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AN EXPLORATORY STUDY OF THE PRICING OF LEGAL SERVICES

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Introduction

Consumers and firms spend some \$200 billion annually on legal services, but little is known about the factors that influence lawyers' prices for those services because comprehensive data on attorneys' fees have not been publicly available. Recently, a large and representative sample of lawyers' fees for specific services has been made publicly available by AttorneyFee.com. Figure 1 presents the empirical distributions of lawyers' hourly rates for assisting with a criminal defense, estate planning, and a divorce. Notably, there is substantial heterogeneity in the rates for those services around an average rate of roughly \$300/hour.

The wide variance in the distribution of prices may be surprising because lawyers must satisfy licensing requirements to practice law, which generally include graduating from a law school accredited by the American Bar Association and passing a state bar examination. In theory, occupational licensing sets minimum standards of competence that all legal practitioners must satisfy to compensate for a consumer's alleged inability to distinguish between competent and incompetent lawyers; accordingly, licensing should narrow the distribution of prices because less-qualified individuals, whose prices would presumably be lower than those charged by licensed lawyers, are prevented from practicing law.¹

In this paper, we explore the determinants of the variation in lawyers' prices to shed light on the extent to which lawyers compete. We then comment on whether occupational licensing's entry barriers to legal practice that restrict competition are justified because they protect consumers who may have imperfect information about potential legal service providers. We do not find evidence in support of that premise.

¹ This comparison should be qualified because we do not observe the counterfactual distribution of prices without occupational licensing for lawyers. Nevertheless, we find little evidence of a truncation of the distribution of prices to the left, which would be associated with a minimum standard of competence.

Competition in the Legal Profession

Lawyers are free to charge any price for their services and also to provide *pro bono* work without raising concerns of anti-competitive (predatory) behavior. Lawyers are not prohibited from advertising their prices in various media outlets, but they seldom do, in all likelihood because the price for a given service will typically vary according to a client's specific requirements or because it is a contingency fee.²

Entry into the legal profession is another matter. In most states, an individual is allowed to practice law only if he or she has graduated from a law school accredited by the American Bar Association (on-line, foreign, and certain U.S. law schools are currently not accredited) and if he or she has passed a state bar examination.³ Winston, Crandall, and Maheshri (2011) estimate that at least half of the people who apply for admission to an ABA-accredited law school every year are prevented from practicing law because they are not admitted to any law school. And an untold number of people are discouraged from pursuing a legal career by the out-of-pocket and opportunity costs of completing a three year course in law.

State governments (and state appellate courts) have gone along with the ABA's wishes to prohibit businesses from selling legal services unless they are owned and managed by lawyers. This means that lawyers can work for a corporation, but they cannot offer professional legal services to other firms or individuals. Finally, the ABA has encouraged state bar associations to

² Jacoby and Meyers is characterized as the law firm that pioneered advertising on television, but they primarily work on a contingency fee basis.

³ Notably, California does not require bar applicants to be graduates of ABA-accredited law schools, and Wisconsin does not require graduates of the state's two major law schools to pass a bar exam.

prosecute the unauthorized practice of law, using a definition of legal practice that is expansive and includes even the sale of simple standard-form wills.

New firms such as Clearspire have developed a new business model to reduce the cost of legal services by replacing hourly billing, which gives lawyers an incentive to add superfluous tasks to increase a project's total hours, with transparent fixed prices for a service. LegalZoom, which offers services online at a substantial savings, has also begun to compete with traditional law firms.⁴ Nevertheless, Winston, Crandall, and Maheshri (2011) argue that the states' protection of lawyers from various potential sources of competition has significantly raised the price of legal services offered by all lawyers regardless of their earnings and the size of the firm where they are employed.⁵

Explaining the Variation in Prices for Legal Services

Economic theory does not appear to derive unambiguous predictions about the distribution of prices in a market in which entry is restricted but pricing is not. Empirical evidence obtained by Kleiner and Krueger (2010) indicates that, in general, occupational licensing has had little effect on reducing the dispersion of wages for individuals in licensed jobs. And by restricting entry and the number of competitors, occupational licensing may actually increase the dispersion of prices (see Morrison and Winston (1995) and Gerardi and Shapiro (2009) for empirical evidence from airline markets).⁶

⁴ Clearspire is a legally sanctioned law firm that can and does provide legal counsel, while LegalZoom is a legal forms provider and cannot provide counsel to its consumers.

⁵ Winston, Crandall, and Maheshri note several other studies that find that lawyers' earnings are increased by entry barriers created by states' licensing requirements and ABA regulations.

