legally accountable for failing to file documents within statutory time limits or for mishandling funds, but their judgments will not be “second-guessed.” Lawyers’ judgments are insulated from review in a way that doctors’ judgments, for example, are not. Relatedly, providers of legal services will generally provide no assurances about either outcome (except indirectly through contingency fees) or the amount of time that a matter will take; that the market for legal services is so overwhelmingly characterized by the absence of flat rates is evidence of this.

As a consequence, the market for legal services is even more fundamentally disrupted than is ordinarily the case for credence goods. There is no way for ordinary competitive mechanisms to operate effectively when it is difficult to assess and therefore compare the services offered by competing providers. The competitive “fixes” one finds in markets for other credence goods — such as the separation of diagnosis and repair — operate only on the margins in law. Outside experts such as in-house counsel or market-provided “watchdog” services can only identify obvious abuses of the use of time or resources; the ambiguity of law makes more extensive assessment impossible. Even self-assessment is difficult: the lawyer in many cases is only left with conjecture about what he or she might have done differently and whether it would have made a difference in the outcome.

The difficulty of assessing lawyers’ performance can be overstated. The “impossibility” of holding lawyers accountable for their judgments is, of course, not an unwelcome fact for the legal profession. Professional platitudes such as, “litigation is always a crap shoot” or

“give a problem to 10 different lawyers and you’ll get 11 different answers” insulate individual lawyers and the profession as a whole. While there is truth to the claim that law is unpredictable, lawyers have no collective interest in parsing this claim. It is likely that lawyers could be held more accountable than they are, more accountable than existing professional norms hold them. Nonetheless, we have to expect that the market for their services will deviate substantially from the hypothetical benchmark of perfect competition.

Consider how competition is likely to work in a market characterized by extreme uncertainty about the value of the service. In order to keep the ideas here separate from others I explore in Sections below, suppose things worked roughly as follows. Suppose that, in fact, all lawyers have the same capacity to influence legal outcomes, but that clients *believe* lawyers differ substantially in their ability to secure good results. Potential clients visit lawyers’ offices and describe their legal problems. Lawyers quote a flat rate for the service and describe how they expect to perform the service. Clients then choose lawyers, and lawyers choose the number of hours they will devote to their matters and the quality of work they will do. Once clients have been quoted a fee, they have to determine whether they think they would do better to go to another lawyer for another quote.

The uncertainty about whether the current lawyer will do good and necessary work and the uncertainty about whether an alternative lawyer would do good and necessary work, leaves the client who is quoted a price that seems “high” but not above the client’s ability and willingness to pay<sup>52</sup> in a difficult position. What reason does the client have for going to another lawyer? The client will be thrown back upon her beliefs about quality. If she believes the alternative lawyer is higher quality, then there’s a reason to go. But if she believes the other lawyer is lower quality — a position she will ultimately be in if she keeps moving to lawyers she judges to be of higher quality — then what? How can the client assess the tradeoff? Whatever tradeoff she can assess will be completely determined by her (spurious) beliefs about quality: the lawyer believed to be of higher quality can charge a higher price. And, indeed, the very fact of charging the higher price may raise the client’s estimate of his quality. Another lawyer may try to woo the client away with a lower price but will have no way of proving that he offers representation of comparable quality. All he can do is to try to manipulate the client’s beliefs about quality which, I assume, were not based on fact but rather on spurious indicia. Hence competition shifts to the production of such indicia (whatever they might be — representation of high profile or wealthy clients, win/loss

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52. Economists speak of this as the client’s “reservation price.” If the value to the client of the legal service when performed well is, say, \$1,000, then the client’s reservation price is \$1,000.

records,<sup>53</sup> expensive art work, academic credentials, tough talk, punctuality,<sup>54</sup> hours of work), and price is governed by clients' beliefs and willingness to pay, not by the cost of the service.

The basic point is that because it is so difficult to get information about the actual value of a lawyer — the extent to which a given lawyer increases the likelihood or magnitude of a good outcome for a client — the competitive mechanism works poorly if at all. So long as clients believe lawyers differ in quality — and in fact lawyers do, it is just very difficult to objectively determine when and how much — prices will be buffeted by beliefs based on signals of quality that are more or less spurious. The extent to which a lawyer can extract the highest price a client is willing to pay — the monopoly price — will depend on the strength of beliefs generated in a world where it is extremely difficult to test those beliefs.

### C. *Winner-Take-All: The Tournament of Superstars*

It might seem that the difficulty of attributing legal outcomes to the quality of lawyering and so differentiating among lawyers would lead to a situation in which clients, recognizing the difficulties, are willing to pay only small premiums for lawyers they believe to be “better.” If that were the case, high prices could be undercut by lawyers clients believed to be slightly less good but considerably cheaper. But the market for lawyers does not work this way. Here's why.

Legal work is conducted in a tournament-style setting.<sup>55</sup> What this means is that the impact of a lawyer on a legal outcome is a function not of the absolute quality of the lawyer, but of the lawyer's quality relative to the lawyers on the other side (including the judge). This is most clearly evident in the case of litigation. Litigation in an Anglo-American regime is an adversarial contest. Success goes to the litigant who is most persuasive on his or her view of the facts and the law. A lawyer who has a good command of the relevant case law is nonetheless bested by a lawyer or judge who has a better command. An advocate with good logical and rhetorical skills is vulnerable to the cut and thrust of another with even sharper wit. The process of litigation is a series of strategic moves and countermoves: sophisticated moves require even more sophisticated responses. Although it is extremely dif-

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53. Under the assumption that all lawyers are in fact identical, win/loss records reflect only the nature of the cases a lawyer ended up with, not the performance of the lawyer.

54. Customer feedback on pre-paid legal plans indicates that the most frequent concerns raised about legal providers are about characteristics such as politeness, punctuality, and returning phone calls.

55. See MARC GALANTER & THOMAS PALAY, *TOURNAMENT OF LAWYERS: THE TRANSFORMATION OF THE BIG LAW FIRM* 98-110 (1991); see also Ronald J. Gilson & Robert H. Mnookin, *Coming of Age in the Corporate Law Firm: The Economics of Associate Career Patterns*, 41 *STAN. L. REV.* 567 (1989).

difficult to assess exactly *which* moves or arguments or case citations or questions on cross-examination “determined” the result — this is what the deep unpredictability and credence quality of law is all about — it is clear that whatever effect lawyers have on the outcome is a function of performance in a given case *relative* to the performance of the other lawyers in the room.

Although it is less obvious, the same is true of transactional legal work. Take the negotiation of a joint venture agreement as an example. The distinctive role of lawyers in this setting is to structure the agreement so as to promote the interests of their respective clients; this is done in the shadow of potential litigation in the event that conflict erupts once the agreement is signed. The skillful lawyer will seek, for example, to promote his or her client’s negotiating position by limiting the disclosure of negative information, skating a line between legitimate silence and misrepresentation. The lawyer on the other side will seek to be one step ahead: challenging the interpretation of disclosure and misrepresentation doctrine, figuring out what questions to ask, representations to seek, and documents to demand in order to defeat or exploit ambiguities in the law. The lawyers will also seek to outfox each other with contract language; in the event of later litigation, the client of the lawyer who missed the potential significance of a phrase or provision pays the price. Again, the process is a series of moves and countermoves; staying one step ahead of the other side is the name of the game.

What makes the relativity of performance so important is the fact that this is a tournament — the winner takes the prize. Having a lawyer who is marginally better pays off disproportionately. Conversely, entrusting your case to a lawyer who is likely to be outperformed, even if only slightly, can cost you the case. As a result, the difference in value between a lawyer who is good and one who is marginally better can be very large. Clients are therefore (rationally) willing to pay a lot for a little.<sup>56</sup>

Robert Frank has called markets in which small differences in relative quality result in large differences in price “winner-take-all” markets.<sup>57</sup> These markets are characterized by high stakes: small differences in quality result in large differences in rewards. There can be a number of reasons why a market becomes structured in this way. Frank’s prime examples of “winner-take-all” markets are the markets for entertainers and athletes. There may be tiny, objectively insignificant differences between the winner of an international piano compe-

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56. Settlement outcomes will reflect the risk of these win-lose possibilities. Having a slightly better lawyer, because it produces a jump in the probability of winning, also produces a jump in settlement amounts.

57. See ROBERT H. FRANK & PHILIP J. COOK, *THE WINNER-TAKE-ALL SOCIETY* 2-5 (1995).

tition and the runner-up, but in a world in which everyone can listen to the winner's performances on CD, the difference in earnings is tremendous. Similarly, the advertising endorsement fees paid to a gold medal winner from the Olympic Games far exceed those of the silver medalist. In these cases, the nonrivalrous nature of musical recordings or advertising images accounts for the disproportionate rewards: my listening to Pavarotti or watching Michael Jordan does not diminish your ability to do likewise. This is the result of technology: the number of potential consumers is vastly greater than in the days when performances could only be heard or seen by the number of people who could fit into a concert hall or stadium. The high returns to the winners in these markets then result from the sheer volume of consumers to whom the winners' performance can be sold.

Legal markets might seem an unlikely candidate for winner-take-all dynamics because, unlike Frank's primary examples, there are obvious limits on the number of clients for whom a lawyer can perform. Some evidence that legal markets are nonetheless driven by these dynamics comes from the dramatic increase in the size of law firms over the past two decades and the tendency for reputations for quality to attach to the firm as opposed to individual practitioners. As Galanter and Palay have argued, the large law firm allows more lawyers to share in the human capital and reputation of successful lawyers; individual partners can act for a larger number of clients when substantial portions of the work are delegated to junior colleagues; the strategic lessons of litigation or contract drafting or client management can be passed down in the firm's records and culture. Knowledge, like musical and athletic performances, is a nonrivalrous good as far as the firm's clients are concerned, even if it is put to rivalrous use.

