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An exploratory study of the pricing of legal services

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ABSTRACT

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. In this paper, we explore the determinants of the variation in lawyers' pricing to shed light on competition among lawyers and to comment on whether 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 this premise.

1. 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 and services have not been publicly available. Recently, a large and representative sample of lawyers' fees for specific services in major metropolitan areas in the United States has been made publicly available by AttorneyFee.com. Fig. 1 presents the empirical distributions of lawyers' hourly rates during 2012 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 competition among lawyers. We then comment on whether entry barriers to legal practice that restrict competition is 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.

2. 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 US 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

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[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.

[2] Jacoby and Meyers is characterized as the law firm that pioneered advertising on television, but they primarily work on a contingency fee basis. Some states regulate advertising by lawyers by preventing endorsements from current clients, requiring that actors be identified as such, and so on.

[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.

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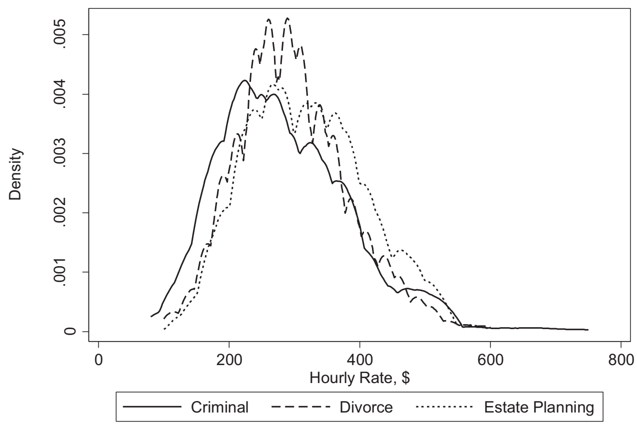

Fig. 1. Empirical distribution of hourly rates ($2012) for three legal services. *Note*: Empirical distributions are constructed using an Epanechnikov kernel and a bandwidth of 23.

Source: Authors' calculations using data from AttorneyFee.com.

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 simultaneously offer professional legal services to other firms or individuals. Finally, the ABA has encouraged state bar associations to 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 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 has also begun to compete with traditional law firms by offering services online at a substantial savings.[4] Nevertheless, Winston et al. (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 that employs them.[5]

3. 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]

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 prices 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 and other judicial institutional characteristics, 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 cross-sectional data set of lawyers' prices. They did so by randomly sampling the websites of lawyers in 2012 who are either solo practitioners or who work at small law firms in major US metropolitan areas, 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. As shown in Fig. 1, there is considerable variation in lawyers' prices for the services in our sample.

We are unaware of other large publicly available samples of legal prices to use for comparative purposes to validate the sample. However, 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 may not coincide with transactions prices because they do not include discounts. Scanner price data from supermarkets have been criticized on those grounds because supermarket shoppers may obtain discounts from coupons, club memberships, loyalty cards, and the like. In contrast, legal services are infrequently purchased and lawyers are unlikely to offer such promotions.[7] If, in fact, significant discounting did occur, then we would expect that our sample would exhibit even greater price variation unless the lower posted prices had much smaller discounts than the higher posted prices.

We summarize the data in Table 1. The mean hourly rates for the services that we consider are around $300 (in 2012 dollars) and their standard deviations are roughly $100. Males make up the majority of lawyers in the sample, who tend to have 15–25 years of experience, although lawyers with much less experience

[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 unambiguous welfare implications for consumers.

[7] Furthermore, if a lawyer goes to the trouble of posting a price for a service, then the lawyer has an incentive to post an accurate price because legal practitioners, unlike car dealerships, do not have a well-known reputation for determining prices by negotiations. Thus consumers are unlikely to expect that significant discounts can be obtained by bargaining on the price of a service and lawyers who post prices that are significantly above transactions prices are likely to reduce demand for their services.