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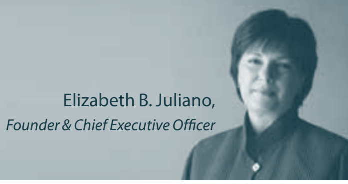

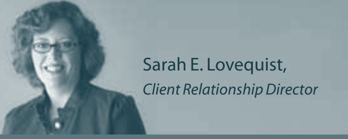

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Survival of the Financially Backed, Not Necessarily the Fittest

On October 6, 2011, the United Kingdom's Legal Services Act 2007, or "Tesco law[i]," went into effect and gave birth to a new type of corporate entity, the Alternative Business Structure (ABS). ABS will allow lawyers to partner with non-lawyers in ownership of a law firm, a partnership traditionally forbidden in both the UK and United States. The motivation behind ABS is to ensure that the legal system is affordable and accessible to the average consumer[ii] while stimulating competition and innovation between firms.

The ABS concept is not entirely new: in 2007, the Australian law firm of Slater & Gordon completed an initial public offering and became the first law firm to be listed on the Australian Stock Exchange. Similarly, the American Bar Association Ethics 20/20 Commission plans to circulate a draft proposal recommending amendment of the current rules of professional responsibility to allow up to 25% of law firm ownership by non-lawyers/other professional services providers.[iii] Although Australia permits unrestricted incorporation for companies that provide legal services, the majority of large Australian law firms have yet to embrace this investment concept.[iv] Further, the UK's Ministry of Justice does not anticipate authorizing licenses for external law firm ownership until at least early 2012.[v] Legal experts believe that both countries' hesitation may hint at an overall, broader reluctance to allow private investment in U.S. firms.

PROS AND CONS

Proponents of ABS hope that law firms will use private capital to invest in technology and other innovations that will allow the firm to operate more efficiently and cheaply.[vi] Lawyers need to focus on developing executive and business skills that complement their legal background – because so many lawyers do not know how to manage, outside capital will not only help shape innovations in the legal delivery model, it will also improve firms by bringing on board managers to achieve these innovations.[vii] According to attorney Susan Hackett, former Senior Vice President and General Counsel for The Association of Corporate Counsel, staffing options will ultimately drive a firm's fee structures, forcing lawyers to become more focused on executive and business skills such as project management, knowledge management and finance that can be gained from partnering with non-lawyers.[viii]

Ethical implications are at the forefront of the minds of those who oppose non-lawyer investing: "One ethical concern is about lawyer-client privilege, as shareholders would have an interest in knowing who the firm's clients were and the specifics of their cases. Another is that lawyers might feel pressured [. . .] to settle a lawsuit to make shareholders happy, [regardless of the client's] best interest . . ."[ix] As stated by Drinker Biddle & Reath partner Lawrence J. Fox in his testimony before the ABA Ethics 20/20 Commission, ". . . to what extent do [non-lawyer investors] become far more powerful than the lawyers in the enterprise itself? And in that situation what we're stuck with is lawyers reporting . . . to non-lawyers who have no obligation to our rules of professional conduct and no dedication to those propositions."[ix]

Opponents further believe that pooling investment money will turn the legal industry into the professional sports industry, allowing firms to use excess capital to lure big name attorneys to the firm; however, given the "free agency" nature of law firm partnerships, offering a large salary is no guarantee that the lured attorney will not jump from high to higher to highest bidder.[xi]

Experts also assert that investors will be sought by smaller firms and/or those firms who provide "basic" legal services rather than large, specialized firms. Large, top-tier firms are generally profitable and make enough money to allow borrowing from a bank if necessary. Further, partners in large firms are likely to be unwilling to surrender control of the firm or earned income to outside, non-lawyer investors.[xii]

Still, many trust that the need to compete for business in the current economic climate will motivate even top-tier firms to seek private investors. University of Illinois law school professor Larry Ribstein fully supports the concept of non-attorney investors and points out that law firms, like any other business, are vulnerable to changing financial climates, including a major client or a rainmaking partner leaving a firm. Allowing firms to rely on investors gives a firm more flexibility while diminishing the need to rely on traditional lenders for support.[xiii]

Likewise, law firm management consultant Bill Jawitz envisions non-lawyer ownership generating more cost-effective solutions for clients: "if ethics and character and quality of professionalism [are] all in place, there's nothing saying you couldn't have non-lawyers bringing their expertise to support consumers and businesses in their acquisition of legal services."[xiv] Such would be the case where a lawyer and accountant partner to provide legal and financial services to businesses from one location.