The potential sharing of legal performance among a large number of clients is, however, not the only feature of legal markets that subject them to winner-take-all dynamics. High levels of uncertainty about the quality of a performance in a setting of high stakes can also be responsible for these dynamics. Frank discusses the incentives of the corporate manager in selecting, for example, an outside consulting firm for marketing advice. In a fast-paced, highly competitive global market where the payoff for a successful advertising campaign can be enormous — and so too the cost of losing — managers are likely to be motivated to “go with the best.” Doing so protects them from being an easy target for blame in the event the campaign is a failure. In a world of great uncertainty and high stakes, sometimes the best you can do is minimize your chances of regret.

So again the uncertainty of law is a key determinant of the working of the market for lawyers. Some missteps in lawyering can be enormously costly, but it is very difficult on the margin to predict which steps will turn out to be missteps. This is precisely why lawyers will always refuse to give guarantees: even in hindsight it is hard to tell



what turned the tide, and even best efforts to choose the most promising course can prove disastrous. Against this uncertainty, the best a client can do in selecting a lawyer is to choose the best she can afford. It is simply too difficult to calculate what the cost of choosing a lesser lawyer might be. The type of rational consumer behavior that drives ordinary market competition is simply not possible. Rationality requires choice among options that can be compared. When all you have is a ranking of lawyers, with no information about just how much the outcomes obtained by lawyers within the ranking might vary, the only rational<sup>58</sup> response is to choose the lawyer you believe to be the best whose fees you are willing to pay.

To the extent the indicia on which clients base their rankings are public and common as opposed to personal and idiosyncratic, individual lawyers or firms will emerge as tournament winners, with the ability to essentially auction their services among potential clients.<sup>59</sup> And it is reasonable to suppose that for the most part the indicia that potential clients look at are indeed public and shared. Against the backdrop of the knowledge that lawyers do differ in their ability to influence legal outcomes but the near impossibility of objectively assessing those differences, potential clients are likely to search for significance in whatever information is publicly available about the performance of a prospective lawyer. They will interpret signals — such as firm size and location, yellow-pages or television advertising, representation of celebrities — with reference to the public meaning of these signals. They will, rationally, look for widely shared indicia of quality because doing so in effect pools the information of disparate clients. In a setting of extreme uncertainty, the public beliefs that emerge may be deeply flawed, but they are at least the result of an aggregation of experiences, each of which contains a tiny bit of data.

Moreover, lawyers face an incentive to signal their quality and so to help develop the public meaning of signals. Given the prospect of emerging as the winner of a tournament, individual lawyers have an incentive to persuade the public that their superior quality is revealed by, for example, their tough attitude or their win/loss record or the high quality of their suits. In doing so they will naturally exploit whatever beliefs lie dormant among the pool of prospective clients and whatever slim informative value a signal might have. The most successful signals will be those that are widely believed to be informative, because clients will have their beliefs confirmed by others, both directly by reputation and indirectly by evidence that the lawyers displaying these signals are able to command high fees. Simultaneously, signals will lose their value as a means of differentiating among law-

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58. This is not to say that people cannot or do not choose “nonrationally,” by which I mean on the basis of criteria which cannot be computed in the economist’s sense.

59. I am grateful to Bruce Chapman for emphasizing the need for a shared ranking.

yers to the extent they become too easily displayed and hence too widely shared among members of the bar.

And so some lawyers will emerge as winners, garnering large rewards for their (marginally) better performance as reflected by signals that are based on difficult-to-test beliefs. As top-ranked players in the legal tournament, these lawyers will be sought after by clients who face all-or-nothing outcomes depending on the legal representation they are able to secure. Their fees will reflect the amount clients have at stake and not, as in the perfectly competitive market, the opportunity cost of the service. This is the basic characteristic of market power: prices driven by the value that consumers place on the good rather than the cost incurred by producers of the good. The deep uncertainty in law and the all-or-nothing nature of the stakes for clients give lawyers market power through winner-take-all dynamics.

The driving role of clients' willingness to pay also suggests that we can predict that there will not be just one legal tournament, but several. Clients form different pools based on the types of legal problems they have, the amounts at stake, and the amount they are able to pay. Lawyers who fail to win big in a high stakes pool with resource-rich clients will move to compete in other pools; so will clients who lose in one pool (the capacity limitations for individual lawyers and firms is an important difference between legal markets and Frank's primary examples of winner-take-all markets). In effect, the market plays successive rounds, with the winners — lawyers and clients — in each round exiting the competition, leaving the losers to compete again. Tournament winners in each pool will be able to charge fees that reflect the willingness to pay of the clients in that pool. Thus, most lawyers will be "winners" in the sense of exercising market power to set fees that extract a large share of the value of their clients' cases.

The only legal work where we should expect a different result is legal work that is not characterized by deep uncertainty. Where legal work is routine and standardized — simple wills, uncontested divorces, house closings — clients need only find a lawyer who meets a threshold level of competence. In these nonadversarial settings, "relative" performance is not relevant. Here the elements of winner-take-all dynamics are absent, and competition is likely to work. And, indeed, it is for these types of legal tasks that the market shows evidence of competition: low flat fees, consumer-oriented legal plans, multiple providers. Incomes earned by lawyers in these markets are not high,<sup>60</sup> and this is where, by and large, the lawyers who do not succeed in the more lucrative tournaments practice.

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60. See Michael G. Crawford, *The 1999 Canadian Lawyer National Compensation Survey*, CANADIAN LAW., June 1999, at 21, 23, 24. This article provides Canadian data on the salaries of lawyers in solo to four-practitioner firms and firms with five to twenty-five lawyers.

D. *“You Don’t Switch Horses in the Middle of a Race”: Sunk Costs and Opportunistic Behavior*

To this point we have been looking at pricing dynamics in the market for lawyers as if all lawyers, and not just those in the market for routinized services, charged a flat fee. In fact legal fees are usually either the product of an hourly rate and the amount of time spent on a matter, or a percentage of settlements or damage awards. In addition, the cost of legal representation in both cases includes disbursements — fees for experts, couriers, phone calls, copying, and so on. In both the hourly fee and the contingency fee setting, the total bill for legal services is incremental and develops over time.

This introduces an important deviation from the hypothetical perfectly competitive market. Once a client chooses a lawyer it is costly to switch. Both client and lawyer invest time and resources into their relationship. Clients spend time explaining their situation to their lawyers; this time usually comes out of a fixed amount of time before a statute of limitations or other time bar or time advantage runs out. Lawyers spend time getting to know their clients, gathering facts, researching law, and analyzing strategy. Lawyers also invest time developing a relationship with the lawyers on the other side of the case. These investments have an important effect on the economics of the relationship because many of them are largely sunk: they cannot be recouped or costlessly transferred to a new lawyer-client relationship. Lawyers can and do keep records that can be handed over, although whether they will produce their notes for a replacement lawyer is another question.<sup>61</sup> Even so, a new lawyer will have to do many things over: develop a relationship with the client and the other parties and lawyers in the case, learn about the facts, read the relevant case law, think through alternative strategies, and review the history of the case to date.

These costs, all of which must be ultimately paid for by the client, are another source of market power for lawyers. Once a client has committed to a lawyer, the lawyer has the ability to exploit the cost of switching. This is a well-known phenomenon in markets known as opportunism.<sup>62</sup> Lawyers can opportunistically expand the number of hours they devote to the case (if they are earning hourly fees) or minimize their investment (if they are on contingency and this case is not as valuable as others in their portfolio). They can engage in con-

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61. According to the Law Society of Upper Canada, (the professional body which regulates the legal profession in Ontario, Canada), a lawyer must surrender all records and notes to his or her client’s replacement lawyer upon receiving written notification from the client of the change. Telephone Interview with Hari Viswanathan, Staff Person, Law Society of Upper Canada (July 19, 1999).

62. See 2 *THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW* 703-10 (Peter Newman ed., 1998).

duct that produces more in the way of advertising for them than results for their clients. They can do low quality or low value work. They can squander resources on experts, studies, paralegals, associates, couriers, and support services. They can do these things because there is little risk, on a given matter, that they will be fired. Here the problem is not the difficulty clients face in recognizing when their lawyer is doing poor or unnecessary work; it is that the client is locked in.

The risk of opportunism is present in many markets, and many markets have mechanisms to control opportunism. In markets in which price and quality can be effectively contracted for up front, opportunism can be prevented. In markets where only quality can be fixed up front, competing providers can devise pricing schemes that allow them to compensate the buyer up-front for the money that will be extracted in the future. In markets in which quality is not fixed but can be measured, compensation schemes can be tied to quality so as to overcome the incentive to shirk. And in many markets, reputation — with the threat of lost future business — serves as an effective check on opportunism.

Legal markets, however, offer few mechanisms for controlling opportunism. Again the problem is complexity and the difficulty of judging the quality and necessity of legal work. In the great majority of cases, it is far too costly, if not impossible, to write contracts that control the lawyer's behavior. The essence of the transaction between lawyer and client is the expert judgment that the lawyer offers in steering a client through the legal process; most of these judgments are of value only to the extent they are responsive to circumstances as they evolve. Reputation, with the market or with a particular repeat client, offers some constraint, but again judging whether in a given case efforts were misdirected or excessive or insufficient is difficult; it is therefore hard for reputations to develop that are truly informative. As we have already discussed, reputations can only be based on indicia of performance that are of limited value as hard data. *Ex post* review of the work of a lawyer is limited.

It is possible, of course, to tie compensation to outcomes with a contingency fee. This creates an incentive for lawyers to devote effective time and effort to a case. The incentive is far from perfect and is of limited applicability, however. For starters, the lawyer receives only a fraction (usually around 30%) of the value of the case and so faces a private return for effort that is less than the joint return: the contingency lawyer will give up on a case before the point at which legal effort is not worth the expected payoff for the client. Second, the client incurs the cost of disbursements in the event of a win, and (usually) the lawyer does so in the event of a loss. If the value of the case is sufficiently high, this means that the lawyer will have an incentive to invest too much in these costs. Third, contingency lawyers have to hold a portfolio of cases so as to hedge the risks they are taking on. At

any given time, then, they are allocating their time based on which cases will produce greater value on the margin. This means that contingency clients are vulnerable to having their cases sidelined when a bigger fish comes along. Even if it were in some sense efficient for the lawyer to allocate time to the bigger case,<sup>63</sup> the sidelined client is not compensated. This both distorts the lawyer's time allocation decision and leads to a loss of the client's sunk investment.

