WILL LAW FIRMS GO PUBLIC?

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Law in the United States is a big business and big law firms (Big Law) are a global business. The legal profession has evolved from solo practitioners and small general partnerships, practicing primarily in a single state and regulated by the courts of that state, to a more complicated and segmented industry, ranging from traditional small partnerships to giant multi-state and multi-country organizations. Yet in the current Great Recession, Big Law is under serious economic stress, epitomized by the bankruptcy of the venerable Dewey & LeBoeuf firm.[1] In addition, the high cost of legal services has led to a lack of affordable representation for many individuals and small businesses.

These developments have led to two related questions: should law firms be allowed to accept equity capital from nonlawyers; and should lawyers be allowed to practice in firms with nonlawyers. These questions have been percolating for a number of years, and have been under consideration by the American Bar Association's (ABA) Commission on Ethics 20/20 (Ethics Commission).[2]

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1 *See* James B. Stewart, *Dewey's Fall Underscores Law Firms' New Reality*, N.Y. TIMES, May 5, 2012, at B1 (highlighting the fiscal pressures Big Law firms currently face leading to the failure of once respected firms).

2 James Podgers, *Ethics 20/20 Commission Seeks Input on Alternative Business Structures for Law Firms*, ABA JOURNAL (Apr. 5, 2011, 1:53 PM). http://www.abajournal.com/news/article/ethics_20_20_commission_seeks_input_on_ alternative_ business _structures_for_law_firms.

Although the Ethics Commission has now decided not to propose changes to ABA policy on nonlawyer ownership of law firms,[3] this non-decision will not end debate about how to finance the law business. This is in part because the United Kingdom, Australia, and other jurisdictions have already changed their regulatory frameworks for lawyers to allow the infusion of outside capital into law firms,[4] and Big Law will find global competitive pressures to expand and compete with U.K. and Australian firms difficult to resist. In addition, charges that legal ethics rules preventing law firms from experimenting with different types of business organizations are anti-competitive are likely to persist and receive a sympathetic hearing in some quarters, and possibly some courts.

The American Lawyer has been tracking the growth of Big Law for a quarter of a century. During that time, the total gross revenues of the 100 largest firms (Am Law 100) have multiplied from $7 billion to $71 billion.[5] Yet, there have been significant changes in the law firm model and the identity of the firms in the Am Law 100. Growth has come largely from the movement of lateral partners, and eleven of the 1986 top twenty are no longer in the top twenty.[6] Nevertheless, seven of the firms on the 1986 list increased their revenues per lawyer by 300% or more, and thirteen increased their revenues per lawyer by over 250%.[7] This growth far exceeded the growth of other income earners in the United States, where per capita GDP grew only at an annualized rate of 3.9%.[8] Further, although this growth had been slowing since 2008, in 2011 gross revenue, revenue per lawyer, and profits per partner

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[3] James Podgers, *Summer Job: Ethics 20/20 Commission Shelves Nonlawyer Ownership, Focuses on Other Proposals*, ABA JOURNAL (June 1, 2012, 2:50 AM), http://www.abajournal.com/magazine/article/summer_job_ethics_20-_20_commission_ shelves_nonlawyer_ownership.

[4] Erin J. Cox, *An Economic Crisis Is a Terrible Thing to Waste: Reforming the Business of Law for a Sustainable and Competitive Future,* 57 UCLA L. REV. 511, 533–37 (2009).

[5] Michael D. Goldhaber, *The Long Run,* AM. LAW. (Apr. 27, 2012), http://www.americanlawyer. com/PubArticleTAL.jsp?id=1202549688718.

[6] *Id.*

[7] Amy Kolz, *Myth Busters,* AM. LAW. (Apr. 27, 2012), http://www.americanlawyer.com/id=1202549688935/Myth-Busters.

[8] *Id.*

all rose by single digit percentages for the Am Law 100.[9] Four firms had 2011 gross revenues in excess of $2 billion, and another thirteen firms had gross revenues in excess of $1 billion.[10] Also, twenty-two firms employed over 1,000 lawyers; five over 2,000.[11]

This continued growth of Big Law should be counterbalanced against the decline in the profitability of the legal profession generally. In 2007 and 2008, the legal services sector shed 40,000 jobs.[12] Further, a number of large firms collapsed into bankruptcy or closed their doors.[13] One lesson of these failures was that financing through bank debt was problematic, and so some law firms have turned to third party funding in the form of hedge fund investment in litigation.[14]

This Article will argue that, even if law firms retain the form of partnerships, they eventually will accept investments from third parties, and possibly even go public. However, this development could lead to a loss of professionalism, as it has with other industries, and could also lead to the end of self-regulation. While the changes that are coming to the legal profession are being and will continue to be resisted, for both good and bad reasons, it would be wise for the bar to think through what kind of regulation would best serve clients, the public, and the profession in the future. This Article will discuss (in Part 1) legal ethics rules regarding law firm organization and the work of the Ethics Commission; (in Part 2) the changes to the regulation of lawyers in England, Australia, and elsewhere; (in Part 3) litigation attacking current ethics rules regarding outside investments in law firms; (in Part 4) the evolution of other industries from closely held partnerships or mutual organizations to large public companies, specifically investment banking and stock exchanges; and (in Part 5) the future of the legal profession.

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9 *The Am Law 100: Firms Ranked by Gross Revenue 2012*, AM. LAW., http://www.americanlawyer.com/PubArticleTAL.jsp?id=1202549382505 (last visited Feb. 28, 2014).

10 *Id.*

11 *Id.*

12 Cox, *supra* note 4, at 517. This figure includes support staff.

13 *Id.* at 520–22.

14 *Id.* at 524–25.

1. RULES OF PROFESSIONAL CONDUCT

1.1. American Bar Association Rules

ABA Model Rule 5.4 provides that, "[a] lawyer or law firm shall not share legal fees with a nonlawyer," and "shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law." [15] Similarly, Rule 5.4 of the New York Rules of Professional Conduct provides that "[a] lawyer or law firm shall not share legal fees with a nonlawyer" and "[a] lawyer shall not practice with or in the form of an entity authorized to practice law for profit, if: a nonlawyer owns any interest therein." [16] These bans on multidisciplinary practice and nonlawyer ownership of law firm partnership interests are of long standing.

The American Law Institute's Restatement of the Law Governing Lawyers similarly provides:

> (1) A nonlawyer may not own any interest in a law firm, and a nonlawyer may not be empowered to or actually direct or control the professional activities of a lawyer in the firm. (2) A lawyer may not form a partnership or other business enterprise with a nonlawyer if any of the activities of the enterprise consist of the practice of law.[17]

Rule 5.4 is a standard promulgated by the ABA, and the ABA is a voluntary bar association. It is not a government agency, and it does not have delegated governmental authority.[18] It is more like a trade association than a self-regulatory organization, and not all lawyers belong to the ABA. However, state bar associations and courts have incorporated this standard into their disciplinary rules, although not all states have done so uniformly.

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[15] MODEL RULES OF PROF'L CONDUCT R. 5.4 (1983), *available at* http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_5_4_professional_independence_of_a_lawyer.html.

[16] N.Y. RULES OF PROF'L CONDUCT R. 5.4 (2009), *available at* www.nycla.org/siteFiles/NYRulesofProfessionalConduct4109_362.pdf.

[17] RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS § 10.1–.2 (2000).

[18] Gomez-Jimenez v. N.Y. Law Sch., 943 N.Y.S. 2d 834, 842 n.4 (N.Y. Sup. Ct. 2012).

The prohibitions against multidisciplinary practices and nonlawyer investments in law firms have been justified as necessary to preserve independence and professionalism, to avoid conflicts of interest, and to preserve a lawyer's duties to clients, especially the duty of confidentiality, and to the courts.[19] Nevertheless, these bans are also anti-competitive. They stand in the way of the provision of low cost legal services in certain areas susceptible to commoditization, and they prevent clients from obtaining combined services from lawyers and other professionals.[20] This is because the bans prevent firms from reaching an optimum size for the provision of higher quality and lower priced services, and to compete with nonlawyer organizations. Further, lawyers are unable to realize the present economic value of their reputations through the sale of stock or other ownership interests.[21] The basic concern animating the ethics rules is that permitting nonlawyer ownership or direction would subject lawyers to meeting the goals of the nonlawyers rather than meeting their duties to clients.[22] In other words, business pressures would trump professionalism.

The organized bar has feared that, on one hand, large accounting firms would combine with law firms,[23] and on the other, that Walmart could provide legal services to customers.[24] But these realistic fears are not an adequate basis for preserving ethics rules that prevent law firms from obtaining capital for expansion, investment in new technologies, financing of contingency fee cases, or other experiments in the delivery of legal services.[25] If these ethics rules are to be preserved, they need to be

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19 Renee Newman Knake, *Democratizing the Delivery of Legal Services*, 73 OHIO ST. L.J. 1, 15 (2012).

20 *See id.* at 16 (arguing that the lack of competition results in higher legal costs for the general public, thus harming the public instead of protecting them).

21 RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS § 10 cmt. c (2000).

22 *Id.*

23 *See* Sydney M. Cone, III, *International Legal Practice Involving England and New York Following Adoption of United Kingdom Legal Services Act of 2007,* 28 NW. J. INT'L L. & BUS. 415, 416–17 (2008) (noting that the fear of such developments was pervasive at the time of the adoption of these rules following such partnership activity between law firms and large accounting firms in France).

24 *See* Knake, *supra* note 19, at 37–40 (providing successful examples of retail legal operations in the United Kingdom feared by the organized bar).

25 *See* Edward S. Adams & John H. Matheson, *Law Firms on the Big Board?: A Proposal for Nonlawyer Investment in Law Firms,* 86 CAL. L. REV. 1, 40 (1998)

justified as necessary to maintain the independence and professionalism of lawyers. Although this may be a valid justification, in view of the existing shift of the legal profession from a profession to a business, the public distrust of lawyers, and client dissatisfaction with the cost of legal services, the professional values protected by current ethics rules needs to be spelled out.

Unfortunately, for many years the ABA has neither articulated why the ethics rules should be preserved, nor proposed changes to the rules. In 1998, the ABA Commission on Multidisciplinary Practice (MDP Commission) was created and began to study and report on the extent to which U.S. lawyers and law firms should be allowed to enter into "alternative law practice structures in which nonlawyers have an ownership interest" and "whether such practices could operate in a manner that is consistent with the American legal profession's core values."[26] The impetus for the work of the MDP Commission was that the large accounting firms had consulting practices that performed work similar to the provision of legal services.[27] One year after its creation, the MDP Commission issued a report to the ABA House of Delegates recommending that the ABA ethics rules be changed to permit multidisciplinary practices conditioned on safeguards to ensure that the core values of the legal profession be maintained.[28] However, the ABA House of Delegates rejected the recommendation and resolved not to change or amend the Model Rules to allow lawyers to offer legal services through multidisciplinary practices "until additional study demonstrates

(concluding that on balance, the benefits of lifting the restrictions on nonlawyer investment in law firms outweigh the harms, and therefore they must be lifted); *see also generally* Robert W. Gordon, *Portrait of a Profession in Paralysis,* 54 STAN. L. REV. 1427 (2002) (reviewing DEBORAH L. RHODE, IN THE INTERESTS OF JUSTICE: REFORMING THE LEGAL PROFESSION (2000)) (proposing the lifting of restrictions on these activities).

26 ABA Comm'n on Ethics 20/20, Discussion Draft, at 1 (2011) [hereinafter Ethics Comm'n Discussion Draft for Cmt. of Dec. 2011], *available at* http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111202-ethics2020-discussion_draft-alps.authcheckdam.pdf.

27 ABA Comm'n on Ethics 20/20, Working Group on Alt. Bus. Structures Request for Cmt.: Issues Paper Concerning Alternative Business Structures, at 5 (2011) [hereinafter Ethics Comm'n Request for Cmt. of Apr. 2011], *available at* http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/abs_issues_paper.authcheckdam.pdf.

28 *Id.* at 6.

that such changes will further the public interest without sacrificing or compromising lawyer independence and the legal profession's tradition of loyalty to clients."[29]

The MDP Commission continued to study and accept comments on these issues, and in July 2000 it issued a new report to the House of Delegates again recommending changes to the Model Rules, but with "more restrictions on proposed multidisciplinary practices" than before.[30] The key change in the new report was that "only lawyer-controlled MDPs would be permitted under the new recommendation."[31] The House again rejected the MDP Commission's recommendation stating that "[t]he sharing of legal fees with nonlawyers and the ownership and control of the practice of law by nonlawyers are inconsistent with the core values of the legal profession" and the rule prohibiting such sharing of fees "should not be revised."[32]

Recently, legal reforms abroad allowing multidisciplinary practices and alternative business structures have prompted reconsideration of these issues by the Ethics Commission.[33] The principles guiding the Commission's deliberations are "protection of the public; preservation of core professional values; and maintenance of a strong, independent and self-regulated profession."[34] At its February 2011 meeting in Atlanta, the Commission decided that, "two options for alternative business structures—passive equity investment in law firms and the public trading of law firm interests" would not be recommended.[35] When the Commission released its April 5, 2011 Issues Paper, it requested comments on just three of the five alternative business models it originally considered: limited lawyer/nonlawyer partnerships with a cap on nonlawyer ownership; lawyer/nonlawyer partnerships without such a cap; and firms with lawyers and nonlawyers that offer both legal and non-legal services.[36]

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29 *Id.* (quoting Report to ABA House of Delegates 10B (as revised) (1999)).