⁶ Note that, in general, the distribution of prices per se does not have any unambiguous welfare implications for consumers.

Price variation in a market for legal services could be explained by variation in lawyers' service quality (determined in part by their human capital), the variety of services that are provided, the cost of service, the intensity of competition among lawyers, and the variation in demand. We investigate empirically which influences are most salient by using the data collected by AttorneyFee.com to estimate the determinants of a lawyer's price (hourly rate) for a given service. We separately specify price regressions for three distinct services: criminal defense (not including misdemeanor defense, driving under the influence, and expungement of criminal convictions), estate planning (not including wills or probate administration), and divorce (not including uncontested divorce.) The independent variables in those price regressions include various lawyer characteristics to partially control for differences in service quality and fixed effects at the city or ZIP code levels. The fixed effects absorb any determinants of price that are common to a market, defined at the city or ZIP code level, including the demand for legal services, costs such as rent and wages, and the intensity of lawyer competition. Note that any determinants of prices that vary at the state level, such as state specific barriers to entry as reflected in bar examination pass rates, are also absorbed by the city or ZIP code fixed effects.

To the best of our knowledge, AttorneyFee.com has assembled the first publicly available data set on lawyers' prices. They did so by randomly sampling the websites of lawyers who are either solo practitioners or who work at small law firms, which is why the legal services in our analysis include only divorce, crime, and estate planning. Services such as antitrust, bankruptcy, mergers and acquisitions, securities, and the like are generally provided by lawyers who work at larger law firms.

In order to address the valid concern that lawyers who post prices online are an unrepresentative subsample of lawyers, AttorneyFee.com commissioned a professional survey based on a random sample of lawyers from the *Yellow Pages*, and they found no statistically significant difference in the mean and median prices from the *Yellow Pages* survey and their sample. Posted prices do not include discounts, but discounts are offered on a case by case basis and are very difficult to collect. Moreover, they are generally offered based on a consumer's specific characteristics and are therefore immaterial to our interest in representative pricing by providers of legal services.

We summarize the data in table 1. The mean hourly rates for the services that we consider are around \$300 and that the standard deviations of rates are roughly \$100. Males make up the majority of lawyers in the sample, who tend to have 15 to 25 years of experience, although lawyers with much less experience are also represented. At least two-thirds of the lawyers graduated from either tier 1 or tier 2 law schools.⁷

We note that the distribution of prices, which can be interpreted as lawyers' gross wages, is skewed to the right for each service (see figure 1). Thus the mass of lawyers earns wages at or below the mean, but a minority of "superstars" earns wages that are considerably above the mean. This skewness is consistent with the theoretical predictions of a variety of models of wage setting (Neal and Rosen (2000)) and with aggregate empirical evidence (for example, Castaneda, Diaz-Jimenez, and Rios-Rull (2003)) from the majority of labor markets that do not

⁷ Law school tiers consist of rankings of 50 law schools by the *U.S. News and World Report*. Thus tier 1 law schools include schools ranked 1-50; tier 2 law schools are ranked 51-100; and so on up to tier 5 law schools. We could not find population figures to compare with our sample figures, but it is plausible that a large fraction of our sample graduated from tier 1 or tier 2 law schools because our random sample of lawyers is primarily drawn from major metropolitan areas.

feature occupational licensing (Autor, Katz, and Kearney (2006)). We are not aware of empirical evidence that explains why the market for lawyers is sufficiently different from those labor markets to justify occupational licensing.

We efficiently estimate price regressions for each legal service by seemingly unrelated regression (SUR). We report the parameter estimates in table 2 for a linear specification.⁸ For each set of price regressions, we present three specifications: (1) without geographic fixed effects, (2) with city fixed effects, and (3) with fixed effects at the ZIP code level. Note that the fixed effects are interacted with the service-type fixed effects and hence can vary for each type of service.

Our preferred specification includes ZIP code fixed effects in order to most flexibly account for the heterogeneity of costs, demand, and competition across different workplace locations and for their effect on prices.⁹ As shown in the table, including the ZIP code fixed effects markedly improves the model's goodness of fit. At the same time, although those effects vary by service type, we are unable to capture the heterogeneity within a service-type category (e.g., some contested divorces are more complex than others), which is likely to account for a large part of the unexplained variance in the estimations.

Lawyers' service quality is captured by years of experience, which tends to have a positive statistically significant effect on hourly rates. The returns from more than twenty years of experience range from \$30 to \$70 per hour or roughly a 10-20% premium on average. We do

⁸ We also estimated the price regressions using a log-linear functional form and obtained qualitatively similar results. We present estimates from linear specifications for ease of interpretation.