Finally, contingency fee arrangements are difficult to structure because of the substantial uncertainty about the relationship between legal effort and outcome, and the unpredictability of law. The fee paid only in the event of a win has to be higher than the fee that would have been paid on a noncontingent basis: if a lawyer can earn \$100 an hour on a noncontingent basis and she has a 50% chance of winning, she needs to charge at least \$200 an hour to her contingency client in order for it to make sense to work on contingency; if she's risk averse, she needs to charge even more to compensate for her risk bearing. To determine the appropriate fee in a given case, then, the lawyer has to have what she considers to be a reasonable estimate of the probability of winning. But this is, as we have emphasized throughout, very difficult to do. It is especially difficult to do at the initiation of the lawyer-client relationship, before the lawyer has had much opportunity to investigate the law, the facts, and her client's reliability. But it is precisely the sunk investment in such investigations that puts the client at risk of opportunism in the setting of a fee. Contingency fees tailored to the risks of a particular case are therefore going to be very difficult to calculate<sup>64</sup> and are not likely to effectively eliminate opportunism.

The fact that contingency fees appear to dominate the market in only a subset of cases, and the fact that they are generally set as a fairly uniform 25 to 33% of money damages, supports these conclusions. Contingency fees are used, primarily, by solo practitioner plaintiffs' personal injury lawyers. This suggests several things. First, the clients in this segment of the market are individuals who, for the most part, lack substantial wealth with which to pay legal fees. Without a contingency fee, these clients are likely not to enter the legal market. Second, as plaintiffs, a "win" for them is a gain rather than the avoidance of a loss; the fee therefore can be taken out of the winnings and

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63. There are many difficult issues embedded here. For one, efficiency is not necessarily the right criterion for allocating access to justice; other values are at stake. Moreover, it is difficult to apply the concept of efficiency here because court-awarded damages (or settlements reached in the shadow of such damages) reflect public, not private, valuations of harm. The victim of racial discrimination on the job may be harmed to a greater extent or judged to be more deserving of access to the courts than the victim of a slip-and-fall, but the latter may be a more lucrative client for the contingency lawyer.

64. The appropriate contingency fee will be even more difficult when the fee is a percentage of money damages. In these cases, the lawyer will also have to have a reasonable estimate of the amount of money damages, something which shows high variance, especially in jury trials.

not out of whatever wealth they have. We know that people are risk loving when it comes to potential wins (people like to buy lottery tickets even when they have negative expected value) but risk averse when it comes to potential losses (the same people buy house and car insurance). The fact that defendants with the wealth to pay in the event of a “win” (avoidance of a loss) generally do not pay on contingency suggests that the additional risk is not worth it.

Most importantly, however, the cases taken on by these lawyers are high volume and bear substantial similarities. Some accident cases are largely routine: there are fairly standard methods of valuing the injuries (broken arms, whiplash, lacerations), fairly standard allocations of liability (running a red light, intoxication, icy walkways). For the same reason, there is usually insurance for the injury, and legal representation largely amounts to processing a settlement claim with an insurer. Even when the injuries or liability are not routine, the high volume of cases still permits lawyers to get the valuation of cases right on average, even if not in a given instance. The standardization of the contingency percentage throughout this segment of the market may well reflect the fact that all a lawyer in this market knows is that by charging that percentage, and signing a portfolio of cases, other lawyers are able to earn a living.

Exploring the economics of contingency fees is a topic in itself,<sup>65</sup> but we can at least say this much: Contingency fees appear in the market in only specialized circumstances. They may create more costs than they save. They may be too difficult to calculate outside of the personal injury setting. They may be less lucrative than hourly fees for lawyers who have succeeded in the tournaments in more prestigious segments of the market (plaintiff personal injury law is ranked as very low prestige by most lawyers).<sup>66</sup> Whatever the case, the fact will remain that most legal fees are charged on an hourly sunk-cost basis and hence expose the client to the risk of opportunism.

#### E. *Fool's Game: The Sunk Cost Auction*

There is a further important economic effect arising from the sunk and incremental nature of hourly fees. It works like this:

Suppose I offer to auction off a \$20 bill under the following rule: the person who bids the most will get the \$20 for the price he bids — this is the standard way in which an auction works. The auction I am running, however, has a special rule: the person who bids the second-highest amount must also pay out the amount she bids even though she loses the \$20 to the highest bidder. This auction, sometimes

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65. For a recent addition to this large literature, see Kritzer, *supra* note 38.

66. See HEINZ & LAUMANN, *supra* note 27.

known as a sunk-cost auction, has in fact been run in many business school classrooms. The usual result? The winning bid exceeds \$20.<sup>67</sup>

The bidding in such auctions is rational. Suppose you have bid \$18 and the only other person in the auction bids \$18.50. If you drop out of the auction at that point you lose \$18 as the second-place bid. If you bid \$19 instead, you stand a chance of being the winner, in which case you will pay \$19 for the \$20 and be ahead by \$1. Your opponent, however, now faces the choice of losing \$18.50 or bidding, say, \$19.50 and being ahead by 50 cents. There is nothing special about breaking the \$20 mark in this process: if your opponent has bid \$25 and you have bid \$24, you'll lose \$24 if you stop; you can reduce your loss to \$6 if you bid \$26. Whatever the second-highest bidder has bid at any point in time is sunk — it must be paid regardless of who wins. The decision to bid again or not depends only on whether the next increment will be bested or not.

There is no rational place for this to end; as a matter of practice it ends only when someone gives up, no longer caring that he can reduce his losses by roughly \$20 if he keeps going, or when someone runs out of money. It may seem that it would be irrational even to get into this auction in the first place. But if everyone refuses to play, it pays to be the only one who's game.

Legal expenses billed by the hour (or any other incremental amount, such as in task-based billing) generally have the same type of structure as the sunk cost auction. This is particularly true for litigation. Once a legal action is started, it costs money to keep going. In most cases, if you stop participating in the action, you suffer a default judgment against you, losing the entire amount at stake. As with the \$20 auction, at any given point in the litigation, it doesn't matter how much you've already spent on legal fees if the next increment — the cost of going to trial one more day, for example, or responding to one more motion — maintains your chance of winning. And as with the \$20 auction, the amount at stake is no limit to what you may end up spending to keep in the game.

It therefore becomes rational for legal fees to exceed the amount of money at stake. If the other side is willing to talk settlement, there is an opportunity to quit the game and rationally weigh the cost of continuing (or even starting) against potential settlements. (This is what could happen in the \$20 auction if players could collude and reach a side-deal.) As we have already seen in different contexts, the uncertainty about legal outcomes and the value of legal inputs makes such assessments difficult in the first place. But when the other side is not talking but litigating, and filing deadlines are approaching, there is

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67. In one reported case, a negotiation professor managed to auction a \$100 bill for \$7,000. See ROBERT H. MNOOKIN ET AL., *BEYOND WINNING: HOW LAWYERS HELP CLIENTS CREATE VALUE IN NEGOTIATION* (forthcoming 2000).

no way to avoid the sunk cost rationality of spending more even after you have exceeded the amount you stand to gain or lose in a judgment.

It gets worse. Half of the players in the litigation game have no choice about getting into the game in the first place: defendants. The legal system, unlike the \$20 auction, is coercive. Shifting fees to the losing party only makes things worse: now the cost of quitting and going into default is even higher. The worse the plaintiff's case, the greater the plaintiff's incentive to continue at any given point. And the increments in which "bids" must be made is set by the auctioneers who collect at the end: lawyers.

With these dynamics, settlement might be better thought of as occurring in the shadow of the sunk cost auction, not the law. Every hour a lawyer works has, in a sense, the same value as the first hour: the entire amount at stake. This puts lawyers in a powerful position to extract amounts governed not by the "value" of their services but rather by the wealth of clients. Even without deliberate padding of the bill, lawyers receive an economic windfall: the rewards of a process the cost of which is unmoored from the economic value of what it produces.

#### F. *Monopoly*

As the discussion to this point has demonstrated, the market suffers from many deviations from perfect competition, without the need to point to monopoly restrictions. It is now important to examine more closely what role monopoly might play and in what form, and how supply restrictions might interact with the market imperfections already enumerated.

Monopoly in the market for lawyers — or, more generically, the ability to extract pure economic rents — comes from three different sources. The commonly recognized source of monopoly power is artificial barriers to entry to the practice of law: state prohibition of the practice of law by nonlawyers and limitations on the number of people admitted to law schools and the bar. I examine the extent to which these artificial barriers give lawyers market power first. I then turn to a more detailed examination of two less recognized but probably more important sources of the power to extract rents. The first is a set of natural entry barriers to the practice of law — the increasing returns to human capital and scale, the limited opportunities to gain experience in procedures and with decisionmakers, and natural limitations on the supply of individuals with the cognitive ability necessary to effectively engage in the complex reasoning of law and legal process. The second is the state's monopoly on coercive dispute resolution — only dispute resolution through the public courts can force the other party to the table.



### 1. *Artificial Barriers to Entry*

The emergence of the legal profession is tied to the emergence of state-enforced restrictions on who may perform certain roles in relation to the legal process: who may advocate for another in court, who may convey land, who may prepare or witness legal documents, and so on. These restrictions, appearing in England in the thirteenth century, were the result of, it appears, both genuine concerns about the quality of work being done by those holding themselves out as legal practitioners and self-interested motives on the part of those with legal training.<sup>68</sup>

Licensing restrictions can create an artificial barrier to entry in two ways: costs and quotas. Obtaining a license requires training of some kind: a demonstration of specialized knowledge is the justification for licensing in the first place. Training is costly to obtain, whether in terms of tuition fees or foregone income during a period of apprenticeship or legal education. As in any market with an entry cost, this raises the equilibrium price above marginal costs. In and of itself, this is not a particularly troubling market imperfection. If the costs of training are the necessary costs of performing the service, those who provide the service are just compensated for that cost. More importantly, the number of providers is still high, and if this barrier were the only imperfection, pricing decisions would still be made by suppliers who behaved as if they had no influence over the market price.