30 *Id.* (discussing Report to ABA House of Delegates 117 (2000)).

31 *Id.*

32 *Id.*

33 *Id.* at 7.

34 *Id.* at 1.

35 *Id.* at 2.

36 *Id.* at 17–19. The second option is currently allowed in the District of Columbia. *Id.* at 17.

However, in June 2011, the Commission "eliminated further consideration of the third approach set out in the Issues Paper"—multidisciplinary practices "in which lawyers offer legal services and nonlawyers offer other professional services to clients who may or may not also be using the firm's legal services."[37] This decision was in line with the ABA's consideration and strong rejection of the proposal to permit multidisciplinary practices back in 1999 and 2000.

As a result of the February and June 2011 narrowing of possible options for consideration, the Commission "narrowed further consideration of [alternative law practice structures]" to just the "first two options identified in the [April 2011] Issues Paper."[38] The two options left were:

> (1) Option B: The approach taken by the District of Columbia, which permits lawyers to share legal fees with nonlawyers where the lawyers practice law in a partnership or other form of organization in which a financial interest is held or managerial authority is exercised by one or more nonlawyers who provide services that assist the firm in providing legal services to clients, under certain conditions, but without a cap on nonlawyer ownership; and
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> (2) Option A: A narrower version of the District of Columbia approach, which would permit lawyers to become partners with (and share fees with) nonlawyers . . .under narrowly defined circumstances.[39]

This rather narrow inquiry did not result in sufficient support for revising the ABA rules, so the Ethics Commission "decided not to develop a proposal on whether nonlawyers should be allowed to have some form of limited ownership interest in U.S. law firms."[40]

Indeed, most comments to the Ethics Commission were negative. Nine General Counsel for large multinational

[37] Ethics Comm'n Discussion Draft for Cmt. of Dec. 2011, *supra* note 26, at 5.

[38] *Id.*

[39] *Id.*

[40] Podgers, *supra* note 3.

corporations vigorously opposed changes to Rule 5.4 on several grounds.[41] First, there was no demonstrated need for change.[42] Second, any nonlawyer ownership of law firms would undermine the attorney-client relationship, especially the duty of confidentiality.[43] Third, the General Counsel were "deeply troubled by a proposed change that would only further undermine the tradition that law is a profession rather than a business."[44] Finally, the General Counsel expressed the view that nonlawyer ownership of law firms could undermine the judicial and self-regulatory oversight of the legal profession and lead to government regulation.[45]

Professor Thomas Morgan submitted a contrary comment, based on the reality that law is no longer practiced primarily by individuals—but rather by institutions—and therefore, the ethics rules of the profession are out of date.[46] Therefore, the distinction that it is "lawful for lawyers to *employ* nonlawyers but not to become their partner if any of the services would traditionally be viewed as practicing law . . . is surely a distinction without a difference."[47] Additionally, there are three reasons why law firms might legitimately sell equity. First, they have traditionally paid

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[41] *See generally* ABA Comm'n on Ethics 20/20, Comments of Nine General Counsel on the ABA Comm'n on Ethics 20/20 Discussion Paper on Alternative Law Practice Structures (2012), [hereinafter Comments of Nine General Counsel], *available at* http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/ethics_20_20_comments/ninegeneralcounselcomments_alpschoiceoflawinitialdraftproposal.authcheckdam.pdf.

[42] *Id.* at 2–3.

[43] *Id.* at 3–4. On the issue of how confidentiality might be undermined by outside capital, see generally ABA Comm'n on Ethics 20/20, Draft White Paper on Alternative Litigation Finance, at 32–38 (2011), *available at* http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111019_draft_alf_white_paper_posting.authcheckdam.pdf.

[44] Comments of Nine General Counsel, *supra* note 41, at 4–5. Considering the source, this comment is a bit rich. General Counsel of large companies enjoy stock options, which has made them not too different from other corporate executives, and their work can sometimes become a profit center.

[45] *Id.* at 5–6.

[46] *See generally*, ABA Comm'n on Ethics 20/20, Comments of Professor Thomas D. Morgan on the Discussion Paper on the Alternative Law Practice Structures (2012), *available at* http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/ethics_20_20_comments/morgan_alpsdiscussiondraft.authcheckdam.pdf.

[47] *Id.* at 4.

out profits instead of retaining earnings. Second, selling equity could create a liquid market in firm shares for the benefit of departing partners. Third, a more lasting institutional character for a modern firm could be created for "brand identity and its reputation for ethics and quality."[48]

Despite the decision of the Ethics Committee not to go forward with changes to Rule 5.4, a resolution was presented to the ABA House of Delegates in the summer of 2012, asking for reaffirmance of its stand against nonlawyer ownership of law firms.[49] This issue came up in the context of fee-sharing arrangements between lawyers and nonlawyers in jurisdictions that allow nonlawyer investment in law firms—especially England, Australia, and Canada. The Ethics Commission has requested comment on how to resolve conflicts of law between ethics rules in different jurisdictions.[50] This could lead to recognition of nonlawyer ownership of firms where it is allowed.[51] The resolution regarding reaffirmance of nonlawyer ownership of firms was so controversial that ninety-two people asked to speak for or against it, but only four people spoke before the House voted to postpone the resolution indefinitely.[52] Nevertheless, this issue will not go away, in part because it is tied to the conflict of law issue at firms where there are partners from England and partners from a U.S. jurisdiction.[53]

In August 2013, the Ethics Commission issued a formal opinion stating that lawyers in jurisdictions that follow Rule 5.4 "may work with other lawyers or law firms practicing in jurisdictions with rules that permit sharing legal fees with nonlawyers."[54] The opinion relied upon Model Rule 1.5(e), which permits lawyers

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48 *Id.* at 5–6.

49 Debra Cassens Weiss, *ABA House Postpones Resolution Reaffirming Opposition to Nonlawyer Ownership of Law Firms*, ABA JOURNAL (Aug. 6, 2012, 11:26 AM), http://www.abajournal.com/news/article/resolution_confirms_aba_stance_against_nonlawyer_ownership_of_law_firms/.

50 *See* Joan C. Rogers, *Ethics 20/20 Floats Revised Proposal on Agreements for Choice of Conflicts Rules*, BLOOMBERG BNA (Jul. 18, 2012), http://www.bna.com/ethics-2020-floats-n12884910736.

51 Weiss, *supra* note 49 (reporting a statement made by Lawrence Fox, a member of the House of Delegates from Philadelphia).

52 *Id.*

53 *See id.*

54 ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 464, at 1 (2013).

working at different firms to divide legal fees in certain situations.[55] Additionally, the August 2013 opinion cited ABA Formal Opinion 91–360 for the proposition that lawyers should not be restricted by rules in jurisdictions where they do not practice.[56] Thus, the Ethics Commission found that the Model Rules support fee-sharing between lawyers, where one lawyer may legally engage in sharing fees with nonlawyers so long as "there is no interference with the lawyer's independent professional judgment."[57]

It would appear that the opposition by the ABA to nonlawyer participation in law firms, either in the form of multidisciplinary practices or equity investment may be driven at least as much by economic protectionism as a need to protect the core values of the profession.[58] In addition, the ABA and many members of the legal profession are wary of threats to self-regulation. Although nonlawyer participation in law firm governance could undermine professional judgment, is the threat of control by equity investors necessarily more pernicious than the threat of control by bank lenders?[59] In-house counsels who work for corporations may claim that the corporation is their client, but they are nevertheless subject to control by their corporate employers.[60] The threat to maintaining client confidentiality is a legitimate concern, but this threat is already present when lawyers work with nonlawyers in connection with the representation of clients.[61] What the bar and other policy makers should consider is whether some of the benefits of nonlawyer involvement in law firms might outweigh the danger that the core values of the profession could be undermined, and what mechanisms could be devised to protect

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[55] *Id.* at 1–2.

[56] *Id.* at 2–3.

[57] *Id.* at 1.

[58] *See* Thomas R. Andrews, *Nonlawyers in the Business of Law: Does the One Who Has the Gold Really Make the Rules?*, 40 HASTINGS L.J. 577, 616–17 (1989) (noting the fear that ruinous competition may develop if for-profit law offices are allowed).

[59] *Id.* at 608–09.

[60] *Id.* It is somewhat ironic that one of the strongest comments against changes in the ethics rules came from general counsel from some of the largest corporations in the United States. Comments of Nine General Counsel, *supra* note 41, at 6–7.

[61] Andrews, *supra* note 58, at 615–16.

those core values in the face of changes to the organization of law firms.

1.2. New York Rules

In the late 1990s, the New York State Bar Association, along with the ABA and other bar organizations, was considering whether demand for multidisciplinary practice firms should lead to changes in ethics rules. As a result, the New York ethics rules were revised in recognition of the need for law firms sometimes to provide clients with non-legal services and the difficulty of distinguishing between legal and non-legal services in certain situations.

The revised Rule 5.7 of the New York Rules of Professional Conduct[62] envisions a firm controlled by lawyers, but requires that if non-legal services are provided to a client; the recipient must be made aware of any services not subject to the attorney-client relationship; the relationship shall be subject to lawyer professional ethics rules when the client cannot distinguish between legal and non-legal services; and, any nonlawyers in the firm may not affect a lawyer's professional judgment or compromise a lawyer's professional responsibilities.[63] Another change in the rule allows a lawyer or law firm to enter into a contractual relationship with a nonlawyer professional or firm.[64] This rule is stricter than the rule allowing nonlawyers to join a law firm and provide non-legal services because, among other things, it is limited to contracts with only five professionals: architects, certified public accountants, professional engineers, surveyors, and certified social workers.[65] Neither of these rules would permit nonlawyer ownership or investments in a law firm.

As will be explained below, it is now legal in England and some other jurisdictions for nonlawyer supervisors and owners to be included as principals of a law firm. When a law firm asked for guidance from the New York State Bar Association as to whether a New York law firm could become an employee of a

62 N.Y. RULES OF PROF'L CONDUCT *supra* note 16, at R. 5.7 (2009), *available at* http://www.nysba.org/WorkArea/DownloadAsset.aspx?id=26646.

63 Cone, *supra* note 23, at 418.

64 N.Y. RULES OF PROF'L CONDUCT, *supra* note 16, at R. 5.8.

65 Cone, *supra* note 23, at 418.

U.K. entity which included nonlawyers, the Committee on Professional Ethics responded in the negative: "The inquiry is governed by Rule 5.4(a), which forbids a lawyer from sharing fees with a nonlawyer, and Rule 5.4(d), which forbids a lawyer from practicing law for profit with an entity that includes a nonlawyer owner or member. These provisions would clearly be violated by the proposed arrangement."[66]

The Philadelphia Bar Association Professional Guidance Committee reached a contrary conclusion, deciding that if lawyers in jurisdictions outside Pennsylvania permit fee sharing with nonlawyers in accordance with their own bar rules, it is permissible for Pennsylvania lawyers to share fees with them, even though they cannot share fees with nonlawyers in the state.[67] It is this conflict in the views of two important jurisdictions that led the ABA Ethics Committee to consider how conflict of laws should apply to firms which have partners from jurisdictions with different ethical rules.[68]

1.3. District of Columbia Bar Rules

1.3.1. History of District of Columbia Professional Conduct Rule 5.4

In the years that followed the ABA's 1983 adoption of the Model Rules, many states adopted professional rules for their own jurisdictions that were similar or identical to the ABA's Rules. Many states adopted the ABA's Model Rules verbatim. The District of Columbia, however, departed drastically from the trend of most other states[69] when it considered adopting the proposed Rule 5.4 that had been rejected by the ABA.

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[66] N.Y. State Bar Assoc. Comm. on Prof'l Ethics, Op. 911 (2012), *available at* http://www.nysba.org/CustomTemplates/Content.aspx?id=4182.

[67] Phila. Bar Ass'n Prof'l Guidance Comm., Op. 2010–7, at 3 (2010), *available at* http://www.philadelphiabar.org/WebObjects/PBAReadOnly.woa/Contents/WebServerResources/CMSResources/Opinion_2010-7Final.pdf.

[68] *See supra* notes 54–57 and accompanying text.

[69] North Dakota was the only other jurisdiction to consider adopting the version of Rule 5.4 rejected by the ABA. *See* Bradley G. Johnson, *Ready or Not, Here They Come: Why the ABA Should Amend the Model Rules to Accommodate Multidisciplinary Practices*, 57 WASH. & LEE L. REV. 951, 963–64 (2000) (describing North Dakota's consideration and ultimate rejection of a proposal closely resembling Model Rule 5.4).