⁹ We explored measuring nonlawyer competition based on the share of the population in a ZIP code that purchased LegalZoom estate planning legal forms. However, that variable is likely to be endogenous and we could not identify a suitable instrument.

not find that lawyers' gender or the tier of the law school from which they graduated have a statistically significant effect on prices (recall, the famed attorney Johnnie Cochran graduated from Loyola Marymount University School of Law).¹⁰ It follows that any unobserved lawyer characteristics that could account for the variation in prices must be uncorrelated with a lawyer's education and experience. We question, however, whether such characteristics are relevant because most consumers rarely require the legal services that are included in our analysis, so unobserved lawyer characteristics that consumers gradually glean through their repeated experiences with a given lawyer are unlikely to support the observed variation in prices.

Finally, the limited information to consumers on lawyers' prices suggests that search costs in this market may be salient and help explain the variation in prices (Diamond (1971), Anderson and Renault (1999)). Because we would expect that those costs vary across locations in our sample in accordance with the supply of lawyers, their effect on the variation in prices would be captured by the ZIP code fixed effects. Although purely lawyer-specific search costs may also exist, we conjecture that they would have a much smaller effect on prices.

In sum, we can explain a modest amount of the variation in lawyers' prices by observed variables, and it appears that service differentiation is the main unobserved determinant of this variation. Accordingly, we characterize the competitive interaction between lawyers as monopolistic competition, where service differentiation does not exist because lawyers differentiate themselves with credentials (i.e., law school ranking was insignificant) or because

¹⁰ Tier 5 is the base law school tier. We explored including a lawyer's AVVO quality rating, but that variable was incompletely sampled and is likely to be correlated with a lawyer's unobserved characteristics. When we constructed a "good" AVVO rating dummy (defined as 1 for a rating greater than or equal to 8 out of 10), it was statistically insignificant and did not affect the other parameter estimates.

they intensely advertise, but rather because consumers demand and lawyers provide a range of services that are inherently different.

Some Comments on Occupational Licensing and Deregulating Legal Services

We have noted that previous work has provided evidence that occupational licensing and ABA regulations have increased lawyers' prices by restricting competition. At the same time, we have concluded that competition among lawyers is plausibly characterized by monopolistic competition, which predicts that firms earn zero excess profits in the long run. Thus by deregulating legal services to eliminate entry barriers, lawyers' rents (excess profits) should be reduced because the prices of those services would move closer to costs. Large price markups might remain if lawyers' competitive interactions were characterized by some type of oligopoly behavior (Tirole (1988)), but we do not find that to be an accurate characterization of competition among lawyers in our sample. In a deregulated environment, even large law firms are likely to face more intense competition because corporations and foreign law firms, whose attorneys were not licensed to practice in the United States because they graduated from a foreign law school, would be free to compete in the U.S. market for legal services.¹¹

An argument against deregulating legal services and in favor of occupational licensing is that it protects consumers from being exploited because they lack sufficient information to accurately evaluate a prospective lawyer's ability. In our analysis, we do not find any evidence that suggests that consumers are incapable of distinguishing between the quality of lawyers, especially infra-marginal ones. Such evidence would likely take the form of bunching in the

¹¹ In the more competitive deregulated environment, our conclusion that lawyer competition is characterized by monopolistic competition should also apply to competitive interactions between larger law firms that provide services that we were unable to analyze here.

observed distributions of prices, conditional on ZIP code level fixed effects. Moreover, the wage distributions of lawyers, who are subject to occupational licensing, have features in common with the wage distributions of workers in other occupations that are not subject to occupational licensing even though it would be expected that employers have much more information about their employees' abilities than consumers have about the abilities of their prospective lawyers.

It is difficult for us to comment further about whether occupational licensing is benefiting consumers by restricting entry into the legal profession because the only competitive environment for legal services in the United States that we observe requires lawyers to obtain licenses. That said, the ABA's own Survey on Lawyer Discipline Systems reported that, in 2009, some 125,000 complaints were logged by state disciplinary agencies—one complaint for every eight lawyers practicing in the United States. Note that this figure is a lower bound on client dissatisfaction because it includes only those individuals who formally filed a complaint. Although many of the complaints were dismissed, their volume suggests that clients are far from satisfied with the quality of legal service that they are currently receiving. Indeed, Berrey, Hoffman, and Nielsen (2012) found in a recent study of employment discrimination cases that more than half of the plaintiffs thought that their lawyers were incompetent.