Spurious training requirements and restrictions on access to the necessary training are potentially more important entry barriers. Both of these are artificial limitations that may result from the abuse of control over entry to the profession. Again the complexity of law is the key factor. The difficulty facing nonlawyers in judging legal competence has, historically, led to self-regulation of the profession: the profession establishes its own entry requirements. The moral hazard in such control is evident and has been well appreciated throughout the history of the profession.<sup>69</sup> In England and Canada, the law societies establish training requirements, including required law school courses and hours, articling (apprenticeship) periods, and required bar-conducted courses prior to bar examinations. In the United States, the bar sets requirements for accreditation of law schools, and most jurisdictions require completion of an accredited law degree before admission to the bar.<sup>70</sup> In all these jurisdictions, the bar examination is set and graded by the bar. At all these points, the profession faces the

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68. See Jonathan Rose, *The Legal Profession in Medieval England: A History of Regulation*, 48 SYRACUSE L. REV. 1 (1998).

69. See *id.*

70. In California, admission to the bar may be obtained solely by passing the bar examination. Historically, extremely few people have managed to pass without a law degree.

temptation to limit its numbers in order to limit competition: limiting the number of accredited schools or establishing requirements that are limited for other reasons (such as the willingness of law firms to take on articling students for economic reasons), and increasing the difficulty and hence reducing the pass rate of the bar exams. Historically, such limitations have been evident. Theoretically, they can raise the price of legal services above competitive levels.

Although these artificial barriers to entry are the commonly recognized sources of monopoly power in the market for lawyers, empirically there has to be some doubt that they are an important source. Compared to England and Canada, the United States has fewer entry restrictions to the practice of law and a much larger number of lawyers per capita, and yet American attorneys charge higher fees and earn higher incomes than their counterparts in the Commonwealth. The past several decades in the United States have seen the elimination of artificial barriers to entry and a tremendous increase in the number of lawyers entering the profession; these same decades have simultaneously seen legal fees and incomes skyrocket in large and elite firms while falling for solo practitioners.<sup>71</sup> The evidence of growing unemployment and underemployment among lawyers,<sup>72</sup> co-existing with fees that are beyond the reach of most individuals for other than routine legal services such as house closings and uncontested divorces or the pursuit on contingency of large monetary awards in personal injury cases, suggests that despite the obvious economics of artificial entry barriers, these are not at the root of the high cost of legal services.

## 2. *Natural Barriers to Entry*

I believe that the more important barriers to entry in the legal profession are naturally occurring limitations on supply related to the complexity of legal reasoning and process. For other than routine, generally noncontested legal matters — house closings, simple business incorporations, administrative procedures, simple wills, and standard contracts — effective legal representation requires substantial human capital. Human capital in law is dependent on access to three factors: legal education, practical experience, and the cognitive ability to process and engage in complex reasoning. I have already considered the importance of artificial barriers to access to legal education and training. In this Section I turn to the natural restrictions on access to practical experience and the supply of individuals with the cognitive ability to engage in legal reasoning.

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71. See Sander & Williams, *supra* note 6, at 449-51.

72. See Monique Conrod, *Unemployment and Under-employment: The Harsh Reality Facing New Lawyers*, LAW. WKLY., Sept. 16, 1994, at 5.

a. *Experience and the Accumulation of Human Capital.* A little knowledge is a dangerous thing. A law degree, by itself, leaves a lawyer poorly equipped to do very much in the real world of client representation. Only experience in the actual practice of law allows a lawyer to convert the knowledge and reasoning skills gained at law school into valuable legal services. The subtlety and variability of legal reasoning and procedure, the sensitivity of legal outcomes to a great multitude of influences, the role of subjectivity, values, time pressures, and serendipity — all these factors and more make practical experience tremendously important in the acquisition of legal skill.

Much experiential knowledge is available to essentially any lawyer who ventures into practice. Practicing lawyers cannot help but learn about client relations, the form of pleadings, standard contract language, filing deadlines and procedures, and so on. The most valuable experiential knowledge is, however, available to only some, not all, lawyers. This is because there are limited supplies of opportunities to gain certain experiences. As a result, even if entry into the profession generally is unrestricted, the supply of providers of specific types of legal services is limited by a barrier to entry to that segment of the profession.

Consider the experience necessary to conduct litigation. Every lawyer who does any litigation work will learn about the procedures and standard approaches to filing the early documents in a trial and conducting the initial phases of litigation. But few cases — between 5 and 10% of filed cases — ever get to trial.<sup>73</sup> This means that in practice either all litigators rarely conduct a full trial or that only a small number of litigators conduct trials with any frequency.

The small number of trials (relative to filed cases) is in part a result of the incentives to settle to save litigation costs and the ability of pre-trial procedures to effectively resolve disputes without trial. But it is also the result of external constraints: the number and capacity of courts to hear trials. These external constraints are a practical limit on the number of trials that can be conducted and hence on the number of lawyers who can gain the practical experience of conducting a trial.

The importance of this limitation on access to trial experience grows in importance as a natural<sup>74</sup> barrier to entry to the litigation segment of the legal profession when we take account of the market dynamics that are likely to operate. Lawyers with trial experience will be more highly valued than lawyers without trial experience. They will be more highly valued by those clients who are committed to tak-

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73. See Herbert M. Kritzer, *Adjudication to Settlement: Shading in the Gray*, 70 JUDICATURE 161, 162 (1986); Carl Baar, *The Myth of Settlement* (1998) (unpublished manuscript, on file with author).

74. I use the term “natural” here only to distinguish these barriers from the “artificial” barriers that are put in place with the objective of restricting entry into the profession.

ing their matters to trial; they will also be more highly valued by those clients who hope to settle but who recognize that their bargaining position will be enhanced by a credible threat of a well-conducted trial. Lawyers who have trial experience will be particularly sought out by those with nonroutine cases that are more likely to result in a trial. As a consequence, experience will breed further experience, and the limited supply of opportunities to gain experience will be even further restricted. And as we have recognized in connection with the winner-take-all nature of legal practice, the response of the market will be largely driven by relative, not absolute, differences in experience. Unable to judge the difference between lawyers with more or less experience as a quantum, clients are likely to base valuations on rankings: not how much experience, but whether more or less experience. In this way even random events affecting initial exposure to trial on the margin will be reinforced and made self-fulfilling and significant.

The point goes deeper. A lawyer with no trial experience is less valuable than one with trial experience; and a lawyer with general trial experience is less valuable than a lawyer with trial experience specific to the case at hand. The complexity and unpredictability of law, as we have explored previously, stems significantly from its sensitivity to multiple influences. Many of these influences are specific to the particular issues and the location of a case. Localized knowledge is important. Conducting trials to the bench is different from conducting trials before juries; experience with the former will teach one thing, with the latter something else. Large trials with vast quantities of documents or complex issues teach skills that smaller, simpler cases do not. Experience with experts, particular kinds of experts, and indeed with particular experts will also differentiate lawyers. Experience-based knowledge about the inclinations of courts in a particular region, of a particular court, or of a particular judge will be progressively more valuable. Local lawyers who know the local rules, practices, and personalities (judges, court personnel, other lawyers) have an advantage over those drawn from a wider area. The more unpredictable law is, the more being an "expert" will be limited to a narrow domain.

These effects are not limited to litigation. Opportunities to gain experience with particular agencies can be limited in administrative law. Opportunities to gain experience with transactions of a particular type or size or complexity will be limited in corporate law. These limitations can be dramatic. As one former Bar Association president observed, at least at one point in time, "[c]orporate acquisition and takeover strategies are the preserve of two New York City firms."<sup>75</sup>

We can begin to see that the complexity of law will result in the breakdown of the profession into increasingly specialized segments,

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75. JOSEPH W. BARTLETT, *THE LAW BUSINESS: A TIRED MONOPOLY* 7 (1982).

each cordoned off by natural barriers to entry. There are only so many opportunities to do jury trials in this jurisdiction, with these types of issues. There are only so many opportunities to manage and litigate big cases, only so many opportunities to defend certain types of environmental or criminal or antitrust matters. There are only so many transactions of this size, in this industry, with these foreign countries. Those who happen to get such opportunities then possess a significant advantage over others in securing further such cases. Competition within these specialized segments is consequently muted.

The role of experiential human capital in the structure and hence competitiveness of the market for lawyers can be understood in terms of two related economic concepts: increasing returns to specialization and increasing returns to scale.

Increasing returns to specialization in law occur for the same reason they occur in any market with significant human capital input. Generally speaking, those with experience — some initial human capital — learn more from subsequent experiences than those without experience. Moreover, as between two individuals with different degrees of experience in a given type of work — giving one a comparative advantage over the other — specialization by the more experienced one in that work will be more efficient, producing greater value in the market overall, than will splitting the work between the two.<sup>76</sup> To the extent the market for lawyers works toward efficient resource allocation, it will take possibly small initial differences between lawyers and magnify them through specialization. The mechanism for this is the recognition by clients of the comparative advantage offered by the lawyer with greater experience in a particular type of legal work and hence their greater willingness to retain, and pay, that lawyer.

Increasing returns to specialization in law also occur because of imperfections specific to the market for lawyers that we have already discussed. These are the difficulty of judging quality in absolute terms and the resulting reliance on relative rankings and signals with only a loose relationship to quality. These imperfections produce the experience-breeds-experience effect in the market, as those with experience are then more likely to be hired by clients who bring with them further opportunities for learning. Specialization exhibits increasing returns, then, because the more experience one has, the greater the expected number of future opportunities to make use of the experience, and hence the greater the marginal value of obtaining further experience. This effect will be present up until the point, if it exists, at which the expected number of future opportunities to use experience falls below the capacity of the lawyer or law firm.

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76. See GARY S. BECKER, *A TREATISE ON THE FAMILY* 33 (1982).