The D.C. Bar had come to recognize "an increasing demand for a broad range of professional services from a single provider."[70] As Mark Lynch, member of the D.C. Bar Legal Ethics Committee ("Ethics Committee") and author of the D.C. Bar Rule 5.4 later explained, "the committee perceived a market demand for one-stop shopping—for collaborative services of lawyers with such other professionals as accountants, lobbyists, social workers and economists."[71] Dissatisfaction with Rule 3–103, which limited partnerships between lawyers and nonlawyers to providing non-legal services, led Mark Lynch to advocate for a proposed change in the rule.[72] In 1986, Chairman Robert Jordan of the Ethics Committee ultimately presented a proposed Rule 5.4 to the D.C. Board of Governors that was identical to the version rejected by the ABA.[73]

When the proposal came before the D.C. Board of Governors in February of that year, several Board members expressed reservations about the proposed Rule, which did not originally include a provision that partnership be limited to the practice of law.[74] Board member Jamie Gorelick[75] was concerned with

[70] *Id.* at 962. Moreover, Washington D.C. was already "the undisputed center of ancillary business activity, so official acceptance of the practice there [was] hardly surprising." Marjorie Meeks, *Alter[ing] People's Perceptions: The Challenge Facing Advocates of Ancillary Business Practices*, 66 IND. L.J. 1031, 1053 (1991).

[71] Susan Gilbert & Larry Lempert, *The Nonlawyer Partner: Moderate Proposals Deserve a Chance*, 2 GEO. J. LEGAL ETHICS 383, 393 (1988) (citing interview with Mark Lynch). The idea of "one-stop shopping," at least with regard to lawyers employing nonlawyer professionals to provide nonlawyer services to clients, was not an unfamiliar concept to the D.C. Bar. In 1980, the D.C. Ethics Committee issued an opinion stating that "[i]t is ethically proper for a lawyer, law firm or professional corporation, while engaging in the practice of law, also to offer and furnish services of other professionals, such as (in this case) psychologists, social workers and family counselors." *Id.* (citing D.C. Bar Code of Prof'l Responsibility & Opinions of the D.C. Bar Legal Ethics Comm., Op. 93 (1980) [hereinafter D.C. Bar Code and Opinions]). Despite this opinion, D.C. Disciplinary Rule 3–103 continued to prohibit a lawyer from having "a nonlawyer as a partner in an enterprise which involves the practice of law (even though it may involve other activities as well)." *Id.* at 394.

[72] *Id.* at 393 n.43. Further fueling Lynch's suggestion was the fact that, over the years, the Ethics Committee "had received numerous inquiries from people who wanted collaborative services between lawyers and other professionals." *Id.* (citing Minutes of the D.C. Bar Board of Governors).

[73] *Id.* at 394.

[74] Proposed Rule 5.4 originally allowed lawyer/nonlawyer partnerships only if (1) there was no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; (2) the confidences and secrets of

whether nonlawyer partners would "recognize potential conflicts between clients,"[76] and whether they would "give conflicts the same sensitive treatment that a lawyer is required to give."[77] Gorelick also worried that if a lawyer "did not control the flow of information" in such an enterprise, a court might refuse to recognize the well-established attorney-client privilege or work-product protection.[78] In addition, Board members questioned whether the proposed Rule 5.4 could "adequately protect against acts by the nonlawyer partner which, if they were done by a lawyer, would violate the rules of professional conduct."[79] Board members noted that such protection was already in place in the traditional lawyer/nonlawyer employer-employee relationship. Ultimately, these concerns, coupled with an all-around fear that adoption of the Rule would "pave[] the way for conglomerates of lawyers and nonlawyers," led the Jordan Committee to modify the Rule to limit "the activities of the partnership to the practice of law."[80]

Another bout of skepticism—this time through the media outlets—occurred after the D.C. Board of Governors submitted its proposed Rules of Professional Conduct to the D.C. Court of

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the lawyer's clients were protected as required by D.C. Bar Rule 1.6; (3) the arrangement did not involve advertising or personal contact with prospective clients by the nonlawyer, as prohibited by D.C. Bar Rule 7.1; (4) the arrangement did not result in charging a fee that violated D.C. Bar Rule 1.5; and (5) the foregoing conditions were set forth in writing. *Id.*

[75] Gorelick was President of the D.C. Bar from 1992–93 and is currently on the Ethics Commission of the ABA. *People: Jamie Gorelick*, WILMERHALE, http://www.wilmerhale.com/jamie_gorelick/ (last visited Feb. 28, 2014).

[76] Gilbert & Lempert, *supra* note 71, at 394.

[77] *Id.* at 395.

[78] *Id.*

[79] *Id.*

[80] *Id.* According to an interview with Chairman Jordan after the Rule's adoption, the idea was "let's try this for a while. Let's not fundamentally change the nature of the institutions providing legal services." *Id.* at 396 (quoting Interview by Larry Lempert with Robert Jordan, Chairman, Jordan Comm'n for the D.C. Bar (Dec. 1, 1987)). President-elect of the D.C. Bar at the time, Paul Friedman, expressed reservations similar to those of Chairman Jordan and other Board members. During a later interview with Friedman, he said "[y]ou don't want a law firm with twenty partners, eleven of them economists. Then it's no longer a law firm[.]" *Id.* (quoting Interview by Larry Lempert with Paul Friedman, President-elect of the D.C. Bar (Feb. 12, 1988)). According to Friedman, law firms should not be managed by "people without knowledge of and commitment to the ethics rules [binding on lawyers]." *Id.*

Appeals in November 1986. *The National Law Journal* and *Business Week* both released articles in January of 1987 discussing the so-called "Fear of Sears." This was part of the same sentiment that had doomed the proposed Rule 5.4 in the ABA House of Delegates, which involved an overwhelming fear that the Bar Association rules could allow firms eventually to go public "pav[ing] the way for such retailers as Sears, Roebuck & Co. to add legal counseling to their array of services."[81]

In the end, the D.C. Court of Appeals approved the D.C. Rule with the added clarification that "[a] lawyer may practice law in a partnership . . . in which a financial interest or managerial authority is exercised by *an individual nonlawyer who performs professional services which assist the organization in providing legal services to clients*."[82] In addition, the Court of Appeals added several comments to the Rule describing the types of lawyer/nonlawyer partnerships the D.C. Bar had in mind. These partnerships included those between economists and antitrust lawyers, CPAs and tax attorneys, and psychologists and family law practitioners. The additional comments "banish[ed] the Sears, Roebuck specter" once and for all, and final adoption of the rule occurred on March 1, 1990.[83]

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[81] *Id.* at 398. *See* Paula Dwyer, *Soon Anybody May Be Able to Own a Law Firm*, BUS. WK., Jan. 26, 1987, at 42 (explaining how such rules would allow nonlawyers to own law firms); David A. Kaplan, *Ethics Change in Works: Want to Invest in a Law Firm?*, NAT'L L.J., Jan. 19, 1987, at 1 (documenting proposed rules in Washington, D.C. and North Dakota that would allow substantial layperson involvement in law firms). This outcry from the media caused the Jordan Committee to submit a supplementary petition to the D.C. Court of Appeals, the highest court in the District of Columbia, clarifying the proposed Rule 5.4. Adams & Matheson, *supra* note 25, at 12. The petition stated that "[t]here was no thought that proposed Rule 5.4 should permit any organization or entity to effectively acquire and control a law firm." *Id.* (quoting Supplementary Petition of the Bd. of Governors of the D.C. Bar Regarding the Adoption of Rules of Prof'l Conduct and Related Comments, at 4–5 (Sept. 11, 1987)). According to Chairman Jordan, the purpose "was to permit nonlawyer professionals to practice their professional skills in cooperation with lawyers in a firm limited to delivering legal services." Gilbert & Lempert, *supra* note 71, at 399 (quoting Memorandum of Robert Jordan, Chairman, Jordan Comm'n for the D.C. Bar, to the D.C. Court of Appeals 63 (Mar. 4, 1987)).

[82] Gilbert & Lempert, *supra* note 71, at 399 (emphasis in original).

[83] *Id.* at 399–400.

1.3.2. Effects of Professional Conduct D.C. Bar Rule 5.4 Since Its Adoption in 1991

In a "Report and Recommendation" issued in the late 1990s, the District of Columbia Bar Special Committee on Multidisciplinary Practice reviewed the effects of Rule 5.4 since the rule's adoption:

> Nearly a decade of experience under the 1991 version of Rule 5.4 has produced no evidence in the District of Columbia that lawyers are unable to honor their professional obligations when they offer legal services within the framework of organizations in which nonlawyers hold an ownership interest or exercise managerial authority.[84]

In addition, no disciplinary action under D.C. Rule 5.4(b) has been taken against any lawyer of the D.C. Bar since it became effective in 1991.[85]

Despite the seeming freedom granted to lawyers in D.C. who wish to form partnerships with nonlawyers, many law firms in D.C. have never taken advantage of Rule 5.4. The rule's limiting condition requiring such partnerships to provide legal services as their sole purpose has proven to be a "major stumbling block."[86] The scope of the rule was even further limited when the D.C. Bar adopted ABA Ethics Committee Formal Opinion 91–360, issued in July 1991, which prohibits multi-jurisdictional law firms from having nonlawyer partners in their D.C. office.[87]

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[84] D.C. Bar Special Comm. on Multidisciplinary Prac., Proposed Rule 5.4: Professional Independence of a Lawyer: Note on History of the Rule (1999).

[85] Laurel S. Terry, *A Primer on MDPS: Should the "No" Rule Become a New Rule?*, 72 TEMP. L. REV. 869, 875 (1999) (citing Testimony of D.C. Ethics Counsel Susan Gilbert (Nov. 12, 1998)).

[86] Mary C. Daly, *Choosing Wise Men Wisely: The Risks and Rewards of Purchasing Legal Services From Lawyers in a Multidisciplinary Partnership*, 13 GEO. J. LEGAL ETHICS 217, 244 (2000).

[87] Terry, *supra* note 85, at 875. As such, even multi-state law firms that wish to take advantage of Rule 5.4 are inevitably prevented from doing so and the availability of the rule is left to "D.C.-based boutique law firms that identify a specific need (i.e., the need for an accountant to do tax work or the need for an office manager)." *Id.*

1.3.3. Consulting Subsidiaries of Arnold & Porter LLP

Some of the impetus for the change in the rules of the D.C. Bar came from Arnold & Porter LLP, which experimented with mixing the practice of law with other professional services through ownership of three consulting firm subsidiaries. None of these ventures proved permanent, however. The first, APCO Associates Inc., was created in 1984 as a wholly owned subsidiary of Arnold & Porter LLP. APCO began as a multidisciplinary practice that dealt with public affairs, government relations, and strategic communications.[88] APCO was eventually sold in 1991 to Grey Advertising. On September 24, 2004, APCO announced that its management concluded a buyout from Grey Global, making it "one of the largest privately owned consulting firms in the public affairs and strategic communications industry."[89]

Around the same time Arnold & Porter opened APCO, it formed another subsidiary called MPC & Associates. MPC was a real estate development consulting firm "that worked primarily with colleges, universities, and other large nonprofit institutions on major real estate projects."[90] MPC evolved because of the "extensive work" Arnold & Porter had already been doing in its representation of non-profit institutional clients for which the firm was "retained to deal with exceedingly complex, sprawling real

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[88] James W. Jones, Vice Chairman and General Counsel, APCO Assocs., Statement to the Center for Professional Responsibility of the American Bar Assoc. (Feb. 6, 1999), *available at* http://www.americanbar.org/groups/professional_responsibility/commission_multidisciplinary_practice/jones1.html [hereinafter Jones Statement]. According to Jones, who served as Vice-Chairman and General Counsel of APCO,

> APCO was conceived as a vehicle for broadening the scope of services offered by Arnold & Porter to its clients and as a means for offering services in a more efficient and cost-effective manner. It grew out of the conviction that—at least for certain types of matters—an interdisciplinary approach combining the skills of lawyers and nonlawyer professionals could lead to better and more creative solutions for client problems.

Id.

[89] Press Release, APCO Worldwide and Grey Global Grp., Inc., APCO Completes Transaction for Management Buyout (Sept. 28, 2004) (on file with author).

[90] Jones Statement, *supra* note 88.

estate projects."[91] MPC was eventually sold to Sallie Mae, but scant information about the sale is publicly available.

Arnold & Porter also opened a financial industry consulting firm called The Secura Group in 1987. The Group served commercial banks and thrift institutions, as well as investors of those entities. The Secura Group was created to complement Arnold & Porter's large bank regulatory practice, and in 1989, James F. Fitzpatrick of Arnold & Porter said in an address: "[t]here is great synergism between our bank regulatory practice and Secura. There is a significant overlap in client base, and one group helps spin off business for the other."[92] Fitzpatrick noted at the time, however, that "particular attention must be paid to the ethical requirements that clients requesting non-legal services have full opportunity to go wherever they want for the legal component of those services."[93] The Secura Group eventually purchased Arnold & Porter's interest in the Group in 1993, and it is no longer a subsidiary of Arnold & Porter.[94]

When Vice Chairman and General Counsel of APCO James Jones made his statement to the ABA Commission on Multidisciplinary Practice on February 6, 1999, he said that when Arnold & Porter created their subsidiaries, the "impact of the *Model Rules of Professional Conduct* on their structure and operations was far from clear."[95] Thus, in order to ensure that the subsidiaries did not run afoul of the ABA professional ethics rules, Arnold & Porter put several elements into place. For example, Arnold & Porter required that all promotional literature and retainer agreements disclose the fact that the consulting firms were subsidiaries of Arnold & Porter, and that the consulting clients were under no obligation to use Arnold & Porter's legal services. The promotional materials also had to be pre-approved by Arnold & Porter's ethics committee "using principles consistent with those applicable in the legal profession."[96] Arnold & Porter also held

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[91] James F. Fitzpatrick, *Legal Future Shock: The Role of Large Law Firms by the End of the Century*, 64 IND. L.J. 461, 470 (1989).