Consumers' abilities to assess a lawyer's quality would likely improve in a more competitive market for legal services that eliminated occupational licensing because more information that bears on a legal practitioner's competence would emerge (Winston (2012)). Legal service providers, especially individuals who do not have law degrees from ABA-accredited law schools and firms that employ them, would face pressure to provide credible information about their capabilities and performance—and perhaps to offer warranties. Third-party evaluations of legal practitioners by private firms and law clinics would also drive

information disclosure. And, of course, all legal practitioners would still be subject to general business laws against dishonest practices. In the final analysis, monopolistic competition among lawyers would still exist, but lawyers could not count on earning rents in the long run that were unrelated to their skills and abilities.

Regulation of the legal profession has created a false sense of security about the quality of service provided by lawyers and has generated hostility toward firms, such as AVVO, which have attempted to provide information about lawyers' quality. Thus price and quality competition have not been fully ingrained in the market for legal services.

Recently, certain consumers with a large volume of legal business have begun to adopt strategies to change that culture. For example, large corporations have hired third parties, non-lawyers and lawyers, to manage outsourcing of legal work by finding domestic and foreign firms to perform certain tasks at lower prices than major law firms charge. They have also hired matter management firms, such as TyMetrix, to manage and ensure the accuracy of the bills and services that they receive from law firms. Insurance companies that have a large stake in controlling the cost of legal services have compiled data to identify law firms that they will and will not approve for work.

In a nutshell, by eliminating occupational licensing constraints, the market for legal services would likely perform more efficiently because all clients, not just a growing few, could further compel lawyers to provide more useful signals of value and quality.

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Table 1. Summary Statistics.

Variable	Criminal Defense		Divorce		Estate Planning	
	Mean	Std. Dev.	Mean	Std. Dev.	Mean	Std. Dev.
Hourly Rate (\$)	300.55	103.91	302.47	86.48	329.23	89.39
Share of Male Lawyers	0.75	0.43	0.57	0.50	0.73	0.45
Years of Experience	16.76	11.89	20.62	12.20	24.13	13.58
Share of Lawyers who Graduated from a Tier 1 Law School*	0.36	0.48	0.34	0.47	0.38	0.49
Share of Lawyers who Graduated from a Tier 2 Law School*	0.36	0.48	0.35	0.48	0.36	0.48
Share of Lawyers who Graduated from a Tier 3 Law School*	0.08	0.28	0.08	0.28	0.08	0.27
Share of Lawyers who Graduated from a Tier 4 Law School*	0.17	0.38	0.20	0.40	0.15	0.36
Share of Lawyers who Graduated from a Tier 5 Law School*	0.02	0.15	0.03	0.16	0.03	0.16
Number of Observations	226		3566		519	

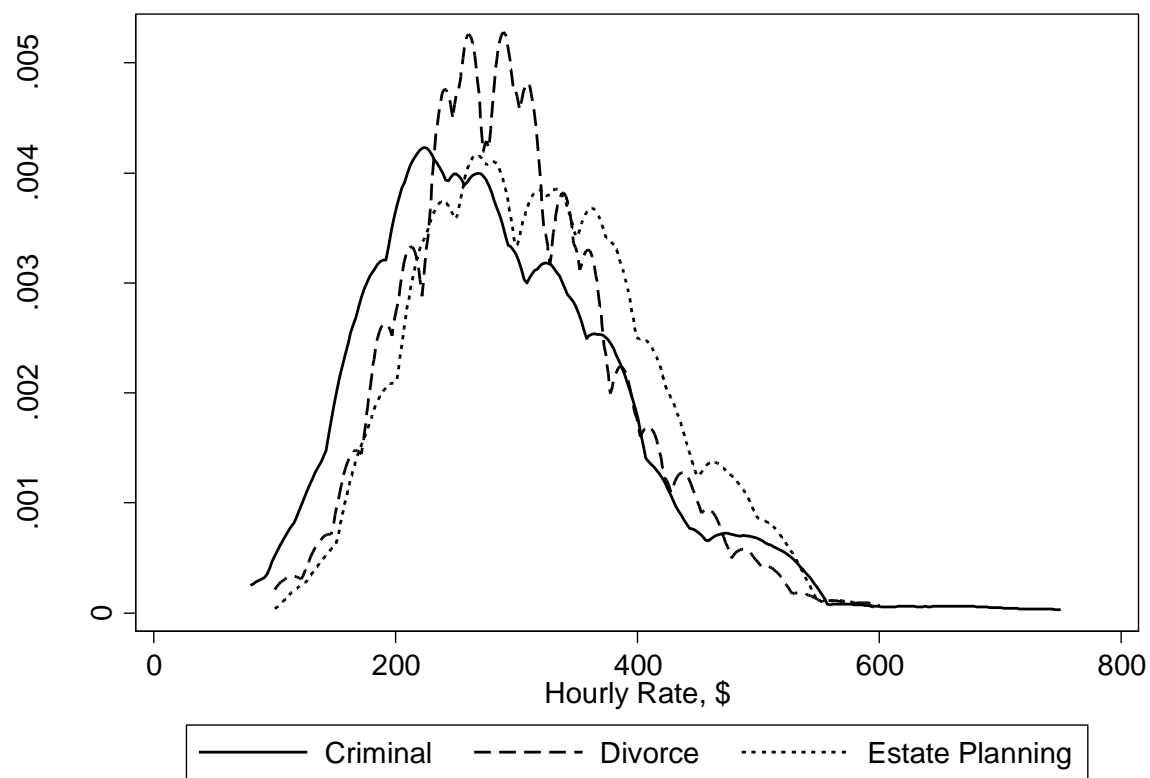
* Law school tiers consist of rankings of 50 law schools by the *U.S. News and World Report*. Thus tier 1 law schools include schools ranked 1-50; tier 2 law schools are ranked 51-100; and so on up to tier 5 law schools.