Markets in which information or knowledge play an important role also tend to be characterized by increasing returns to scale. Information is a nonrivalrous input. This means that the use of information in the provision of services to one user does not diminish the capacity to use the information in the provision of services to another user.<sup>77</sup> Even though information is costly to obtain in the first instance, the marginal cost of using the information for additional users is zero. As a result the marginal value of additional users is increasing as the number increases, and the fixed costs of obtaining the information are spread across a larger number of users. This produces increasing returns to scale, and again the market will tend to gravitate to small numbers of providers with large scale. The number of providers — whether one, a few, or many — will depend on the capacity limits facing providers and the level of demand.<sup>78</sup>

In the case of legal services, the scale of providers within a given segment of the market depends on the ability to share experiential human capital.<sup>79</sup> In one sense this is limited by the very nature of experiential human capital: it is best or only learned through experience. Still, there are some ways to share some types of human capital gained through experience. Some information can in fact be conveyed by presentations and conversations, observation, and critique among lawyers. Experience can also be shared by delegating tasks or whole cases to inexperienced lawyers whose work is directed or overseen by experienced ones. Access to limited opportunities to gain experience can also be increased by expanding the number of lawyers who participate in a given opportunity to gain experience: sitting in on meetings and strategy sessions, preparing documents, attending trials and negotiations, performing due diligence searches and legal research, and so on.

The distinctive size differences between the personal and business sectors of the legal profession suggest that there are substantial differences between the possibilities for sharing experience and human capital among lawyers in these sectors. The growth of the large law firm, which is almost always dedicated to corporate clients, stands in stark contrast to the continuing reliance on solo or small firm practice by

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77. This is not to say that there are not competitive or other advantages to having private access to information, or that the information is less valuable the more others have it. Nonrivalry in consumption refers only to the fact that the quantity or quality of information is not diminished by consumption, as is the case for most goods.

78. For other analyses of the role of human capital and intangible assets such as reputation in the organization of law firms, see Ronald J. Gilson & Robert H. Mnookin, *Disputing Through Assets: Cooperation and Conflict Between Lawyers in Litigation*, 94 COLUM. L. REV. 509 (1994); Gilson & Mnookin, *supra* note 55; 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 (1985).

79. Sharing human capital is central to the analysis of GALANTER & PALAY, *supra* note 55.

those representing individuals. In the personal sphere, only in the provision of standardized services such as simple wills or uncontested divorces has there been some move to large organizations. Here scale has been achieved in the form of chains of small offices which share the benefits of experience concretely in standardized documents and procedures.<sup>80</sup> Transactional work is probably inherently subject to greater sharing possibilities than litigation work: much of the work product in transactions is done over time (and hence capable of review if delegated to subordinates) and memorialized in documents. Litigation experience tends to play out significantly in performance on the spot and trial techniques. Overall, there are varying limitations on the extent to which scale economies in the production of some legal services can be achieved.

*b. Cognitive Aptitude.* The acquisition of human capital through formal education or practical experience depends not only on the opportunity to learn but also on the underlying capacity of a particular individual to absorb and engage in a given form of reasoning. People differ in their aptitude for (not to mention interest in) logical puzzles and strategic analysis, their ability to perceive relationships among factors, and their capacity for drawing linguistic and normative distinctions. The complexity of legal reasoning establishes a minimum level of aptitude for specific tasks that lawyers must possess if they are to be effective. This is a minimum that in many cases implies a significant “natural” limit on the supply of potential providers of legal services. Again, by “natural” I do not mean to imply that the supply is not determined by all kinds of factors that are subject to social control, influence, and change; I only mean to distinguish this barrier to entry from “artificial” barriers erected for the purpose of restricting supply below competitive levels.

The importance the profession attaches to aptitude for specific types of reasoning tasks is underscored by the reliance on the Law School Admission Test (“LSAT”) for evaluating potential applicants to law school. Essentially all law schools in North America require applicants to take the test, and most rely heavily, if not exclusively, on the LSAT score in combination with undergraduate grades in selecting students. The scored portions of the LSAT test three skills: reading comprehension, logical reasoning (tested by asking questions about the implications or validity of short arguments), and analytical reasoning (tested by asking questions about the solution to logical games

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80. See Carroll Seron, *Managing Entrepreneurial Legal Services: The Transformation of Small-Firm Practice*, in *LAWYERS' IDEALS/LAWYERS' PRACTICES* 63 (Nelson et al. eds., 1992). Standardization, however, appears to have effectively put these lawyers out of business. See Karen Dillon, *After the Revolution*, *AM. LAW.*, Apr. 1996, at 64-66. The pioneers — Jacoby & Meyers and Hyatt Legal Services — have largely folded. Hyatt now focuses on offering pre-paid plans — which pay the plan attorney of the client's choice a set fee for providing standardized services — as employee benefits to large corporations. See *id.* at 66-67.

and puzzles). Test-takers also complete a writing sample, which is forwarded to law schools but not scored.

Judging by LSAT score alone, practicing lawyers are an elite group. Fewer than 10% of the over 175 law schools in the United States have median LSAT scores below the 50th percentile. Schools in the top 25%<sup>81</sup> have median LSAT scores above the 85th percentile. The top 15 schools have medians above the 94th percentile. These statistics establish that entry into law school is largely restricted to those with above-average aptitude for logical and analytical reasoning. Moreover, they are above average for the pool of individuals who have determined that they are potential candidates for law school, a self-selection that undoubtedly rules out a great majority of the population. In addition, whereas students attending top schools have bar pass rates over 90% — above the average for the jurisdiction — students attending lower-ranked schools have pass rates that are roughly average for the jurisdiction, generally between 70 and 80%. This means that the distribution of LSAT scores of those actually entering the profession (as opposed to law school) is more skewed to the well-above-average than the data for law school admission reveals.

When we take into account the legal work done by different members of the profession, these numbers take on added significance. Studies of the profession suggest that there are distinct differences among lawyers.<sup>82</sup> Elite lawyers graduate from elite law schools and tend to practice complex law in large firms, largely doing work for corporations. The “storefront lawyer” who is providing routine legal work for individuals is, generally, a graduate of a lower tier school. Whereas there appears to have been, over the past several years, a glut of lawyers in the lower tiers, there has been a shortage of lawyers in the upper tier.<sup>83</sup> This suggests that the ability to provide non-routine legal services is limited to those with the aptitude reflected in the admissions statistics for the top schools, such as above the 85th percentile.

Admittedly, these statistics do not tell us definitively about the necessity of a given level of aptitude for legal reasoning, nor the rarity of that level of aptitude. They could be the result merely of the limitation on the number of places in leading law schools and competition for those slots. But the experience of teaching law students, especially at the leading law schools, supports the inference that the statistics do reflect an important barrier to entry. The LSAT is used to classify candidates for law school because it is a decent predictor of law school

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81. As ranked by *U.S. News and World Report* in 1999. See *Exclusive Rankings: Schools of Law*, U.S. NEWS & WORLD REPORT, Mar. 29, 1999, at 94.

82. See HEINZ & LAUMANN, *supra* note 27.

83. See Sander & Williams, *supra* note 6.



grades, better than undergraduate grades on their own.<sup>84</sup> This implies that the skills tested by the LSAT are more specific than general academic ability and that those who do well in law school will tend, on average, to be better at these skills. This links up with teaching experience in the following way.

Most law professors would agree that students, even students at elite schools, differ substantially in their ability to engage in legal reasoning. And in fact, snobbish or not, most law professors at elite schools think that students who do not “get” the exam question are not very smart, even though they are in fact drawn from the upper echelons of LSAT test-takers. Law professors have little difficulty, with experience, setting an exam question which will produce a natural bell curve (and in fact most law schools require grading on the bell curve): most students will get the basics but miss the deeper, more complex, issues, a handful will “see” the problem in its deeper dimensions of subtlety, and some will miss crucial points or indeed the point entirely. All of these gradations will of course be relative — to the pool of students and indeed to the professor’s own legal reasoning skills.

What teaching teaches is that some students are able to analyze a legal problem better than others, and that those who stand out are few in number. For problems that are sufficiently complex — or, rather, for which there are sufficient client resources available to explore sufficient complexities — these stand-outs are not just marginally better than the rest, they are categorically better. Increasing admission to elite law schools, which implies a lower LSAT median for the entering class, probably will not significantly change the number of students who stand out in their capacity for legal analysis. Because legal reasoning is as complex as one participant wants to make it,<sup>85</sup> this small group of people with a high aptitude for analytical reasoning, logical puzzles, and reading comprehension define a (very high) threshold of effectively necessary competence in the high-end large firm or boutique legal market. The limited supply of people in the population with such aptitude (and interest in and access to a legal career) is borne out by the perceived shortage of lawyers in this market, despite the glut of lawyers in the solo and general practice small firm segments of the market. Competitive cognitive processing progressively raises the level of cognitive skill necessary to play the game.<sup>86</sup>

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84. See Linda F. Wightman, *Predictive Validity of the LSAT: A National Summary of the 1990-1992 Correlation Studies*, in LSAC RESEARCH REPORT SERIES 23 (1993).

85. Actually there is a limit imposed by the ability of the judge to understand the level of complexity; it is possible to overshoot the court and lose as a result.

86. This point is similar to, but not the same as, the winner-take-all point. The focus here is on increases in the absolute level of skill that a tournament which rewards on the basis of relative skill establishes as a threshold for being a potential competitor. The difference

The significance of this “naturally” limited supply of potential high-end lawyers is then the easy free-market economics of a scarce resource: the resources go to the highest bidders. The perceived shortage of such lawyers suggests that this is not just a market characterized by inelastic supply, but indeed a market in which demand exceeds supply, all sources of supply have been exhausted, and the resource is consequently priced as high as it can be — extracting the entire (expected) surplus (or more) derived from its use. The allocation of high-end legal skill is then driven by the wealth of potential clients, not the opportunity cost of supply. This is the characteristic of a monopolized, not competitive, market. The key point is that the source of the monopoly is the “natural” barrier of the scarce availability of the cognitive skills necessary to engage in complex legal reasoning.

### 3. *State Monopoly on Coercive Dispute Resolution*

The ability to extract monopoly rents for the use of human capital assets that are in limited supply, or to exploit the market imperfections arising from the credence quality of legal services or the sunk nature of investments in lawyers and legal process, is ultimately dependent on the existence of a more fundamental monopoly. That is the monopoly the state possesses over coercive dispute resolution. Only the state can force an individual or an entity to respond to the conflict perceived by another individual or entity; only the state can enforce a resolution of that conflict. Private agreements and statutory procedures for dispute resolution have force — can coerce a response and enforce a resolution — because the state has coercive power over the parties to the agreement and the subjects of the statute. It is this underlying monopoly that establishes the value of access to the legal system and hence the surplus at risk of extraction by lawyers.