[92] *Id.* at 468.

[93] *Id.*

[94] Jim McTague, *Secura Forms Alliance with Andersen*, AM. BANKER, Jan. 18, 1994, http://www.highbeam.com/doc/1G1-14919203.html.

[95] Jones Statement, *supra* note 88, at 2.

[96] *Id.*

each subsidiary to "the same ethical requirements—in terms of conflicts of interest, protection of client confidences, advertising of services, etc.—that applied to the law firm itself."[97] In addition, any questions concerning these issues were "required to be resolved by the firm's ethics committee and not by the subsidiary company."[98]

1.4. Threats to the Rules

Even if bar associations do not alter traditional ethics rules prohibiting multidisciplinary firms or ownership of interests in law firms by nonlawyers, the financing of law firms is likely to change either due to international competition (which will be discussed below), changing business practices on the ground, or as a result of lawsuits challenging the ethics rules. Competition from other professionals is also a factor in the changing complexion of the legal services industry. Although accounting and consulting firms eschew the idea that they are providing legal advice, the line between such services is often a line in the sand. This is particularly true because of the emphasis on compliance, corporate governance, and risk management systems in financial and other businesses. Further, it has long been true with regard to tax law practice.[99]

Prior to 2002, the U.S. Securities and Exchange Commission (SEC) did not stop accounting firms from providing consulting services to their audit clients, although arguably it could have done so. Although the SEC was empowered to define "independence" in terms of the filing and certification of financial statements by independent auditors, Congress had not given the SEC the specific authority to regulate auditing standards.[100] Early attempts by the SEC to place limits on accounting firms' ability to provide consulting services to audit clients were unsuccessful because of "contentious arguments between [the then-]Big Five accounting firms and the SEC."[101]

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97 *Id.*

98 *Id.*

99 Andrews, *supra* note 58, at 632–36.

100 Robert J. Anello, *Sarbanes-Oxley's Wake Up Call to Attorneys*, 22 PENN ST. INT'L L. REV. 545, 552 (2003–04).

101 *Id.*

After the fall of Enron and a number of other corporate and accounting scandals in 2001, Congress passed the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley),[102] which created new and enhanced standards for the accounting profession. In addition to creating the Public Company Accounting Oversight Board (PCAOB) and granting it the power to establish rules and regulations governing the accounting profession, Sarbanes-Oxley granted the SEC the authority to adopt its own rules to "expand the requirements of auditor independence."[103] Section 201(a) of Sarbanes-Oxley[104] effectively put an end to the multidisciplinary practices "that had been cultivated by the Big Five accounting firms" prior to 2002.[105] This provision makes it unlawful for a registered public accounting firm that is performing an audit for an issuer to contemporaneously provide certain non-audit services, including legal services.[106] Although the list of non-audit services is extensive, it does not prohibit the contemporaneous performance of tax consulting services so long as pre-approval is received from the issuer's accounting board. In addition, the PCAOB may add to the list of prohibited services "any other service that the Board determines, by regulation, is impermissible."[107]

Though accounting firms are limited in their ability to provide consulting services to audit clients, they can provide these services to other clients; thus, big accounting firms have developed sophisticated consulting practices. Independent consulting organizations have done so as well. For example, Deloitte, one of the Big Four accounting firms, has an affiliated subsidiary called Deloitte Financial Advisory Services LLP that advises clients on a variety of matters that overlap with the advice given by business

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102 Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28 and 29 U.S.C.).

103 Anello, *supra* note 100, at 555.

104 15 U.S.C. § 78j-1(g) (2012).

105 Anello, *supra* note 100, at 561.

106 Sarbanes-Oxley prohibits auditors from performing non-audit services for their clients, including (1) bookkeeping or other services related to the accounting records or financial statements of the audit client; (2) financial information systems design and implementation; (3) appraisal or valuation services, fairness opinions, or contribution-in-kind reports; (4) actuarial services; (5) internal audit outsourcing services; (6) management functions or human resources; (7) broker or dealer, investment adviser, or investment banking services; and (8) legal services and expert services unrelated to the audit. 15 U.S.C. § 78j-1(g) (2012).

107 *Id.*

lawyers. To that end, its services include managing business controversies and disputes, executing deals, and maintaining regulatory compliance.[108] In addition, Deloitte advertises to hire legal services employees in corporate law, corporate governance, corporate reorganizations, private equity, venture capital, and other categories that overlap with services provided to clients by law firms.[109] Likewise, Accenture, a publicly traded consulting firm that spun off from Arthur Anderson, another large accounting firm, advertises for its Legal Services Group.[110]

These activities do not mean that Deloitte or Accenture are engaging in the illegal practice of law, but rather that legal services are not confined to the courtroom, and the giving of legal advice in connection with business transactions and compliance matters is difficult to distinguish from management consulting. Even in litigation, consulting organizations provide legal as well as other professional experts.[111] These services overlap with the services provided by business lawyers, and law firms experiencing economic stress may decide they should be competing with accountants and consultants in advising corporations and other businesses. This was the pressure that led to changes in the ethics rules of the D.C. bar a number of years ago.

Outsourcing of legal work to lawyers and nonlawyers and the utilization of nonlawyers with regard to the work of large law firms have raised some questions about nonlawyer participation in the provision of legal services and its impact on ethical rules. These issues were addressed by the Ethics Commission and resulted in some minor modifications to Rules 1.1 Competence, 5.3 Responsibilities Regarding Nonlawyer Assistance, and 5.5 Unauthorized Practice of Law; Multijurisdictional Practice of Law.

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108 *Learn More: Financial Advisory Services*, DELOITTE, http://www.deloitte.com/view/en_US/us/Services/Financial-Advisory-Services/a27e4bdacd0fb110VgnVCM100000ba42f00aRCRD.htm (last visited July 22, 2013).

109 *Legal Services*, DELOITTE, http://www.deloitte.com/view/en_GX/global/services/deloitte-legal/index.htm (last visited Sept. 9, 2012).

110 Legal & Commercial Services, Talent Segments, ACCENTURE, http://careers.accenture.com/us-en/your-future/career-paths/Pages/index.aspx (last visited Sept. 9, 2012).

111 *See, e.g.*, ROUND TABLE GROUP, http://www.roundtablegroup.com (last visited Nov. 13, 2013) (providing an example of a consulting firm that provides legal and other professional services).

The Ethics Committee suggested only minor changes in the rules, but it submitted an interesting report on outsourcing.[112] The report emphasized appropriate supervision and the ban on assisting in the unauthorized practice of law.

The widespread use of temporary lawyers from agencies and the outsourcing of legal work can be justified under ethics rules because law firm partners supervise these independent contractors. But what is the justification when the independent contractors combine to provide legal services directly to clients? A very interesting example of such a firm is Axiom Global, Inc. (Axiom), a long-term legal placement agency with 450 temporary attorneys. Although it began by supplying lawyers to the financial services industry, it changed its business model after 2008 and now does outsourcing work for large corporations such as Hewlett-Packard Co., Kraft Foods, and Vodaphone. Some of the legal work for these businesses was formerly done in house. "Since its inception, Axiom has been the beneficiary of more than $30 million in venture capital."[113] Because it is a corporation with nonlawyer investors, it is limited by the rules of ethics so that it is unable to render legal opinions, represent a client in court, take a company public, or lead a major corporate transaction.[114] Nevertheless, Axiom is competing directly with business lawyers and is being financed by nonlawyers. Axiom's business model could possibly be defended pursuant to cases upholding pre-paid group legal services or the right of non-profit groups to provide services to their members.[115]

Another development that is undermining current ethics rules is the financing of claims and contingency fees in plaintiff side

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[112] ABA Comm'n on Ethics 20/20, House of Delegate Resolution 105C Adopted—Amends the Comments to Model Rules 1.1, 5.3, and 5.5 (2012) (on file with author.)

[113] Drew Combs, *Disruptive Innovation*, AM. LAW., July/Aug. 2012, at 1, *available at* http://www.axiomlaw.com/Images/Attorneys/0010811201Axim.pdf. *See also* LEGALZOOM.COM (last visited Mar. 4, 2014) (advertising the provision of some legal services, such as wills, over the Internet).

[114] *Id. See also* Daniel Fisher, *New Precedent for Law Firms*, FORBES (June 8, 2011, 6:00 PM), http://www.forbes.com/forbes/2011/0627/entrepreneurs-mark-harris-axiom-law-moving-target.html (describing Axiom's business model of providing temporary attorney placement).

[115] *See* Andrews, *supra* note 58, at 636–40 (describing extensive nonlawyer involvement in prepaid group legal services, supported by U.S. Supreme Court decisions upholding the rights of nonprofit groups to provide legal services. Note that Axiom is an openly for-profit corporation).

lawsuits. Banks, hedge funds, and private investors are bankrolling lawsuits with loans that have high interest rates. If the case is successful, the loans are repaid out of the proceeds of the recovery.[116] Although these investments are loans rather than equity, so they do not directly contravene ethical prohibitions against nonlawyer investments in law firms, questions have been raised about investor control of the lawsuits and whether the duty of confidentiality has been breached.[117]

Litigation attacking current ethics rules is underway and under contemplation. This litigation will be discussed below. Although this litigation has been premised on constitutional grounds, it is unclear what constitutional rights are impinged upon by the rules preventing nonlawyer investment in law firms or multidisciplinary practices.[118] Yet, a very interesting article has argued that preventing corporations from owning law firms violates the First Amendment.[119] Another possible attack on the prohibitions of equity investment in law firms by nonlawyers is under the antitrust laws.

In view of the deregulation of other industries, specifically investment banking and stock exchanges, which will be discussed below, and the rationale for reforms in the England, Australia, and Canada, challenges under the antitrust laws may also be made, but such challenges face substantial problems because of the involvement of the courts in lawyer regulation.

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[116] Binyamin Appelbaum, *Investors Put Money on Lawsuits to Get Payouts,* N.Y. TIMES, Nov. 14, 2010, http://www.nytimes.com/2010/11/15/business/15lawsuit.html?pagewanted=all; Lisa Rickard, *Why are Hedge Funds Allowed to Invest in Litigation?,* THE ATLANTIC (July 3, 2012, 1:42 PM), http://www.theatlantic.com/national/archive/2012/07/why-are-hedge-funds-allowed-to-invest-in-litigation/259345/.

[117] *Id.*

[118] *See* Jacoby & Meyers, LLP v. The Presiding Justices of the Appellate Div., 847 F. Supp. 2d 590 (S.D.N.Y. 2012) (ruling that Jacoby & Meyers, LLP and an affiliate lacked standing to seek a declaration that N.Y. R. Prof. Conduct 5.4 (22 NYCRR 1200.0), which prohibited nonlawyer equity investment in law practices, was unconstitutional).

[119] Knake, *supra* note 19.

2. REGULATION OF LAWYERS ABROAD

2.1. In England and Wales

The Legal Services Act of 2007 (LS Act)[120] reformed the regulation of lawyers in the England and Wales to encourage competition and deal with consumer complaints. The LS Act provides for the creation of alternative business structures (ABS) for law firms permitting lawyers and nonlawyers to work together, and allowing for external investment in firms. The predicate for this reform was a December 2004 Report by Sir David Clementi (Clementi Report)[121] commissioned "[t]o consider what regulatory framework would best promote competition, innovation and the public and consumer interest in an efficient, effective and independent legal sector."[122] Sir Clementi was also instructed to recommend a new framework for the regulation of the legal profession pursuant to a reformed structure. This commission resulted from a report by the Department for Constitutional Affairs that had reached the conclusion that the English regulatory framework for lawyers was "outdated, inflexible, over-complex and insufficiently accountable or transparent."[123]

There are two premises that underlay the Clementi Report and the LS Act that stand in the way of similar reform by the ABA. The first premise is a rejection of the idea that the roles of lawyers as professionals and as business people conflict. According to Sir Clementi, "[a]ccess to justice requires not only that the legal advice given is sound, but also the presence of business skills necessary to provide a cost-effective service in a consumer-friendly way."[124] The second premise is a rejection of self-regulation that lacks significant government oversight and has no nonlawyer involvement.

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[120] Legal Services Act, 2007, c. 29 (U.K.) [hereinafter Legal Services Act], *available at* http://www.legislation.gov.uk/ukpga/2007/29/pdfs/ukpga_20070029_en.pdf .

[121] SIR DAVID CLEMENTI, REVIEW OF THE REGULATORY FRAMEWORK FOR LEGAL SERVICES IN ENGLAND AND WALES: FINAL REPORT (2004) [hereinafter CLEMENTI REPORT].

[122] *Id.* at 1.