STATE-SPECIFIC ARGUMENTS

Regardless of whether the ABA's current ethics rules are amended, each state will have final say on whether to allow non-lawyer ownership of a firm within that state. Currently, Washington D.C. is the only U.S. jurisdiction that permits up to 25% non-lawyer ownership of a firm, but challenges to this ban have been raised in at least two other states.

1) North Carolina

Earlier this year a North Carolina legislator introduced a bill that proposes to allow non-lawyer ownership of a minority percentage of shares in a law firm, up to 49%.[xv]

Local attorneys fear that this bill could very well destroy the profession, specifically in terms of conflicts of interest. The proposed legislation attempts to address this potential issue by including the following language: "No non-licensee shareholder shall interfere with the exercise of professional judgment by licensed attorneys in their representation of clients."[xvi] The legislation further states that an attorney's duty to the Court prevails over all other duties, and duty to his or her client comes before his or her duty to a shareholder. In theory this language eliminates any conflicts of interest; in reality, the attorney will still be answerable to non-attorney shareholders who expect a profit.

Kathryn Bradley, a legal ethics professor at Duke University, finds that the legislation as currently written violates North Carolina's ethics rules. If the bill becomes law, the North Carolina Supreme Court would be forced to change the ethics rules to match, or else allow attorneys to legally commit rule breaches. Bradley points out that, if a North Carolina firm with offices in a jurisdiction other than Washington D.C., invited contributions from non-attorney investors, the firm would likely face ethics rule violations in other states, too.[xvii]

2) New York

The New York personal-injury law firm Jacoby & Meyers filed a federal lawsuit in May 2011 against the New York judiciary, petitioning the court system to allow the firm to receive capital from outside, non-lawyer investors.[xviii] The firm specifically named the presiding justices of the First, Second, Third and Fourth Departments of the Appellate Division of New York Supreme Court, the justices responsible for implementing and enforcing New York's Rules of Professional Conduct.[xix]

The suit specifically attacks the constitutionality of New York's Rules of Professional Conduct Rule 5.4, which is modeled after the ABA's Model Rules. The firm stated in its filing that, "the new realities of the global legal marketplace should be recognized and Rule 5.4's absolute bar of non-lawyer investment in law firms should be struck down as unconstitutional."[xx] The constitutional provisions at issue include discriminatory trade practices in violation of the Commerce Clause, a violation of one's First Amendment right to free association, and a violation of one's Fourteenth Amendment right to due process and equal protection.[xxi] The firm further claims that there is no "inherent linkage" between the concepts of financing and ethical conduct.[xxii]

New York Rule 5.4 states in pertinent part that a lawyer or law firm shall not share legal fees with a non-lawyer, shall not form a partnership with a non-lawyer, and shall not permit a non-lawyer to direct or control the professional judgment of a lawyer, or compromise the lawyer's duty to maintain the confidential information of the client.[xxiii] Legal scholars believe that this litigation has a limited chance of succeeding on constitutional grounds, specifically because the Rule embodies a long-recognized restriction on the practice of law – for instance, the Rule "does not on its face discriminate against out-of-state lawyers or businesses" in violation of the Commerce Clause.[xxiv]

As stated above, changes to ABA Rule 5.4 are currently under consideration by the ABA's Commission on Ethics 20/20.

FUTURE LIKELIHOOD FOR INVESTMENT OPPORTUNITIES

Some attorneys vehemently oppose the idea of allowing non-lawyer investors, believing that same will "denigrate the practice of law and lawyers."[xxv]

> *Non-lawyers with a financial stake in a firm's performance will need full access to the firm's files, further complicating efforts to preserve attorney-client confidentiality and zealously represent one's client.*

Even those who do not outright oppose the idea of non-lawyer investors maintain there is a slim likelihood for other-than-large-firm investors since there is no guarantee of a return on investing in a small firm; returns from investments in large firms are much more attractive and plausible.[xxvi]

There are those who believe that allowing non-lawyer law firm ownership is purely evolutionary since firms must operate as a business in a global marketplace in order to maintain a competitive edge. Introducing a non-lawyer into law firm management does not automatically mean client interests will be abandoned.[xxvii]

As stated in the Jacoby & Meyers Complaint, the firm "seeks to free itself of the shackles that currently encumber its ability to raise outside financing and to ensure that American law firms are able to compete on the global stage."[xxviii] If U.S. firms observe English firms gaining an advantage once licenses for outside ownership are authorized in the UK, there will be a push to quickly change the rules in the U.S.[xxix]

Several key events in the coming year will aid in narrowing the debate: whether English investors successfully obtain licenses and reap profits; whether North Carolina passes the pending non-lawyer investor legislation; what transpires in the Jacoby litigation; and whether ABA Rule 5.4 is modified to permit lawyers partnering with non-lawyers. While the ABA's ethics committee's findings will certainly be instructive, how this issue will be handled by each state remains to be seen – the debate will undoubtedly continue well into 2012.