The legal profession is granted this monopoly on coercive dispute resolution on a society-wide basis by jurisdiction. It is empowered to design and operate the only institution for coercive dispute resolution. As a collective body, the profession can and does act as a monopolist, offering a mechanism for dispute resolution that has no competition. The complexity of the reasoning and process that this collective body produces — as a result of its established means of resolving disputes about reasoning and process — means that outsiders to the profession cannot easily assess their rights and obligations or the prospects for how their disputes will be resolved by the profession. Nor can they, as a result of the coerciveness of the mechanism, avoid having their dis-

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between the gold and the silver medalists in a given year may be miniscule, but over time the skill necessary to have a shot at winning increases substantially.

putes, at some point, subject to the reasoning and process controlled by the profession.

The cost of monopoly here is not so much the moral hazard or exploitation of market power for private gain by the profession, as it is the inertia and unresponsiveness of an insulated service provider.<sup>87</sup> The legal system qua system is largely immune to pressures to reduce costs: those with disputes have no coercive alternative to the costly system if they are plaintiffs and no choice, period, if they are defendants. The autonomy of law is, in very important respects, that of an institution that can establish its own values — the importance of due process or refined distinctions between cases for example — without pressure to take into account an important value for participants in the system: the cost of participating. This is not a criticism of the ethics of the profession. It is a fact about the nature of institutions that are driven largely by internal logic rather than by the need to respond to outside pressures and demands.

The study of innovation emphasizes this point. Innovation tends to be local, in the sense of responding to the problems generated by an existing technology or process. This gives rise to path dependence in the development of new technologies and processes: what comes to be grows out of what is.<sup>88</sup> The greater the diversity among potential sites of innovation, the greater the potential for creative leaps from what has been to what is possible.

In light of its monopoly over coercive dispute resolution, the unified and importantly homogeneous nature of the legal profession takes on tremendous importance. The profession defines and reproduces itself. It establishes entry requirements that homogenize the reasoning processes and to some extent the values of its members — judges, lawyers, even many legislators. Despite the diversity of political views and theoretical perspectives among law professors, every law student learns to read cases and see in them whatever other lawyers will see in them: the holding, the reasoning, the procedure, the relation to the body of doctrine, the ambiguities that provide openings for argument and persuasion. As every first year law student learns, the hard way, learning the law is not simply the process of memorizing a set of rules. More importantly it is the process of learning to recognize and participate in a discourse, and to foresee how others initiated into the discourse will see and argue a case. It is the process of learning the un-

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87. See George Symeonidis, *Innovation, Firm Size and Market Structure: Schumpeterian Hypotheses and Some New Themes*, 27 OECD ECON. STUD. 35 (1996). This work presents a survey of empirical literature rejecting Schumpeter's hypothesis that market power and large firms stimulate innovation. See JOSEPH A. SCHUMPETER, *CAPITALISM, SOCIALISM AND DEMOCRACY* (1950).

88. See W. BRIAN ARTHUR, *INCREASING RETURNS AND PATH DEPENDENCE IN THE ECONOMY* (1994); DOUGLASS C. NORTH, *INSTITUTIONS, INSTITUTIONAL CHANGE, AND ECONOMIC PERFORMANCE* (1990).

written but shared norms of argument, persuasion, and judgment: being an outlier in argument or perception is rewarded only to a point — too much nonconformity in reasoning fails to connect with the other members of the profession and so fails to accomplish its goals. The nature of the training is, precisely, the induction into a *particular* form and process of reasoning.

It is this overarching uniformity in legal reasoning — what makes an argument recognizably “legal” — that lends force to the claim that the profession’s monopoly over coercive dispute resolution mechanisms has costs. Innovations in dispute resolution — be they addressed to considerations of justice or cost — are muted and limited to what will occur to a group of people who share, by virtue of their professional training and tutored identity, a largely common set of ideas, perceptions, and norms about dispute resolution. More dramatic responses to the perceptions, needs, and constraints — including financial — of those who require dispute resolution services are unlikely to come from within the profession.

Alternative dispute resolution mechanisms can be offered by non-lawyers, but they suffer from two important, related impediments: the lack of free-standing coercive power and the resulting dependence on the legal mechanism for binding resolution of disputes (including disputes about the process of dispute resolution). Marriage counselors can, for example, help divorcing couples resolve their disputes, but they will have to refer their clients to lawyers for advice about the effective content and enforceability of their process and its resolution. Industry experts can help companies negotiate transactions, but they too will have to refer their clients to lawyers for advice about the effective content and enforceability of their contracts. It becomes natural, then, for lawyers’ monopoly in coercive mechanisms for dispute resolution to give lawyers a great advantage in performing the role of mediator or negotiator. Developments in the nature of these processes are therefore on a fairly short tether from the system to which they are the “alternative.”

The insulation of the system generated and operated by the legal profession from serious competition also underpins the strength of the market power conferred on individual lawyers by the market imperfections I have reviewed in the preceding Sections. Lawyers’ monopoly over coercive dispute resolution establishes the value of a given lawyer’s legal services as essentially the entire amount at stake (more precisely, the difference between the expected outcome with representation and without). It is this amount that is then potentially extracted by the various imperfections in the market — the deep uncertainty about quality, the sunk nature of investments in a choice of lawyer, and incremental participation in legal procedures. The keys to the courthouse unlock a great bounty.

### G. *Summary: The Sources of Imperfection*

What may be most striking from the preceding catalogue of ways in which the market for lawyers departs from the competitive benchmark is how this wide gap has gone largely unnoticed in a systematic way. Or, more precisely, how the nature of the market has been finessed into the ethics of professionalism. Attention to the imperfections in the market for lawyers has been almost exclusively focused on artificial barriers such as limited law school seats and restrictions on advertising. Yet there is little evidence that increasing law school enrollments and the elimination of overt market restrictions has had any substantial effect. Indeed the period of increasing growth in the relative size of the business sector, and the rise of the large firm and the escalation in legal fees in this sector, has coincided with increasing numbers of lawyers entering the market.

Closer economic analysis has identified multiple sources of imperfection that cause the market for lawyers to deviate, perhaps very substantially, from the competitive model. Overall there would appear to be significant market power wielded by lawyers, despite their increasing numbers. The major concession to competition would appear to be the ultimate fall-out of successive winner-take-all tournaments: spurned by more lucrative uncompetitive markets, lawyers compete to provide basic services for individuals with routine, largely non-contested legal matters. Outside of this relatively small sector, legal fees would appear to be determined by a host of dynamics that are related to the wealth of the client and not the opportunity cost of the service.

Looking at the market imperfections as a whole, it is possible to identify three fundamental features of the market for lawyers as the source of the market power lawyers possess: the complexity of legal reasoning and process, the monopoly the profession holds over coercive dispute resolution, and the unified nature of the profession.

*Complexity.* The complexity of legal reasoning and process is fundamental to the entire market. It is the source of direct cost, as we have seen. But more importantly it plays a central role in a host of indirect distortions. It is responsible for the credence nature of legal services: the complexity of law is so extensive that even the expert providing the service has difficulty assessing the quality and necessity of services provided. This makes price and quantity in the market predominantly the result of beliefs and wealth, rather than of cost. Complexity and unpredictability are also responsible for the winner-take-all dynamics that structure successive tournaments among lawyers, tournaments in which winning may reflect only negligible quality differences in fact. Winning nonetheless establishes a public signal that drives clients to bid for the winner's services. Complexity also gives rise to the sunk costs associated with establishing a lawyer-client

relationship, sunk costs that grant a lawyer power to extract wealth with only muted competition. Complexity is responsible for the incremental nature of legal billing, which results in sunk cost auction dynamics that leave clients vulnerable to being in a position where they face no rational choice but to expend legal fees beyond the value of the case and up to the amount of wealth available. And complexity places a practical limit on the supply of individuals who have the capacity to engage in legal reasoning.

Paradoxically, complexity is also at the root of the historical absence of regulation to control the dynamics that complexity creates in the market for lawyers. Complexity of law, it is argued, makes it impossible for nonlawyers to judge the conduct of lawyers or the legal needs of clients. This is the purported justification for self-regulation. It is also the purported justification for granting lawyers a monopoly over the provision of services necessary to access the legal institutions of the state and the state's coercive dispute resolution power.

*Monopoly.* But rather than controlling the consequences of complexity, monopoly forms the second leg on which the market power of the legal profession rests. The monopoly that is essential is not the monopoly the profession has over the provision of legal services. This monopoly is only of importance because it transfers into the hands of lawyers a much more fundamental monopoly: the state's monopoly over the democratically legitimate exercise of force. This is most recognizable when the legal system is seen as a dispute resolution mechanism: it is the only *coercive* mechanism available. It is without competitors. Whatever coercive power alternative mechanisms possess comes only through the invocation of state power, such as in the enforcement of arbitration awards.

The state also has a monopoly over the protection of individual rights, social order, management of the economy, and so on. If this sounds jarring it is only because it is definitional of the emergence of states. On a social contract view, individuals and groups give up the right to exercise force, or rather accept the illegitimacy of their exercise of force, in exchange for state protection. The state's legal system then regulates the state's exercise of force. It does so, again, without competition from alternative sources of protection, order, economic regulation, and so on: whatever competitors may present themselves is either illegitimate, or else derives its legitimate use of force from the state and so is subject to the limitations established by the state.<sup>89</sup>

It is important to emphasize this apparently obvious point because it is so often missed when we begin to speak of a market for legal services. Market language here tends to conjure up the idea of substi-

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89. For a careful treatment of the difficulties with this concept, see Meir Dan-Cohen, *Between Selves and Collectivities: Toward a Jurisprudence of Identity*, 61 U. CHI. L. REV. 1213, 1213-18 (1994).

tution and choice among alternatives. But while there may be a market for lawyers, in the domestic setting there is no market for legal systems or coercive mechanisms.<sup>90</sup>

The market power that lawyers ultimately possess, then, is that the system to which they hold the keys exercises the only legitimate coercive power in society. The value potential clients derive from access to the system, whether as plaintiff or defendant, is then virtually unlimited. At times it is the value of life itself; at others the value of one's children, employment, health, dignity, security, privacy, and so on. Frequently it is the wealth, or large components of the wealth, of an individual or entity. The market power of lawyers is the power to extract these values, this wealth. The result is that of a classic monopoly: price is determined by wealth, not cost.