[123] *Id.* (internal citations omitted).

[124] *Id.* at 5.

The Clementi Report comes to a number of important conclusions regarding multi-disciplinary practices and outside ownership of such firms. It concludes that outside ownership of law firms should be permitted. Sir Clementi expressed the view that "[s]uch ownership should be subject to a 'fit to own' test; but the main focus of the regulatory authorities should be upon the identity of the management team."[125] This type of ownership was already permitted with regard to conveyancing services, and the Report proposed that "subject to proper safeguards . . . it should now be permitted in other areas of the legal services market."[126]

The Report was more equivocal on the subject of multi-disciplinary practices "which bring together lawyers and other professionals to provide legal and other services to third parties."[127] It recognized that there were many issues to be resolved before such practices could be permitted and regulated, but it suggested that a new regulatory system would be a step on the way to allowing multi-disciplinary practices.

The LS Act implemented the Clementi Report by establishing the Legal Services Board (LSB) and Office for Legal Complaints (OLC) for the regulation of lawyers, enabling firms to explore new ways of organizing their legal businesses. The LSB was designed to provide proportionate, independent oversight, while approved regulators, such as the Law Society, The General Council of the Bar, and councils for specialists such as conveyancers, have responsibility for day-to-day regulation. Although this is a continuation of the self-regulation of lawyers, the LSB differs because it is a government body overseeing the self-regulatory organizations. The LSB Chairman and non-executive Board members are appointed by the Lord Chancellor in consultation with the Chief Justice. The LSB is accountable to Parliament through the Lord Chancellor and the Ministry of Justice.[128]

The LS Act provides for the licensing of new business structures or ABSs. An ABS is a firm in which a nonlawyer is a

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[125] *Id.* at 138.

[126] *Id.* at 139.

[127] *Id.*

[128] Ministry of Justice, Framework Doc.: Agreement between Ministry of Justice and Legal Servs. Bd., June 2011, at 8, *available at* http://www.legalservicesboard.org.uk/about_us/lsb_framework_document/pdf/moj_framework_agreement_june_2011.pdf.

manager of the firm or has an ownership interest in the firm. Also, an ABS is a firm where another body is a manager of the firm or has an ownership interest in the firm. A nonlawyer is a person who is not authorized to carry out "reserved legal activities."[129] In order for a firm to become an ABS, it must be approved by a licensing authority such as the LSB or a day-to-day self-regulatory organization.[130]

A licensed body must have a Head of Legal Practice who is a lawyer, and is responsible for ensuring that the firm and its lawyers comply with duties imposed by the licensing authority and the LS Act.[131] A licensed body must also have a Head of Finance and Administration who is responsible for ensuring that the firm complies with rules made by a licensing body regarding accounts.[132] Further, a licensed body must have arrangements in place to ensure that lawyers comply with "professional principles."[133] These principles require authorized persons to act with independence and integrity; to maintain proper work standards; to act in the best interests of their clients; to comply with their duties to a court to act with independence in the interests of justice; and to keep their clients' affairs confidential.[134] The licensing authority must approve each nonlawyer's holding of ten percent or more of shares in a firm, even if the shares are publicly traded.[135] Such a holder must be a "fit and proper" person and may not compromise regulatory objectives or the firm's ability to fulfill duties imposed by the licensing authority.[136]

The Law Society has set forth the potential benefits and risks of becoming an ABS.[137] Advantages include the ability to raise equity

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[129] *See* Legal Services Act, *supra* note 120, at pt. 3, § 12 (defining "'reserved legal activity'" to include: "(a) the exercise of a right of audience; (b) the conduct of litigation; (c) reserved instrument activities; (d) probate activities; (e) notarial activities; [and] (f) the administration of oaths.").

[130] *Id.* at pt. 5, § 73.

[131] *Id.* at pt. 5, § 91.

[132] *Id.* at pt. 5, § 92.

[133] *Id.* at pt. 3, § 17.

[134] *Id.* at pt. 1, § 1.

[135] *Id.* at sched. 13, pt. 1.

[136] *Id.*

[137] *Alternative Business Structures Practice Note*, THE LAW SOCIETY (May 4, 2011), http://www.lawsociety.org.uk/Advice/Practice-notes/Archive/Alternative-business-structures/4-May-2011/.

from a broader base of potential persons, including non-solicitor employees.[138] Further, equity can be raised from outside the legal sector without the need for nonlawyer involvement at the management level so that a wider range of services to clients can be provided than by a traditional law firm.[139] Balanced against these advantages are potential risks to the firm's culture.[140] Also, many foreign jurisdictions may not accept the ABS model and the firm may be inhibited in providing services through an overseas office.[141] The level of control of an outside investment and whether such control could interfere with the firm's ability to act in its clients' best interests needs to be considered.[142] Although ABS firms are not limited in the services they can provide, an ABS firm needs to consider whether offering certain services, such as auditing, might conflict with a duty of confidentiality.[143] One of the fears that lawyers express regarding nonlawyer investment in law firms is that large corporations could own law firms. Such a development has happened in England, where London-based WHSmith stores are hosting legal kiosks through a partnership with QualitySolicitors. Londoners can therefore obtain routine legal assistance where they buy stationery supplies and newspapers, in such matters as divorces, wills and real estate transactions.[144]

2.2. *In Australia*

Australia's reform of the legal profession preceded the England's reform. The Legal Profession Act of 2004 authorized law firms to incorporate, and also to obtain investments from nonlawyers.[145] Although each state in Australia has its own law regarding the regulation of lawyers, all have adopted the New South Wales legislation for "incorporated legal practices" (ILP)

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[138] *Id.*

[139] *Id.*

[140] *Id.*

[141] *Id.*

[142] *Id.*

[143] *Id.*

[144] Knake, *supra* note 19, at 7.

[145] *Legal Profession Act 2004* (NSW) (Austl.) [hereinafter Legal Profession Act 2004], *available at* http://www.austlii.edu.au/au/legis/nsw/consol_act/lpa2004179/.

based on the Model Laws for the Legal Profession promulgated by the Law Council of Australia in 2004. This development occurred primarily to increase competition for legal services and secondarily to create a law-firm structure that would enable partners to have limited liability.[146]

The Australian government was interested in applying competition policy to the legal services industry in order to make the Australian capital markets attractive in a global economy.[147] The legal profession was interested in obtaining limited liability for lawyers and an ability to do business in a governance form that would be more flexible than a traditional general partnership.[148] The Australian reform therefore permitted law firms to do business as multi-disciplinary partnerships, as corporations, and even go public. In May 2007, Slater & Gordon, an Australian personal injury litigation law firm, became the first law firm in the world to make a public offering and then it listed on the Australian stock exchange (ASX).[149]

Opponents of the Australian law reform were concerned about threats to attorneys' ethical duties, especially the duties of confidentiality, privilege, independence, and competence.[150] These concerns are addressed in the Legal Profession Act. An ILP may provide legal and other lawful services, have external investors, and list on the ASX.[151] Prior to providing legal services, an ILP must give written notice to the Law Society of its intention to do so.[152] Additionally, an ILP must comply with the Australian Federal Corporations Act, and must register with the Australian

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[146] Justin D. Petzold, Comment, *Firm Offers: Are Publicly Traded Law Firms Abroad Indicative of the Future of the United States Legal Sector?*, 2009 WIS. L. REV. 67, 75–76 (2009).

[147] *Id.*

[148] *Id.* at 76.

[149] Peter Lattman, *Slater & Gordon: The World's First Publicly Traded Law Firm*, WALL ST. J. (May 22, 2007, 9:19 AM), http://blogs.wsj.com/law/2007/05/22/slater-gordon-the-worlds-first-publicly-traded-law-firm.

[150] Petzold, *supra* note 146, at 78.

[151] ABA Comm'n on Ethics 20/20 Working Group on Alternative Business Structures, Request for Comment: Issues Paper Concerning Alternative Business Structures, at 9 (2011) [hereinafter ABA Comm'n on Ethics Request for Cmt of Apr. 2011], *available at* http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/abs_issues_paper.authcheckdam.pdf.

[152] Legal Profession Act 2004, *supra* note 145, § 137.

Securities & Investment Commission.[153] An ILP must appoint at least one legal practitioner who must ensure that appropriate management systems are implemented and maintained, allowing the ILP to provide legal services in accordance with the professional obligations of legal practitioners.[154] Although an incorporated legal practice may engage in non-legal businesses, where there are conflicts of interest between legal practitioners and others, the duties of the lawyers trump the interests of third parties.[155]

The Slater & Gordon prospectus discusses the firm's regulation and how it would deal with conflicts of interest. First, it sets forth its principles of corporate governance as: "fulfilling Slater & Gordon's duties to the Court and to [its] clients; providing meaningful employment for employees; providing services of value to clients; and generating rewards for Shareholders, in a way that contributes to the welfare of the community."[156] Then, the prospectus explains that if there is a conflict of interest between those duties, resolution of the conflict will be as follows: "the duty to the Court will prevail over all other duties; and the duty to the client will prevail over the Company's other corporate responsibilities and duty to shareholders."[157] Because the ASX recommends that a majority of the board of a listed company should be independent directors, the Slater & Gordon board is not composed of its lawyer-shareholders, and under Australian regulations pertaining to incorporated law firms, only one director need be a legal practitioner. Slater & Gordon seems to have prospered as a publicly traded law firm, and in January 2012, it

[153] ABA Comm'n on Ethics Request for Cmt. of Apr. 2011, *supra* note 151, at 9.

[154] *Id*.

[155] *Id*.

[156] SLATER & GORDON LTD., SLATER & GORDON PROSPECTUS § 4.3, 36 (2007), *available at* http://www.slatergordon.com.au/files/editor_upload/File/prospectus/Prospectus.pdf.

[157] *Id*. *See also* Andrew Grech & Kirsten Morrison, *Slater & Gordon: The Listing Experience*, 22 GEO. J. LEGAL ETHICS 535 (2009) (illustrating the ethical and practical issues that were considered as Slater & Gordon became the first law firm to list its entire practice on the Australian Stock Exchange).

purchased the U.K. firm of Russell Jones & Walker and entered the U.K. legal services market.[158]

2.3. In Canada

In Canada, certain regulations adopted in three provinces allow for modified forms of MDP. Two common law provinces, Ontario and British Columbia, have adopted regulations that permit MDPs, but with significant restrictions.[159] Quebec, which is a civil law jurisdiction, has adopted a more liberal MDP regime.[160] However, none of these provinces currently allow for nonlawyer ownership of law firms.

2.3.1. The Canadian Bar Association and the Debate over MDPs in Canada

In Canada, governance of the legal profession lies within the provincial Law Societies acting under statute.[161] While the Canadian Bar Association (CBA) does not regulate the practice of law, like the ABA, it plays a significant role in developing the codes of professional conduct.[162] In 1997, the CBA established its International Practice of Law (IPL) Committee to monitor the "activities, negotiations and developments regarding the globalization of legal practice and the trend towards multi-disciplinary practices through NAFTA, the World Trade Organization (WTO), and the International Bar Association."[163] The IPL's position on MDPs reversed course three times in a short period. First, in 1998 the IPL recommended that "MDPs should

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158 *Slater & Gordon to Enter UK Market With £54m Purchase of Russell Jones & Walker,* LEGAL FUTURES (Jan. 30, 2012), http://www.legalfutures.co./latest-news/slater-gordon-to-enter-uk-market-with-54m-purchase-of-russell-jones-walker. This combination was approved on April 27, 2012 by the Solicitors Regulation. Michael Cross, *Russell Jones & Walker Approved as ABS*, THE LAW SOCIETY GAZETTE (April 27, 2012), http://www.lawgazette.co.uk/65363.article.

159 ABA Comm'n on Ethics Request for Cmt of Apr. 2011, *supra* note 151, at 11.

160 *Id*.

161 Paul D. Paton, *Multidisciplinary Practice Redux: Globalization, Core Values, and Reviving the MDP Debate in America*, 78 FORDHAM L. REV. 2193, 2203 (2010).

162 *Id.* (citing *About the Canadian Bar Association*, CAN. BAR ASS'N http://www.cba.org/CBA/about/main).

163 *Id*. at 2212 (citing Can. Bar Ass'n, Special Comm. On the Int'l Practice of Law, Multi-Disciplinary Practices: An Interim Report, at ic (1998)).

not be permitted to provide legal services to clients" unless they were controlled by lawyers.[164] However, in August 2000, the IPL changed its position and the CBA Council approved a "final" resolution[165] that permitted lawyers to engage in "business arrangements in which individuals with different professional qualifications practise together . . . to combine different skills to provide a broad range of advice to consumers."[166] This resolution allowed lawyers to participate in MDPs even if such MDPs were not controlled by lawyers.[167] Additionally, the resolution did not limit the services that MDPs could provide to services of a legal nature.[168] Then, in a "stark reversal," in February 2001, the CBA Council "clarified" its earlier resolution with a further resolution that restricted the MDP regime by requiring that lawyers have "effective control over the MDP."[169] The CBA Council provided that effective control would ensure that MDPs would be in "continuing compliance with the core values, ethical and statutory obligations, standards and rules of professional conduct of the legal profession."[170]

The CBA's final position seems to have been the product of "political intrigue and overt manipulation" by the Law Society of Upper Canada (LSUC), which is the provincial regulator of Ontario.[171] This is because LSUC had already adopted an MDP regime significantly more restrictive than the CBA's initial position.[172] Thus,

> when it became clear that [LSUC] would be embarrassed by having the Canadian Bar Association sanction a far more liberal regime for MDPs than the one that LSUC had

164 *Id*.