ENDNOTES

i. The Act has been dubbed "Tesco law" after the UK supermarket since non-lawyers, including retailers, may offer legal services under the Act.

ii. Eligon, John. "Selling Pieces of Law Firms to Investors." The New York Times. October 28, 2011. October 31, 2011. http://www.nytimes.com/2011/10/29/business/selling-pieces-of-law-firms-to-investors.

iii. Id.

iv. Id.

v. Neil, Martha. "UK Consumers Could Buy Legal Services with Bread, Milk and Eggs as Soon as January, Under New Law." AbaJournal.com. October 6, 2011. November 11. 2011. http://www.abajournal.com/news/article/uk_consumers_could_buy_legal_services_with_bread_milk_and_eggs_as_soon_as_j/

vi. Eligon, John. "Selling Pieces of Law Firms to Investors.", *supra*.

vii. Bohrer, David. "Non-Lawyer Investment Will Happen: Follow Up." Flat Fee IP. August 18, 2010. November 11, 2011. http://www.flatfeeipblog.com/tags/nonlawyer-owner/

viii. Hackett, Susan. "The Slow Motion Riot – The Change Agenda for Legal Departments and Law Firms." In-house ACCess, Association of Corporate Counsel. March 30, 2010. November 30, 2011. http://www.inhouseaccess.com/2010/03/articles/inhouse-practice/the-slow-motion-riot-the-change-agenda-for-legal-departments-and-law-firms/

ix. Id.

x. Lawrence J. Fox. Quote from: American Bar Association. "Commission on Ethics 20/20." February 5, 2010. Available from: American Bar Association; Accessed November 29, 2011.

xi. Kowalski, Jerome. "Here's a Great Idea: Let's Get Some Private Equity Funds to Invest in Large Commercial Law Firms and We'll All Make a Ton of Money; Then We'll All Be Rich!" Kowalski and Associates Blog. April 2011. November 11, 2011. http://www.kowalskiandassociatesblog.com.

xii. Bohrer, David. "Non-Lawyer Investment Will Happen: Follow Up.", *supra*.

xiii. Baysden, Chris. "Bill Would Allow Investing in Law Firms." The Triangle Business Journal. March 18, 2011. November 11, 2011. http://www.bizjournals.com/triangle/print-edition/2011/03/18/bill-wouldallow-investing-in-law-firms.html.

xiv. Grady, Marie P. "Should Non-Lawyers Be Allowed to Own Law Firms?" Law.com. June 3, 2011. November 11, 2011. http://www.law.com/jsp/law/LawArticleFriendly.jsp?id=1202496004598&slreturn=1.

xv. Baysden, Chris. "Bill Would Allow Investing in Law Firms.", *supra*.

xvi. Ramirez, Adam. "North Carolina May Allow Non-Attorneys to Invest in Law Firms." Strategist. March 31, 2011. November 11, 2011. http://blogs.findlaw.com/cgi-bin/mt/mt-tb.cgi/21169.

xvii. Baysden, Chris. "Bill Would Allow Investing in Law Firms.", *supra*.

xviii. Jacoby & Meyers also filed similar federal lawsuits in New Jersey and Connecticut.

xix. Reuters. "Jacoby & Meyers Continues Fight for Non-Lawyer Investors." Thomson Reuters News & Insight. August 29, 2011. November 11, 2011. http://newsandinsight.thomsonreuters.com/New_York/News/2011/08.

xx. Id.

xxi. Grady, Marie P. "Should Non-Lawyers Be Allowed to Own Law Firms?", *supra*.

xxii. Id.

xxiii. N.Y. R. Prof. Conduct 5.4 (2009).

xxiv. Grady, Marie P. "Should Non-Lawyers Be Allowed to Own Law Firms?", *supra*.

xxv. Id.

xxvi. Id.

xxvii. Id.

xxviii. Granat, Richard. "Should law firms be owned by non-lawyer investors?" eLawyering Blog. May 19, 2011. November 11, 2011. http://www.elawyeringredux.com/2011/05/articles/competition/

xxix. Id.