*The Unified Profession.* The driving role that complexity and monopoly give to wealth takes on special significance in the market for lawyers because of the third leg on which the market power of lawyers rests: the unified nature of the legal profession. Although there are systematic differences among lawyers, and plenty of specialization and socioeconomic barriers affecting the distribution of lawyers across the corporate and personal spheres,<sup>91</sup> we nonetheless have a single "legal system." We train all our lawyers in essentially the same way, and they receive the same license to practice. In most cases, and in all cases at the appellate level, the judge is a generalist who hears and decides on law from across the legal spectrum. Civil procedure is generally established by a single set of rules that cover all cases; statutory and common law exceptions are derived from the same basic principles and subject to the limitations ultimately found in the Constitution and principles of natural justice. The substantive norms — both those known and those unacknowledged — are fairly constant throughout the entire system. As the functions of law have evolved over time — from keeping public order and enforcing individual promises to protecting individual rights, structuring democratic institutions and governments, regulating complex economies, resolving disputes in increasingly heterogeneous communities, and so on — "law" has taken it all in under one umbrella.

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90. Again, the large corporate client has some scope for choice in the international setting. International transactions can select a jurisdiction and make a choice of law; within a federal system such as in the U.S. and Canada, some selection can be made between states or provinces. Even then, however, because the systems among which there can be choice are the only systems in those jurisdictions, and hence they serve multiple goals, this "market" cannot be terribly responsive to "incentives" to innovate or improve procedure. More troubling, however, is the fact that whatever response there can be is responsive to the needs of large corporate actors, which will often run counter to the needs of noncommercial or smaller actors and individual citizens.

91. See HEINZ & LAUMANN, *supra* note 27.

Seen from a market perspective, this means that all these interests, all the individuals and entities who represent and pursue these interests, are pitted against one another in competition for access to legal resources. If we divide the world into personal and business clients, personal and business legal matters (as empirical research confirms we confidently can), it is immediately evident that these client groups fundamentally differ in terms of their command of wealth. It is the wealth of the business client group that ultimately determines pricing in the market(s) for lawyers. Driven by corporate demand, backed by corporate wealth, the legal system prices itself out of the reach of all individuals except those with a claim on corporate wealth.

This is not a point about income distribution. The wealth of corporations is structurally different from the wealth of individuals. Corporations are aggregations of individual valuations. Their total command of wealth is a function of the number of consumers on whose individual wealth their products lay a claim: a consumer products company, for example, is valued in the multi-millions, if not billions, of dollars if it commands even just a few dollars of the wealth of a huge number of consumers. Their ability to capture consumer wealth is generated often by the further aggregation of individual shareholder wealth.

Corporate wealth is consequently of a different order of magnitude than the wealth of individuals, even wealthy individuals. The wealthy individuals for whom this is least true generally derive their wealth from their ownership of corporations. But even these individuals face a competitive disadvantage in the competition for legal services. Corporate legal fees are tax-deductible, not so the fees paid by an individual. And while there may be defensible justifications for this tax policy, it remains true that the differences in tax treatment imply that corporations ultimately pay a lower price for lawyers than do individuals. Depending on corporate tax rates, an individual may end up paying as much as twice the fee paid by a corporation and hence is even more vulnerable to being outbid by the corporation.

A market that puts individual clients in a bidding competition with corporate clients therefore necessarily ends up serving predominantly corporate clients at a price determined by corporate pre-tax wealth. This is a price that is systematically out of the reach of individuals. The only exceptions are individuals who have claims on aggregated wealth which can be accessed to pay lawyers, such as the victims of torts committed by corporate or insured tortfeasors, or shareholders with the right to maintain a derivative action against corporate managers. These exceptions are the rule: the market for lawyers — lawyers who can provide services to individuals and corporations alike — overwhelmingly allocates legal resources to clients with interests backed by corporate aggregations of wealth.



#### IV. CONCLUSION: NORMATIVE IMPLICATIONS AND REFORM

The market for lawyers is fundamentally noncompetitive. As a consequence of the complexity of legal reasoning and procedure, the profession's derived monopoly on the legitimate use of coercion, and the unification of the profession to serve the diverse needs for access to law, the price of law that emerges from the free market for lawyers is too high. This has fundamental implications for the (mis)allocation of legal resources among the diverse goals of a legal system and for the achievement, in fact, of justice in society.

The economic analysis of the imperfections in the market for lawyers and their roots in complexity, monopoly, and the unification of the profession, gives rise to two very important questions. The first is, to what extent, if any, does the market allocation of lawyers meet the normative goals of a justice system in a democratic society? The second is, if the allocation of legal resources stemming from the market for lawyers is inconsistent with our normative precepts, what might be done to reform the system? Each of these questions demands careful treatment on its own. What follows are brief introductory remarks on the normative implications and possibilities for reform of the legal system.

##### *A. Normative Implications: Judging the Justice System*

The allocation of resources according to wealth is hardly news in a market economy. Every student of basic economics realizes that the demand curve reflects not only willingness but also ability to pay. The great normative challenge is the assessment of need, want, and entitlement across individuals, and the reconciliation of imperfections in allocation with the efficiency benefits of market systems. Theories of distributive justice, such as that of John Rawls, work to develop principled means of establishing when individuals are entitled to equality with others and when allocative differences among individuals are justified.

The wealth-based allocation of lawyers, and hence of access to the legal system, is of categorically different normative significance from the wealth-based allocation of ordinary goods and services across individuals. The market for lawyers allocates access to law not merely among individuals but, more importantly, between individuals as a group and corporations as a group. Any conception of social justice, however, is about the rights and well-being of individuals qua individuals. The public interest in the legal claims of corporations is derivative of the fundamental interests of individuals. Law governing corporate relationships and conduct is primarily of interest because of its impact on the functioning of the economy, the source of wealth for

the members of the society. The corporation is not a member of civil society; it is an object and instrument of civil society.<sup>92</sup>

The allocation of lawyers and access between individuals and corporations is not, in the main, a matter of choosing amongst the claims of the members of society. It is a matter of choosing amongst the variety of goals on which the aspirations of a just society depend. The separate client groups that emerge in the market for lawyers represent fundamentally different goals for the legal system. Individuals invoke those parts of the legal system concerned with individual rights, personal dispute resolution, democratic governance, and social control. Business clients invoke those parts of the legal system concerned with management of the economy and corporate relationships — policing market conduct, regulating the production and distribution of goods and services by businesses, and resolving disputes between market competitors and contracting partners. Even in a case between an individual and a corporate entity, the individual interests at stake invoke considerations that are fundamentally different from those invoked by the corporate entity. To put the point in its starkest form, individual clients invoke the justice concerns of the legal system, and business clients invoke the economic concerns.

A more nuanced treatment of the normative implications of the primacy that the market for lawyers accords to the legal claims of corporations will have to take into account the fact that corporations are composed of individuals: they act through the actions of individuals, and they are funded by the individual wealth of shareholders. It will also have to take into account the access that is available to the individual who has a claim on the resources of the corporation. The access to legal protection that a corporate connection affords these individuals is a more familiar matter of distributive justice: between the rich and the poor in a society, between individuals who own capital and those who rely on labour income, between (surprisingly) those who are injured by corporations and those who are injured by fellow citizens. Recognizing these more conventional normative consequences of the market allocation of lawyers does not, however, take away from the fundamental point that has gone largely unnoticed: when our legal system relies on the market allocation of lawyers under conditions of complexity, monopoly, and unification, it chooses the management of the economy over the justice of social and political relationships as its central preoccupation. It establishes the governance of the economy as the principal role of the justice system.

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92. For an analysis of a corporate “right” to freedom of speech from this perspective, see Meir Dan-Cohen, *Freedoms of Collective Speech: A Theory of Protected Communications by Organizations, Communities, and the State*, 79 CAL. L. REV. 1229, 1244-48 (1991).

### B. *Reforming the Justice System(s)*

Although a thoughtful approach to reforming the justice system must await the more careful normative work to which I have alluded, a few points clearly follow from what we have learned thus far.

First, it is important to emphasize that governance of the economy is a legitimate and necessary role for a legal system. There is no justice in the freedom to starve. The problem with the market for lawyers, however, is that this role squeezes out the other legitimate, and arguably primary, roles for law. It does so not on the basis of a principled determination of the balance between efficiency and the distribution of goods, including Rawls's primary goods,<sup>93</sup> but rather on the basis of the structural differences in the nature of individual and corporate wealth. It is hard to imagine any normative theory that would justify this distribution, particularly given the derivative nature of corporate claims and entitlements on resources, autonomy, and so on. The question for reform, then, is likely to be how the legal system might be restructured so as to reconcile the achievement of economic goals with more fundamental justice goals.

Although a careful treatment of prescriptions for what ails the justice system requires further work, the economic analysis of the market for lawyers provides a starting point for thinking about reform. Above all, the economic analysis tells us that the problem of access to the legal system as between corporate and individual clients is not simply a matter of legal ethics. This is not to say that there are no ethical issues that lawyers must face in terms of if and how they charge for their services. It is to say that exhortations to the bar to increase their pro bono efforts or to law students to choose low paying public interest work over corporate careers are incapable of making significant inroads on the fundamental incentives and outcomes of the market for lawyers. It is to say that the causes of the problems of access and (mis)allocation in the system have deep, structural roots that only deep, structural change can reach. What follows are some preliminary conjectures that flow from the identification of the three legs which support the market power of lawyers and give wealth the defining role in the allocation of resources across the diverse goals of the legal system.