165 Can. Bar Ass'n, Council Res. 00-03-A (2000).

166 Can. Bar Ass'n, Int'l Practice of Law Comm., Striking a Balance: The Report of the International Practice of Law Committee on Multi-Disciplinary Practices and the Legal Profession, at 11 (1999).

167 Paton, *supra* note 161, at 2213.

168 *Id.*

169 Can. Bar Ass'n, Council Res. 00-01-M, para. 1.a (2000).

170 *Id.*

171 Paton, *supra* note 161, at 2211.

172 *See* Law Soc'y of Upper Can., By-Law No. 25 (1999) [hereinafter By-Law No. 25], *available at* http://www.lsuc.on.ca/WorkArea/DownloadAsset.aspx?id=2147485895 (describing the by-law behind multi-discipline practices and partnerships).

> already imposed while purportedly acting 'in the public interest,' LSUC representatives embarked on an ultimately successful campaign through the legal press and at the CBA itself to have the will of the CBA national counsel reversed and a narrower MDP regime with a lawyer-control requirement adopted.[173]

2.3.2. Ontario

MDPs have been permitted in Ontario since LSUC adopted By-Law 25 on April 30, 1999.[174] This regulation exists today, in much its same form, under By-Law 7.[175] Part III of By-Law 7 sets forth the rules governing MDPs in Ontario. A lawyer (licensee) can form a partnership or other association (but not a corporation) with a nonlawyer professional "for the purpose of permitting the licensee to provide to clients the services of the professional" if certain conditions are met.[176] Prior to entering into such an arrangement, the licensee must apply to LSUC and be approved.[177] The nonlawyer professional must be of good character, and "qualified to practice a profession, trade or occupation that supports or supplements the practice of law or the provision of legal services."[178] Additionally, the licensee must retain "effective control" over the professional's practice insofar as the professional is providing services to the clients of the partnership or association.[179] Further, the professional must agree to comply with

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173 Paton, *supra* note 161, at 2211.

174 *See* By-Law No. 25, *supra* note 172 (stating the by-law behind multi-discipline practices). By-Law No. 25 was "later amended three times in 1999 (May 28, June 25, and December 10), twice in 2001 (April 26 and May 24), and once in 2002 (October 31), but the changes [were] not substantial . . . By-Law [No. 25] was revoked on May 1, 2007, as part of 'house keeping.'" Paton, *supra* note 161, at 2217 n.106 (internal quotes added). By-Law 25 exists today under By-Law 7. *See id.*, at 2217 n. 106 (describing the amendments made to By-Law No. 25 and referencing By-Law No. 7).

175 Law Soc'y of Upper Can., By-Law No. 7, pt. III (2009) [hereinafter By-Law No. 7], *available at* http://www.lsuc.on.ca/WorkArea/DownloadAsset.aspx?id=2147485808.

176 *Id.*

177 *Id.*

178 *Id.*

179 *Id.* Effective control requires that "the licensee may, without the agreement of the professional, take any action necessary to ensure that the licensee complies with [the society's rules, regulations and policies]."

the Law Society's rules, regulations and policies, and must agree not to practice his profession, trade or occupation, except to provide services to the clients of the partnership or association.[180] Any independent practice of the professional's occupation must be performed outside the premises of the partnership or association.[181]

In addition, LSUC adopted By-Law 32 on May 24, 2001 to regulate affiliations between law firms and other service providers.[182] Today, By-Law 32 exists in its original form in Part IV of By-Law 7, which regulates "affiliated" law firms.[183] This regulation came about due to the "captive law firm model."[184] The concern was with the presence of Donahue & Partners, a law firm established in Ontario by the accounting firm Ernst & Young, as well as other law firms "captive" to Big Five accounting firms in Europe.[185] As a result, By-Law 7 imposes a notification requirement, and various restrictions, on a licensee that "affiliates with an affiliated entity."[186] A licensee "affiliates with an affiliated entity when the licensee on a regular basis joins with the affiliated entity in the delivery or promotion and delivery of the services of the licensee and the services of the affiliated entity."[187] A licensee who is involved in such an arrangement must own and maintain control over the professional business through which the licensee practices law or provides legal services.[188] Additionally, there must be a physical segregation of the premises from which the legal services are delivered from those used by the affiliated entity for the delivery of its nonlegal services, "other than those that are delivered by the affiliated entity jointly with the delivery of the

[180] *Id.*

[181] *Id.*

[182] Law Soc'y of Upper Can., By-Law No. 32 (2001), *repealed* 2007, *available at* http://www.lsuc.on.ca/WorkArea/DownloadAsset.aspx?id=2147485902. By-Law No. 32 was repealed on May 1, 2007 and exists today under By-Law No. 7, pt. IV. *See* Paton, *supra* note 161, at 2220–21 n.125.

[183] By-Law No. 7, *supra* note 175, at pt. IV.

[184] Paton, *supra* note 161, at 2220.

[185] *Id.*, at 2220.

[186] By-Law No. 7, *supra* note 175, at pt. IV (2009).

[187] *Id.*

[188] *Id.*

services of the licensee."[189] Finally, no fee splitting or profit sharing is permitted between the law firm and the affiliated entity.[190]

2.3.3. British Columbia

In 2001, The Law Society of British Columbia (LSBC) contemplated a much more liberal regime than the one adopted in Ontario. In fact, the governors of the LSBC (benchers) rejected a more restrictive approach stating: "A restrictive approach may preclude sensible and economic arrangements between lawyers and members of other occupations that may serve the public well."[191] However, although these proposed rule changes received a majority of the bencher's votes, a two-thirds majority was necessary to adopt the resolution.[192] As a result the resolution was rejected in order to protect the "core values" of the profession as well as what the benchers called a "lack of demand within the profession for such a regulatory scheme."[193] The LSBC did not adopt any MDP regime until 2010 when it adopted Rules 2-23.1 to 2-23.12 into its practice rules.[194]

The rules adopted by LSBC function in much the same way as MDPs in Ontario. For example, the lawyer member of the MDP must obtain express permission by the LSBC to enter into a MDP.[195] The nonlawyer members of the MDP must be of "good

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189 *Id.* Further, it requires notification to the board and an annual filing that must include information on the financial arrangement that exists between the lawyer and the affiliated entity, as well as other arrangements including the ownership, management, control, and compliance with the rules, regulations and policies of the society.

190 LAW SOC'Y OF UPPER CANADA, RULES OF PROF'L CONDUCT R. 2.08(9) (2001).

191 The Law Soc'y of B.C., *Consultation on Multi-Disciplinary Practice*, BENCHERS' BULL., no. 1, July-Aug. 2001 Supp., http://www.lawsociety.bc.ca/page.cfm?cid=1904.

192 Paton, *supra* note 161, at 2225.

193 The Law Soc'y of B.C., *Benchers Say* No *to Multi-Disciplinary Practice*, BENCHERS' BULL., no. 6, Nov.-Dec. 2001 Supp., http://www.lawsociety.bc.ca/page.cfm?cid=1854&t=Benchers-s.

194 THE LAW SOC'Y OF B.C., LAW SOCIETY RS. §§ 2-23.1–2-23.12 (2009), *available at* https://www.lawsociety.bc.ca/page.cfm?cid=979&t=Law-Society-Rules-Part-2-Membership-and-Authority-to-Practise-Law#2-23-1 [hereinafter LSBC PRACTICE RULES].

195 *Id.* § 2-23.2(1)(b).

character and repute."[196] Additionally, all members must agree in writing that the lawyer members of the MPD will have actual control over the delivery of legal services, and that nonlawyer members will not interfere with the lawyer's obligation to the rules regulations and polices of the LSBC.[197]

In October 2011, the LSBC requested that the Independence and Self-Governance Committee ("Committee") examine the debate surrounding alternative business structures (including models with outside ownership) and outline their views on whether or not they should be adopted in British Columbia.[198] The Committee expressed their concern about "the lack of empirical evidence given by proponents of ABSs, and believes that if the only demonstrable effect of ABSs was to enrich the legal profession or those who invested in it, the image of the profession and the Law Society would be tarnished."[199] Thus, the Committee urged that:

> some considerable caution needs to be exercised to ensure that there is a public value in ABSs (such as improving access to legal services) and that valuable public protections that currently exist (such as client confidentiality, an absence of conflicts of interest, and the public right to an independent lawyer) are not lost.[200]

The Committee concluded that "some outside ownership involvement in law firms could be considered, provided it is properly regulated and that lawyers remain in control of the provision of the legal services offered."[201] However, the Committee rejected the notion that law firms be put up for public sale through securities markets, because they were "not convinced that there are benefits to users of legal services that outweigh identified risks."[202] Although the Committee recommended that

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196 *Id.* § 2-23.2(1)(c).

197 *Id.* § 2-23.2(1)(d).

198 The Law Soc'y of B.C., Alternative Business Structures in the Legal Profession: Preliminary Discussion and Recommendations (2011), *available at* http://www.lawsociety.bc.ca/docs/publications/reports/AlternativeBusinessStructures.pdf.

199 *Id.* at 1.

200 *Id.* at 1–2.

201 *Id.* at 2.

202 *Id.*

the LSBC give "serious consideration to ABSs," they suggested that the LSBC wait and see what happens elsewhere: "The [LSBC] should await the outcome of the debate currently underway through the American Bar Association."[203]

2.3.4. Quebec

In Quebec, the Code des professions (Professional Code) was amended with regulations in 2010 to provide for a more liberal MDP regime than that which exists in Ontario and British Columbia.[204] The regulations in Quebec require only a "simple majority ownership by members of the Barreau du Quebec of the firm through which the professional services are provided."[205] Membership of non laywers is:

> restricted to those members of various other recognized professional bodies (including actuaries, patent agents, and members of the Chambre de l'assurance de dommages) [damage insurance adjusters and brokers] or the Chambre de la securite financiere [financial planners and insurance agents], but the regulation does not require that their activities 'support or supplement the practice of law' in the manner of the Ontario and British Columbia MDP rules.[206]

MDPs are required to:

> provide an undertaking to the Barreau du Quebec that in essence ensures that all members of the partnership comply with rules of law so as to permit the lawyer members to carry on their professional activities, particularly as regards the following:
>
> a) professional secrecy, the confidentiality of information contained in client files and the preservation thereof;
>
> b) professional independence;

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[203] *Id.*

[204] *See* QUEBEC PROF'L CODE (2014), available at http://www2.publicationsduquebec.gouv.qc.ca/dynamicSearch/telecharge.php?type=2&file=/C_26/C26_A.HTM; Ethics Comm'n Request for Cmt. of April 2011, *supra* note 27, at 12.

[205] Ethics Comm'n Request for Cmt. of April 2011, *supra* note 27, at 12.

[206] *Id.* at 12 (translations in original) (footnote omitted).

c) the prevention of situations of conflict of interests;

d) activities reserved for advocates;

e) liability insurance;

f) professional inspections;

g) advertising;

h) billing and trust accounts; and

i) access by the syndic of the Barreau to this undertaking and, if applicable, to every contract or agreement regarding a [member of the Barreau].[207]

2.4. Other Jurisdictions

Jurisdictions in addition to England, Australia, and Canada have been considering whether to permit multidisciplinary practices and ownership of interests in law firms by nonlawyers. In particular, various European countries are studying whether to liberalize restrictions on the practice of law. France, Spain, and Scotland have studies or proposals in this regard.[208]

The Organization of Economic Cooperation and Development ("OECD") released a report in 2007 questioning the regulation of the legal profession.[209] This report asserted that regulation and self-regulation of the legal profession appear "to serve mainly the private interests of the profession rather than broader consumer interests."[210] The report found the restrictions on ownership and management of law firms difficult to justify because these restrictions limit the available sources of capital for a law firm and because spreading the risk by allowing more widespread ownership could reduce prices to clients. Also, prohibiting nonlawyer management may "stifle more efficient and innovative methods of delivering legal services to consumers."[211] Further, the OECD rejected the argument that financial control of law firms by

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[207] *Id.* at 13 (citing QUEBEC PROF'L CODE Sched. B (s.3)).

[208] Cox, *supra* note 4, at 538–39.

[209] OECD, COMPETITIVE RESTRICTIONS IN LEGAL PROFESSIONS (2007), *available at* http://www.oecd.org/regreform/liberalisationandcompetitioninterventioninregulatedsectors/40080343.pdf.

[210] *Id.* at 9.

[211] *Id.* at 50.

nonlawyers would improperly influence lawyers by putting commercial interests ahead of client interests "since lawyers are not less driven by profits than their commercial counterparts."[212] This OECD Report seems to have had a greater impact in Europe than elsewhere, but the United States is a member of the OECD and so its views regarding competition should be heeded.

