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A DERIVATIVES MARKET IN LEGAL ACADEMIA

Paul H. Edelman

ABSTRACT: Building on the success of derivatives markets in the financial arena, I show how similar markets can be used to hedge risk in legal academia. Prudent use of these markets will generate cash, mitigate errors in hiring, and increase the academic prestige of law schools. In short, they can do for legal academia what they have already done to the financial world.

IN TUMULTUOUS ECONOMIC TIMES there is considerable comfort in being ensconced in legal academia. Unemployment does not lie in wait for those of us fortunate enough to be tenured. To be sure some of the perquisites of the profession – free meals, a nice travel budget, maybe a laptop or two – may be pruned, but those are small quibbles in the face of lay-offs at major firms or 3Ls who seek permanent jobs while servicing a large debt. We really have little about which to complain.

One area where shrunken endowments do manifest themselves meaningfully, though, is in the inability to hire. In these times the errors of past recruitments come to the fore. Hiring is a risky endeavor. The Brilliant Supreme Court clerk (BSC) who seemed a sure thing decides to spend his time marketing haiku on the inter-

Paul Edelman is a Professor of Mathematics and Law at Vanderbilt University. You can reach him at paul.edelman@vanderbilt.edu.

net. The fellow from Harvard with the stellar recommendations develops writer's block and is unable to finish a manuscript. Or the former associate at Cravath decides to pursue a second career in mathematics and spends all of her time teaching calculus. Mistakes happen. Are law schools destined to absorb these mistakes? Perhaps there is a way to hedge this risk?

This short essay outlines just such a way to hedge errors in legal academia. Borrowing from the notorious success of such financial leaders as Lehman Brothers and AIG, I propose a derivatives market for legal academia. By bundling the various academic assets from the faculty, and tranching them appropriately, a law school will be able to hedge its errors in hiring, reinvigorate its own scholarly profile, and perhaps even supplement its revenue. The risk can be managed and all will benefit.¹

Consider the problem of High-theory Law School (HLS). It is about to hire the BSC, but there is uncertainty as to whether he will write anything that might burnish the HLS brand. On the other side is Our Little Sisters of the Poor Law School (OLSPLS), which desires to advance its scholarly profile but is unable to hire any candidates who are likely to do so. Suppose that HLS bought a put from OLSPLS for the writing of the BSC. If the papers that the BSC writes are not very good, HLS can ship them off with any citation counts, page counts, etc., now credited to OLSPLS. OLSPLS makes some money on the front end and, even if the put is exercised, gets credited for some scholarship that it would not likely get any other way. HLS is protected from low quality work for a small price. The downside risk to HLS of hiring the BSC is hedged, and OLSPLS potentially gets some exposure that it would never see otherwise.

Call options might be of use in this situation, too. Suppose the BSC's production is voluminous but the marginal benefit to HLS of his twelfth article in a year is small. It might be more efficient for

¹ You may wonder about the wisdom of introducing derivatives in this market given their less than stellar reputation in other areas of the economy. In response I will remind you that all the great cutting-edge insights in legal academia arrived many years after they had been repudiated in their fields of origin.

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HLS to sell a call on the BSC's work to OLSPLS. HLS makes some money on the transaction and can avoid the dilution of its brand as long as the article produced by the BCS exceeds the less than stringent standards of OLSPLS. On the other hand, OLSPLS can guarantee an improvement of its scholarly profile without the significant expense of maintaining the BSC.

There may well be other parties interested in these futures. Law reviews might be interested in buying calls on certain faculty. Indeed, some law reviews might even be interested in buying puts, so they can unload an article by a home faculty member that is not worth publishing. The possibilities are limitless.

Having seen the opportunities available there is no turning back. Consider HLS once again. Given its eminence, it hardly needs any of its faculty to publish. Scholarship could be turned into a revenue stream. HLS could bundle its faculty's work and sell off the whole stream of articles to other law schools or law reviews. Of course even the fine scholarship from HLS has some variations, so we might want to tranch the offering into different qualities. That is, sell off the top 10% of the articles for one price, the next 10% at another, and so forth. To do this we would need an independent auditor of academic quality. Surely once the market niche is available someone will come and fill it. *U.S News* has demonstrated acumen in assessing legal quality. The AALS is also well-positioned to play this role. I am sure that the two together would provide the same reliable ratings that we have come to expect from Standard & Poor's and Moody's in the financial context.

But what would happen if HLS somehow defaulted on its production of papers? Law reviews, waiting for their papers to arrive, would have nothing to publish. The whole academic endeavor might creak to a halt. How can we protect against this (incredibly unlikely) scenario? Once again we can turn to the financial markets for inspiration. Some law school might insure the appearance of scholarship by offering legal academe default swaps. In the unlikely case that HLS should fail to produce an adequate supply, the professors at Crank-it-out Law School (CLS) will, for a fee, guarantee to provide substitute articles. If CLS were to insure too many aca-

demic streams, and if they were to all default, there might be a problem. No article can be published in more than one law review (at least not without changing the title and abstract, and those are often the most difficult things to do well), and CLS might not be able to fully meet the contract. But surely this scenario is unlikely, and we can count on the ethical behavior of the leadership at CLS to avoid this moral hazard.²

A different approach to hedging risk might be to allow options on the faculty themselves. That is, if OLSPLS were to sell a put on the BSC, then HLS would have the option of actually sending him away if his work were below standard. It would be far cheaper than denying tenure.³ There are obvious contractual issues that arise⁴ should we take the market to this level. But if endowments were to drop a little more



² But cf. AIG.

³ I imagine that the put market would spike after faculty meetings, as well.

⁴ And possibly constitutional ones, as well. See the 13th amendment.