*Complexity.* As we have seen, complexity is at the root of numerous distortions in the market for lawyers. These are not limited to the well-recognized direct effects arising from the cost of learning, inter-

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93. Rawls uses the term "primary goods" to refer to liberty, dignity, and so on. See JOHN RAWLS, *A THEORY OF JUSTICE* (1971).

preting, applying, and litigating complex rules and procedures.<sup>94</sup> The effect of complexity runs deep, disabling competitive mechanisms and limiting the supply of potential providers, setting up tournament and auction dynamics that extract wealth. It is natural, therefore, to look to the possibility of reduced complexity as a way of reducing the distortions in the justice system.

Reducing complexity, however, raises deep philosophical and practical questions which all come down to this: is legal reasoning, as we know it,<sup>95</sup> what law and justice *is*? Our law is complex as a result of a natural entropy arising from the reasoning that leads lawyers, most importantly judges, to see distinctions or parallels that were previously hidden or unappreciated. The redrawing of the lines in the law that results from recognition of new distinctions and parallels is not, however, seen as a matter of election or caprice. It is seen as a matter of justice: justice requires, compels even, that the lines be redrawn. Our legal reasoning is our way of reasoning about justice. Should we reason otherwise? What would that mean? Would it be possible? Would it be stable?

These are enormously difficult questions about human thought and justice, well beyond the ken of an exclusively economic analysis. What the economic analysis does illuminate, however, is what it is that legal theorists need to think hard about. Because law is not delivered in the abstract but is delivered through a market mechanism, justice in theory not only departs from justice in fact, but it is the *cause* of the departure. When justice in our case-by-case system compels an increment in the complexity of our understanding of the just treatment of a dispute between litigants, it does so, incrementally, at the expense of reducing access to justice more generally. Exquisite justice for some *systematically* results in rough justice for others. Where is the justice in that? The question is not rhetorical.

*Monopoly.* Given the mind-boggling jurisprudential questions implicated in any effort to reduce legal complexity, monopoly problems seem straightforward in comparison. Monopoly is at least a well-rehearsed market imperfection. In the legal market, however, monopoly is a tough nut to crack.

The first problem is that the standard responses to monopoly are either largely inapplicable or ineffective in the market for lawyers. While reductions in artificial barriers to entry are possible, and necessary, we have seen both from the theory and the empirical evidence

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94. Richard Epstein has examined some of the implications of complex rules in his writings. See RICHARD A. EPSTEIN, *SIMPLE RULES FOR A COMPLEX WORLD* (1995).

95. My own familiarity with common law systems, and the interpretation of statutes in a common law system, leads me to restrict this observation to those systems. Whether the legal reasoning in civil or other legal systems shows the same natural entropy as common law systems is a matter for further research.

that artificial barriers play a relatively small role in the restriction on the supply of potential lawyers. Despite significant reductions in artificial barriers over the past several decades, the cost of lawyers in the dominant sector of the market has increased substantially. Together with the theory, this suggests that the more important entry barriers are ones that are much more difficult to address: the “natural” limitations on supply arising from the level of cognitive ability required to effectively participate in our complex legal system and the fundamental monopoly held by the state over the use of coercion in the resolution of disputes and the protection of rights and social order. Reducing the barriers raised by complexity puts us back to enormously difficult jurisprudential questions. Eliminating the state’s monopoly over force is equivalent to undoing the social contract.

The relevant monopolies in law are akin to natural monopolies such as public utilities. The complexity barrier to becoming a lawyer is also akin to the barrier that makes physicians a limited and hence expensive resource. The price regulation that is conventionally used to control monopoly power in these more familiar monopolies is, however, at risk of being counterproductive in law. Pure price regulation, given the other features of the market for lawyers, is likely only to exacerbate the distorting role that wealth plays. Capped prices make volume of work even more important; a corporate client becomes even more attractive than an individual client because the corporate client is likely to generate, and have the wealth to pay for, more hours of work. It is not even clear, given the distortions of complexity, and particularly the dynamics of the sunk cost auction and the credence nature of legal services, that total fees for a given legal matter will be reduced if prices are regulated: the power to extract wealth under cover of complexity can be exercised through hours and procedures as well as rates. Even regulation of total fees for legal services is likely to leave the preference for corporate clients untouched: corporate clients are likely to be repeat customers, whereas individuals are not. All of this is not to say that price regulation is impossible, but rather that it is clearly a challenge to conventional regulatory theory.

There may be more promise in what is becoming a conventional piece of modern public utility regulation: unbundling. The state has, practically by definition, a monopoly on the use of coercion in dispute resolution and social control. This does not imply, however, that the state must exercise a monopoly on the procedures or the venues regulating coercion, or a monopoly on the substantive determination of the merits of a dispute. It is conceivable, for example, that the state would blindly enforce the dispute resolution orders of a purely private arbitration mechanism, without avenue for review of the merits or procedures. This would minimize the contact with the state monopoly

element and present the possibility of competition among arbitration mechanisms and, indeed, private legal systems.<sup>96</sup> The question would then be a normative one: to what extent should the state be involved in the development and implementation of substantive and procedural law? Does the rationale for the state's role in law vary across the different goals of a legal and democratic order? What the economics of the market for lawyers tell us is that any answers to this question must take into account that the state's monopolistic exercise of an expansive role has important effects in practice on the achievement of the diverse goals of a just society.

*The Unified Profession.* Both the empirical evidence regarding the dominance of commercial clients in the system and the economic analysis of the market for lawyers indicate that there is some urgency in coming to grips with the apparently widening gulf between the ideals of justice and the reality of how those ideals are achieved in practice. The necessity of complex legal reasoning and the state's role in developing and implementing law are, however, monumental questions and truly daunting for the project of legal reform. Fortunately these questions also bring into sharper focus the importance of the third leg on which the distortions in the market for lawyers rest, because it is this third leg that is the most amenable to social change. Moreover, it turns out that the questions of complexity and monopoly are more easily approached when we pay attention to the unified nature of the legal profession.

As we have seen, by keeping under one roof the multiple roles for a modern legal system — management of the economy, individual justice, social control, and so on — the role that complexity and monopoly accord to wealth, rather than cost, in the market allocation of lawyers perpetuates a system that is heavily, and it seems increasingly, skewed towards managing the economy rather than safeguarding just relationships and democratic institutions. The boundaries of the profession, of “the” legal system are, however, a matter of institutional and deliberate choice, established by licensing and educational requirements. While there are very important practical questions to be answered, in theory at least it is quite possible to conceive of a different set of boundaries and indeed of a separation between the justice system and the legal governance of the economy. Abandoning the concept of the unified profession here would mean, over time, the development of professional identities, degrees, training, and practices that could become as distinct from each other as, for example, those of the M.B.A. and the M.S.W.

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96. See LISA BERNSTEIN, *THE NEW LAW MERCHANT: PRIVATE COMMERCIAL LAW IN THE UNITED STATES* (1995) (discussing private legal systems and merchant law history).

To some extent, this market “fix” would endeavour to segregate corporate clients from individual clients and reduce or eliminate the movement of “lawyers” between these groups in response to market incentives. It is an interesting question as to whether, if forced to choose between a degree in preparation to work in corporate law and one in preparation to work in the justice system, students would flock to the corporate world in the same numbers as lawyers do now. Part of the attraction of law to many law students seems indeed to be that the degree allows them to maintain some contradictions in their career and life goals: law students are (usually) ones who did not sign up for the M.B.A., but nor did they sign up for the M.S.W. Most law students come into law school with some motivation to do work related to social justice; as the data indicate, most come out and eventually do work related to the management of commerce and the economy.

The importance of exploring the potential for disaggregating the profession, however, extends beyond putting in place a barrier to the mobility of “lawyers” between social justice work and economic management work. The legal profession does more than just deliver legal services; it constitutes the legal system. It is the group in society that develops and implements the structures, the reasons, the norms, and the processes of legal order. As an organic institution, what emerges in the different spheres of the legal system grows out of common soil. Indeed, one of the justifications for a unified profession has come to be precisely the idea that the principles governing the relationships in all these spheres — contract, property, tort, due process, and so on — are universal. But are they? And even if they are, should they be, if the price is, in practice, a skewed emphasis on economic relationships rather than on the other relationships of a civil society?

The questions raised about complexity and the state’s role in coercive dispute resolution suggest not. Indeed they suggest that part of the unified appearance of the legal system across these different spheres comes from a failure to attend closely enough to the misapplication to economic entities of ideas rooted in conceptions of justice for the members of a democracy. The mind-boggling quality of the question — is the complexity of legal reasoning necessary to the very idea of justice — stems from the intricacies of the justice of human social, familial, and political relations. Respect for the individual establishes an enormous barrier to any sort of instrumental approach to dishing out justice case-by-case; the equality of persons and the incomparability of the moral worth of individuals is what makes tradeoffs in justice for him against justice for her so difficult. It may be technically challenging, but it does not appear philosophically challenging, however, to take an instrumental approach to trading off the predominantly economic values at stake in the structuring and regulation of economic relationships. It just *is* categorically different to say to a corporate litigant, “although we can see the merits in this case of an expansive

reading of the contract or the statute, we will not do so because of the consequences for the cost of system as a whole,” than it is to say this same thing to someone accused of a crime or at risk of losing contact with his or her children or seeking enforcement of a democratic right. The justice system does have to attend to the costs of administration, but the tenor of the inquiry is fundamentally different in these spheres because the values at stake are fundamentally different.

Similarly, the question of the appropriate role of the state in the development and implementation of the legal rules recognizes a sharp distinction between management of the economy and management of individual, social, and political relations. There is something quite appealing about relegating commercial disputes to a market for private dispute resolution mechanisms with blind state enforcement: failures in individual cases would be left to market correction, not judicial correction. But there is something quite appalling about suggesting the same in the protection of individual rights or the resolution of individual disputes. Justice may well demand public care in the latter, and allow private determination in the former.

What began as a simple question, then, about the price of lawyers has transformed into a series of fundamentally important questions about how the legal system and the legal profession have evolved and how they should meet the future. The economic answers that the analysis has uncovered in the role of complexity, monopoly, and the unified profession in deforming the market for lawyers and hence the allocation of legal effort have left us with fundamental jurisprudential questions that demand careful attention from the legal profession. Unless we take this work seriously, the price of law will be justice.