3. THE JACOBY AND MEYERS LITIGATION

On May 18, 2011, Jacoby & Meyers, LLP (Plaintiffs) filed a complaint in the U.S. District Court for the Southern District of New York against the Presiding Justices of the First, Second, Third and Fourth Departments of the Appellate Division of the Supreme Court of the State of New York (N.Y. Defendants), challenging ABA Rule 5.4 and its state law counterparts on a variety of constitutional grounds.[213] The Plaintiffs challenged Rule 5.4 of the New York Rules of Professional Conduct, which prohibits lawyers from practicing law for profit in an entity in which a nonlawyer has an ownership interest. The Plaintiffs filed a similar complaint on the same day against the Justices of the Supreme Court of New Jersey (N.J. Defendants) in the U.S. District Court for the District of New Jersey[214] and against the Judges of the Connecticut Superior Court of the U.S. District Court for the District of Connecticut.[215]

In their original New York Complaint, Plaintiffs set forth a lengthy list of reasons why Rule 5.4 is antiquated and should be changed. First, the rule prevents law firms from competing in today's global marketplace, restricts public access to "affordable, quality representation," and impedes law firms' ability to "raise the capital necessary to pay for improvements in technology and infrastructure, and to expand its offices and hire additional personnel."[216] The traditional modes of obtaining capital—through

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[212] *Id.*

[213] Jacoby & Meyers, LLP v. Presiding Justices of First, Second, Third & Fourth Depts., Appellate Div. of Supreme Court of New York, 847 F. Supp. 2d 590 (S.D.N.Y. 2012).

[214] Jacoby & Meyers Law Offices, LLP v. Justices of the Supreme Court of New Jersey, No. 11-cv-2866-JAP (D.N.J. filed May 18, 2011).

[215] Jacoby & Meyers Law Offices, LLP v. Judges of the Connecticut Superior Court, No. 3:11-cv-00817-CFD (D. Conn. filed May 18, 2011).

[216] Complaint at para. 1, *Jacoby & Meyers*, 847 F. Supp. 2d 590 (No. 11 Civ. 3387).

personal contributions of the partners and commercial bank loans—are unavailable to firms like Jacoby & Meyers and, although the firm has had capital contribution offers from nonlawyer investors, it has been unable to take advantage of such offers due to the prohibitions of Rule 5.4.[217]

Second, the current ethical system "perpetuates economic inequity" between small law firms with no access to the capital markets, and those on Wall Street, as well as between Wall Street firms and firms in England and Australia, where lawyers are allowed to accept funding from nonlawyers.[218] In England and Australia, there are alternative safeguards in place to ensure that nonlawyer equity investors do not interfere with lawyers' professional responsibilities, and the system has worked well in both countries.[219]

Third, one need only look to the practice of the District of Columbia, where lawyers may partner with nonlawyers, to see that the restrictions of Rule 5.4 are unwarranted. No "violation of clients' confidences" or "erosion of lawyers' independent judgment" in D.C has ever occurred.[220] Indeed, "the claimed evils most often advanced by critics of outside, nonlawyer investment . . . have not materialized in the wake of others' efforts to allow such outside investments."[221] Finally, Rule 5.4 should no longer be enforced because "no compelling legal argument or public policy rationale exists to prevent lawyers from raising capital in the same manner as any other business."[222]

Because of these reasons, Plaintiffs' first Complaint sought to enjoin the enforcement of Rule 5.4 against them and other similarly situated law firms, and a declaration that the Rule violates: (1) the Judiciary Law, (2) the Dormant Commerce Clause, (3) the Equal Protection and Due Process Clauses, (4) Plaintiffs' First Amendment rights to free speech and association, and (5) that the Rule constitutes a regulatory taking without compensation.[223]

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[217] *Id.* at para. 28.

[218] *Id.* at para. 4.

[219] *Id.* at para. 33.

[220] *Id.* at para. 5.

[221] *Id.*

[222] *Id.* at para. 6.

[223] *Id.*

The New York Defendants subsequently moved to dismiss the Complaint on July 15, 2011, for lack of subject matter jurisdiction pursuant to Federal Rule of Civil Procedure 12(b)(1) and for failure to state a claim upon which relief could be granted pursuant to Federal Rule of Civil Procedure 12(b)(6). During the oral argument held before Judge Kaplan on February 7, 2012, the Court stated that Plaintiffs "faced a significant uphill battle to establish standing," but that Plaintiffs' claims were ripe and that the Court "should entertain the case rather than abstain."[224] Afterwards, Plaintiffs were granted leave to amend their complaint to correct certain procedural defects. On November 23, 2011, Plaintiffs filed an Amended Complaint, naming Jacoby & Meyer USA, LLC, as an additional Plaintiff, and thus rendered the Defendant's first Motion to Dismiss moot.[225]

The Amended Complaint reiterated the same policy arguments against Rule 5.4 as discussed above and stated that Jacoby & Meyers, LLP, had recently created the LLC, Jacoby & Meyers USA, "for the express purpose of allowing nonlawyers to 'own an interest' in the entity through which Jacoby & Meyers is authorized to practice law for profit."[226] Plaintiffs stated that Jacoby & Meyers, LLP, was immediately prepared "to transfer all of its assets to Jacoby & Meyers USA, LLC and immediately obtain nonlawyer investment—as soon as Rule 5.4's blanket suppression of nonlawyer ownership of an interest in law firms is declared unconstitutional and its enforcement permanently enjoined."[227] In this way, the New York Defendants could no longer claim that Plaintiffs' inability to add a nonlawyer partner to their firm was barred by New York State Partnership Law, since their newly created entity was a LLC not subject to Partnership Law.[228]

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224 Memorandum of Law in Support of Defendants' Motion to Dismiss Plaintiffs' Amended Complaint at 1, Jacoby & Meyers, LLP v. Presiding Justices of First, Second, Third & Fourth Depts., Appellate Div. of Supreme Court of New York, 847 F. Supp. 2d 590 (S.D.N.Y. 2012) (No. 11 Civ. 3387) [hereinafter Memorandum in Suppprt to Dismiss].

225 Amended Complaint for Declaratory and Injunctive Relief at para. 14, *Jacoby & Meyers*, 847 F. Supp. 2d.

226 *Id.*

227 *Id.*

228 Defendants argued in their first Motion to Dismiss that Plaintiffs had no standing to sue because New York State Partnership Law, not Rule 5.4, prevented them from adding a nonlawyer partner to their firm. *See* Memorandum in

On December 23, 2011, the New York Defendants moved to dismiss the complaint. The bulk of the parties' arguments concerned the procedural and jurisdictional aspects of Plaintiffs' claims, and the defendants chose to address standing, ripeness, immunity, and abstention. On March 8, 2012, Judge Kaplan issued a decision holding that Plaintiffs did not have standing to raise the constitutional claims advanced in their complaint because they are a limited liability company and a limited liability partnership, and, as such, are a "corporation or voluntary association" within the meaning of Section 495 of the New York Judiciary Law.[229] This decision bars the Plaintiffs from obtaining nonlawyer ownership equity independently of Rule 5.4.[230] As such, Plaintiffs had no standing to bring this suit and, because "the ruling that they seek would be a purely advisory declaration of the sort that is forbidden to federal courts under Article III of the U.S. Constitution," the action was dismissed.[231] Accordingly, the Court did not address the merits of Plaintiffs' claims against the New York Defendants.

The Plaintiffs appealed the District Court decision, and on November 21, 2012, the Second Circuit Court of Appeals remanded the case to the District Court and instructed the lower court to vacate the original judgment and allow the Plaintiffs to amend their complaint.[232] The Second Circuit opinion stated that "the district court can proceed to adjudicate the parties' dispute as to whether [Section 495 of the New York Judiciary Law, Section 201 of New York LLC Law] and Rule 5.4 are constitutional."[233] As a result, the merits of the Plaintiffs' claims will ultimately be addressed by the New York Court.

Judge Sheridan took a different approach in the New Jersey case, where the New Jersey Defendants also made a motion to dismiss. He held that it was best for the Court to restrain its authority in light of the rightful independence of the New Jersey

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Suppprt to Dismiss, *supra* note 224, at 5 (stating that the Partnership Law precludes the hiring of a nonlawyer at a law firm).

[229] *Jacoby & Meyers*, 847 F. Supp. 2d at 597.

[230] *Id.* at 591–92.

[231] *Id.*

[232] Jacoby & Meyers, LLP v. Presiding Justices of First, Second, Third & Fourth Dep'ts, App. Div. of Sup. Ct. of State of N.Y., 488 F. App'x 526 (2d Cir. 2012), *as amended* (Jan. 9, 2013).

[233] *Id.* at 527.

Supreme Court over Rule 5.4(d), and therefore he denied the motion to dismiss and remitted the issue of an Alternative Business Structure, as proposed by Jacoby & Meyers, to the New Jersey Supreme Court.[234]

A motion to dismiss in Connecticut by the Connecticut defendants has not yet been decided.

Whether any rights protected either by the U.S. Constitution or the constitutions of the States of New York, New Jersey, or Connecticut are abridged by the prohibition against partnerships or other forms of business organizations that include both lawyers and nonlawyers are complicated issues. For obvious political reasons, federal district court judges would rather not decide these questions in cases against state judges. Whether the U.S. Supreme Court might entertain these cases is another question.[235]

In *Goldfarb v. Virginia State Bar*,[236] the Supreme Court struck down suggested minimum fees for legal services imposed by the Virginia State Bar. In *Bates v. State Bar of Arizona*,[237] the Supreme Court struck down bans against lawyer advertising as contrary to the First Amendment. In *NAACP v. Button*,[238] the Supreme Court held that the states could not ban the delivery of legal services through a nonprofit corporation. This precedent was then extended to permit unions to offer legal services to their members.[239] In *Citizens United v. FEC*,[240] the Supreme Court held that the Government may not suppress political speech by

[234] Jacoby & Meyers Law Offices, LLP v. Justices of Sup. Ct. of N.J., (No. 11-2866) (D.N.J. filed May 18, 2011).

[235] Seemingly independent of its pending litigation in U.S. federal courts, Jacoby & Meyers announced in August 2013 its participation in a joint venture with a U.K. firm in order to create "the world's largest privately-owned, full-service consumer legal group" to be based in the United Kingdom. *Jacoby & Meyers Builds Platform in the U.K. for a Global Build-Out*, JACOBY & MEYERS LAW OFFICES (Aug. 8, 2013), http://www.jacobymeyers.com/blog/jacoby-meyers-builds-platform-uk-global-build-out.html. The new firm, Jacoby & Meyers Europe Limited, will be owned by Jacoby & Meyers, LLP, and affiliated with MJ Hudson. *Id.* Going forward, the firm expects to seek ABS status in the United Kingdom to solicit for nonlawyer equity ownership and funding. *Id.*

[236] 421 U.S. 773 (1975).

[237] 433 U.S. 350 (1977).

[238] 371 U.S. 415 (1963).

[239] United Transp. Union v. State Bar of Mich, 401 U.S. 576 (1971); United Mine Workers of Am. v. Ill. State Bar Ass'n, 389 U.S. 217 (1967).

[240] 130 S. Ct. 876 (2010).

corporations. Whether these cases and some related decisions amount to a theory that the First Amendment's protections of speech, assembly, and association make state prohibitions on business combinations between lawyers and nonlawyers unconstitutional has been argued by some[241] and opposed by others.[242]

The ABA appears to have determined that organizations that do not operate at a profit can provide legal services, but for profit entities cannot do so if they profit from these services.[243] Recently, many states have made provision for the incorporation of benefit and flexible purpose corporations, which straddle a space between for-profit and non-profit corporations. The benefit corporation commits its owners to pursue social or philanthropic objectives, although shareholder profits may also be pursued. However, there is no obligation to give shareholders priority.[244] Flexible purpose corporations similarly would allow customers, the community, or society to trump shareholder interests.[245] If the bar were more serious about protecting professional values over protecting economic interests, it might consider adapting these corporate forms to law firms so that law firms could join with nonlawyers either as shareholders or in other capacities, but client interests would nevertheless trump shareholder interests. This proposition is similar to the way in which the regulation of law firms evolved in Australia.

Jacoby & Meyers did not sue for relief under the antitrust laws. At one time there was thought to be a "learned profession"

[241] *See* Knake, *supra* note 19 (arguing that current restrictions on nonlawyer ownership of law firms may be unjustified); Gary A. Munneke, *Dances with Nonlawyers: A New Perspective on Law Firm Diversification*, 61 FORDHAM L. REV. 559 (1992).

[242] Brief for Conn. Bar Ass'n. as Amicus Curiae Supporting Defendants at 2, Jacoby & Meyers Law Offices v. Justices of Sup. Ct. of N.J., No. 11-cv-2866 (D.N.J. filed May 18, 2011) (No. 11-cv-00817).

[243] *See* Andrews, *supra* note 58, at 589–90 (arguing that this distinction prevents the potential harms envisioned by opponents of allowing nonlawyer ownership of law firms).

[244] *See, e.g.*, CAL. CORP. CODE § 14620(d) (West 2011) (codifying this lack of shareholder priority); N.Y. BUS. CORP. LAW § 1707(a)(1)–(3) (McKinney 2011) (codifying this lack of shareholder priority).