Table 2. SUR Coefficients for the Determinants of Lawyers' Hourly Rates (heteroskedastic robust standard errors clustered by city)

Independent Variable:	Criminal Defense			Divorce			Estate Planning		
	(1)	(2)	(3)	(1)	(2)	(3)	(1)	(2)	(3)
Male Dummy	-3.25 (15.84)	7.97 (14.50)	21.72 (14.05)	6.23 (4.32)	2.79 (3.62)	2.50 (4.73)	6.7 (10.07)	3.00 (9.79)	7.26 (5.44)
6-10 Years of Experience	37.18** (13.31)	40.37* (16.07)	24.87 (17.75)	9.90 (7.39)	8.00* (3.85)	5.07 (4.49)	-6.3 (13.09)	-4.28 (12.99)	-7.58 (5.2)
11-20 Years of Experience	66.77** (20.76)	70.16** (16.05)	65.28** (17.69)	30.30** (5.23)	33.48** (5.45)	29.01** (6.14)	27.26** (10.43)	22.18 (13.06)	18.24 (13.92)
21 or more Years of Experience	56.90** (17.97)	66.81** (15.91)	70.05** (15.40)	55.65** (8.01)	57.95** (10.43)	53.80** (10.83)	58.81** (12.07)	40.81** (12.40)	29.80* (12.40)
Graduated from a Tier 1 Law School ^a	55.17 (30.82)	14.94 (15.02)	19.09 (17.41)	-30.13** (9.17)	-16.77 (10.07)	-17.61 (13.76)	-28.97 (20.61)	-13.36 (21.82)	-18.43 (25.07)
Graduated from a Tier 2 Law School ^a	8.78 (24.73)	-11.28 (12.71)	-7.13 (16.79)	-35.12** (9.68)	-19.89 (12.34)	-20.03 (15.54)	-44.88* (19.26)	-29.14 (19.98)	-31.11 (23.92)
Graduated from a Tier 3 Law School ^a	34.81 (35.63)	17.80 (20.46)	15.31 (18.17)	-28.07** (6.72)	-15.51 (9.07)	-15.28 (12.12)	-43.99** (15.56)	-31.34* (14.52)	-33.02 (17.48)
Graduated from a Tier 4 Law School ^a	-1.60 (21.81)	-11.31 (13.32)	2.60 (14.54)	-29.73* (12.99)	-17.02 (11.90)	-17.57 (14.84)	-30.75 (23.22)	-13.67 (22.83)	-31.77 (20.76)
Service-Type Fixed Effects?	Yes			Yes			Yes		
City-Service Type Fixed Effects?	Yes			Yes			Yes		
ZIP Code-Service Type Fixed Effects?	Yes			Yes			Yes		
Number of Observations	4311	4311	4311						
Adjusted R ²	0.08	0.23	0.29						

Notes: For each specification, the three equations are estimated jointly by SUR, and the joint adjusted R² is reported. * - significant at 95% confidence level; ** - significant at 99% confidence level; ^a Graduated from a Tier 5 Law School is the base law school tier.

Figure 1. Empirical Distribution of Hourly Rates for Three Legal Services



Note: Empirical distributions are constructed using an Epanechnikov kernel and a bandwidth of 23.