[245] *See* CAL. CORP. CODE § 2602 (West 2011) (providing an example of flexible purpose corporation and its unique guidelines).

exemption from the antitrust laws,[246] but the Supreme Court rejected this concept in *Goldfarb v. Virginia State Bar*.[247] Nevertheless, in an earlier case, *Parker v. Brown*,[248] the Court adopted the "state action" exemption from the antitrust laws in situations where state regulation required conduct the antitrust laws prohibited. This doctrine has generally protected legal ethics from attacks under the antitrust laws, except in cases involving blatant price fixing.[249]

The restraint against nonlawyer and lawyer association in a law firm is a standard of a voluntary non-governmental organization, the ABA, and therefore is not sovereign action. Nevertheless, this ban has been adopted by state bar associations, and generally is approved and enforced by the state courts. Whether this acceptance should make any difference is an interesting question, but it seems pertinent that the restrictions against equity investment in law firms by nonlawyers was abolished in England and Australia on antitrust grounds. In a different context, involving the membership rules of the New York Stock Exchange (NYSE), the U.S. Supreme Court held that an implied repeal of the antitrust laws by the federal securities laws existed only to the extent necessary to make securities regulation work.[250] A similar rationale could perhaps be applied to Rule 5.4 of the ABA and the states that have adopted it. In other words, are these bans necessary to protect the core values of the legal profession or could these values be protected in other, less anti-competitive ways?

4. THE EVOLUTION OF THE SECURITIES INDUSTRY

Lawyers make much of their professionalism, but "to term them noncommercial is sanctimonious humbug."[251] Further, other

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246 Thomas D. Morgan, *The Impact of Antitrust Law on the Legal Profession*, 67 FORDHAM L. REV. 415, 419 (1998).

247 421 U.S. 773, 787 (1975).

248 317 U.S. 341, 350–51 (1943).

249 *See* Morgan, *supra* note 246, at 423–27, 436–39 (discussing various scenarios where antitrust law would apply to law firms; including, price fixing, lawyer arranged boycotts, and conspiracies between law firms relating to advertising practices).

250 Silver v. N.Y. Stock Exch., 373 U.S. 341, 357 (1963).

251 Bates v. State Bar of Arizona, 433 U.S. 350, 368 n.19 (1977) (citing Transcript of Oral Argument at 64).

industries have confronted the problem of eliminating restrictions on their form of organization and financing. In this part, this Article will discuss the elimination of such restrictions on securities firms that were members of the NYSE and the NYSE itself. While the results of these changes in the organizational form of these firms have been both beneficial and detrimental, if lawyers find that alternative business structures are necessary, they will push for the abolition of absolute bans on lawyer-nonlawyer associations.

Until 1953, only individuals could be members of the NYSE, and all exchange member firms were required to do business as partnerships. Further, all member firms were required to be primarily engaged in a public securities business.[252] The rationale for these regulations was related to the mutual form of exchange organization. When making a trade, an exchange member had to be trusted to stand behind the trade.[253] Because all partners are liable for the debts of a partnership, the personal wealth of every firm partner guaranteed stock exchange trading contracts. This regime worked reasonably well when commission rates were fixed and all orders in exchange listed stocks were required to be executed over an exchange.[254] In addition to contributing to the financial stability of the NYSE, these regulations kept institutions, which were the customers of exchange members, from becoming exchange members.[255]

After the paperwork crisis on Wall Street in the 1960s, and the unfixing of stock exchange commission rates in 1975, it became apparent that the traditional regime of the brokerage firm partnership form was doomed. In the 1960s, over 150 securities firms failed.[256] In addition to the problems unleashed by the

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[252] *See* PBW Stock Exch., Inc. v. SEC, 485 F.2d 718, 720 (3d Cir. 1973) (discussing the application of the "'institutional membership' rule" to all members of the exchange); ROBERTA S. KARMEL, REGULATION BY PROSECUTION: THE SECURITIES AND EXCHANGE COMMISSION VS. CORPORATE AMERICA 118–20 (1982) (explaining that this regulatory scheme provided for the self-policing of the finacial industry).

[253] *See* Jay F. Coughenour & Daniel N. Deli, *Liquidity Provision and the Organizational Form of NYSE Specialist Firms*, 57 J. FIN. 841, 844 (2002).

[254] KARMEL, *supra* note 252, at 129–31.

[255] *See* Moses v. Burgin, 445 F.2d 369, 375 (1st Cir. 1971) (reasoning that since "all brokers, to be members, must be engaged primarily in brokerage" the defendants "would not have been able to qualify for membership").

[256] CHARLES R. GEISST, WALL STREET: A HISTORY 296 (1997).

unfixing of brokerage commissions in the next decade, the structure of the underwriting business was challenged, and sales and trading with institutional customers became more important even to the wire houses.[257]

In 1953, the NYSE allowed its member firms to incorporate. Woodcock Hess & Co. and A.G. Becker & Co. were the first to do so and remain member firms.[258] In 1959, Merrill Lynch, Pierce Fenner & Smith, a large, nationwide wire house catering to retail customers, incorporated.[259] Donaldson, Lufkin & Jenrette, a firm that catered to institutional customers by executing their trades, also incorporated in 1959, and then it became a public company in 1971.[260] Merrill Lynch soon followed with an initial public offering. These offerings were in response to a 1970 relaxation of the rules of the NYSE allowing member firms to go public.[261]

These changes occurred because of the greatly increased need for capital required to run a securities business, and the financial needs of the securities industry generally.[262] The number of customers and the volume of trading greatly increased, and firms were required to invest large amounts of money in computerizing their back offices. The partnership form of business organization could not raise sufficient capital to support the business of large firms. Subordinated loans, which were counted as regulatory capital, were not a viable long-term solution to business needs.[263] The problems of partnership succession and the unwieldy nature

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[257] *Id.* at 297–98.

[258] JERRY W. MARKHAM, 2 A FINANCIAL HISTORY OF THE UNITED STATES: FROM J.P. MORGAN TO THE INSTITUTIONAL INVESTOR (1900–1970) 292 (2002).

[259] Michael J. Kaufman, *Living in A Material World: Strict Liability Under Rule 10b-5*, 19 CAP. U. L. REV. 1, 67 (1990).

[260] CHARLES R. GEISST, THE LAST PARTNERSHIPS: INSIDE THE GREAT WALL STREET MONEY DYNASTIES 226–27 (2001).

[261] Alan D. Morrison & William J. Wilhelm, Jr. *The Demise of Investment-Banking Partnerships: Theory and Evidence* 31 (Oxford Centre, Working Paper, 2004), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=569109 (noting how the NYSE amended its rules in 1970 to admit publicly quoted members).

[262] *See* GEISST, *supra* note 260, at 206–07, 227–28 (articulating how the changing financial landscape required firms to go public in order to meet their capital demands).

[263] *See* CHRIS WELLES, THE LAST DAYS OF THE CLUB 153-54 (1975). Several prospectus for brokerage firm public offerings stated that the proceeds of the offering would be used to retire subordinated loans. Under stock exchange rules, these loans could not be repaid if repayment would jeopardize a firm's compliance with net capital regulations.

of large securities firm partnerships also contributed to the need to incorporate and then go public.[264]

Not all NYSE member firms incorporated and went public even when such an organization was allowed. Goldman Sachs remained a partnership until 1999, and was able to do so because it was enormously profitable, and it compelled partners to leave capital in the firm.[265] Lazard Freres chose to remain a partnership for even longer, but eventually went public in May of 2005.[266]

The impetus for going public was the need for capital. "Without adequate equity capital on their books, the investment banks could not underwrite enough deals or make their influence felt on Wall Street . . . . Even when the firms had surplus capital, their futures were still not certain because, as their partners retired, they withdrew their capital, shrinking the firms' financial bases."[267] Another theory, espoused by Professors Morrison and Wilhelm, regarding the transformation of securities firm partnerships into large public corporations is that going public was a response to "technological innovations in both information technology and finance."[268]

According to this theory, "[p]artnerships will not make capital investments when the costs of idle capital are sufficiently large: the going public decision therefore boils down to a trade-off between investment in human and physical capital."[269] In the 1960s, the increase in computer power allowed certain types of securities firms to substitute computers "for human capital in . . . settling transactions, maintaining client balances, [and] mailing confirmations . . . ."[270] Retail rather than wholesale firms took advantage of the opportunity to go public at this time. Later, the development of the microcomputer led to financial engineering and the creation of new products that decreased the bid/ask

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264 *See* GEISST, *supra* note 260, at 226 (explaining how aging partners draw capital from the firm upon retirement).

265 *Id.* at 307–10 (noting the pressures Goldman faced to go public even though it remained a profitable firm).

266 *See* LAZARD LTD., ANNUAL REPORT 2005 Form 10-K (2006) (detailing the organization's finances as a public company).

267 GEISST, *supra* note 260, at 314–15.

268 Morrison & Wilhelm, *supra* note 261, at 2.

269 *Id.* at 4.

270 *Id.*

spread, and therefore the wholesale firms needed additional financial capital and went public.[271] For both retail and wholesale firms, competitive pressures to expand pushed them into becoming public companies, thereby substituting financial capital for human capital.[272]

Although the above thesis has some appeal, it is an incomplete analysis of why securities firms went public. An examination of the "Use of Proceeds" section of some of the early initial public offerings reflects that firms were concerned about the expected deregulation of stock exchange commission rates and increased capital requirements of their regulators.[273] Although this explanation for the public offerings of wire houses fits to some extent into the Morrison and Wilhelm thesis, the prospectus for the initial public offering of Donaldson, Lufkin & Jenrette stated that proceeds from the offering would be used to support the firm's block positioning activities, a business in which Goldman Sachs was also prominent. However, Goldman Sachs did not go public until much later.

The same economic pressures that led to the breakdown of the partnership form of organization for securities firms also led to the demutualization and public company status of the NYSE. The NYSE incorporated in 1971, although the SEC was concerned that this step would impair the effectiveness of the exchange as a self-regulatory organization (SRO).[274] Nevertheless, the exchange continued to operate as a mutual organization for the benefit of its members until 2003, when scandals involving the chairman of the exchange and stock exchange specialists led to a board reorganization that positioned the exchange for a public offering.[275]

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[271] *Id.* at 5.

[272] *Id.* at 31–32.

[273] *See, e.g.*, BACHE & CO., INC., PROSPECTUS FOR 2,500,000 SHARES OF COMMON STOCK 3–4, 8–9 (1971); MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., PROSPECTUS FOR 4,000,000 SHARES OF COMMON STOCK 4, 10–11 (1971).

[274] *See* Securities Exchange Act Release No. 9112, 1971 SEC LEXIS 98 (Mar. 17, 1971) (reporting how the commission asked for consideration regarding the potential conflict between limiting liability for members and still being an effective self-regulatory organization).

[275] *See* Roberta S. Karmel, *Should Securities Industry Self-Regulatory Organizations Be Considered Government Agencies?*, 14 STAN. J.L. BUS. & FIN. 151, 164–65 (2008) (noting how scandals involving the chairman and CEO of the NYSE led to doubts about its self-regulatory capacities and long-term viability).

The exchange then went public through a reverse merger with Archipelago Holdings, Inc., thus sidestepping long negotiations with the SEC with respect to a public offering that the NASD went through.[276] This suited powerful members of the securities industry, which had invested large sums in electronic trading networks and wished to break up the NYSE's quasi-monopoly on trading listed securities.[277]

As a result of the incorporation and public offerings of NYSE member firms and the NYSE itself, the securities industry has expanded and become part of the banking industry. Although this has enabled U.S. firms to compete with foreign universal banks, there is a serious question as to whether this growth has been beneficial to the capital markets. The financial meltdown of 2008 and the resulting reduction in the number of large U.S. banks that are players in the global markets may be the end game in the restructuring of the securities industry that began with the transformation of securities firms from partnerships to giant too-big-to-fail banks. Similarly, the fragmentation of the securities markets into fifty or more trading venues[278] is the result of the destruction of the NYSE specialist system, which operated as a mutual company. Although these developments can be looked upon as the creative destruction of a capitalist system, many wonder whether the giant banks should be broken up, and also whether new regulation for the trading markets is necessary to alleviate the occurrence of "flash crashes."[279]

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[276] *Id.* at 165.

[277] *See id.* at 167–68 ("some small broker-dealers who were not NYSE members brought a lawsuit alleging that their interests had been overrun by the large NYSE member firms.").

[278] *See* Rachelle Younglai & Jonathan Spicer, *U.S. Probes Trading Practices in Fragmented Markets*, REUTERS (Dec. 8, 2010, 7:04 PM)), http://www.reuters.com/article/2010/12/09/us-financial-regulation-markets-idUSTRE6B714820101209 (reporting that a congressional hearing listed "lack of surveillance" of these entities as a problem to address to avoid a future "flash crash").

[279] *Id. See also, e.g.*, Sebastian Mallaby, *Breaking Up the Banks Will Win Investors' Approval*, FIN. TIMES, July 18, 2012, at 9 ("If regulators want a 'reasonable' policy that will be accepted by the equity market, they should break up the giant banks."); *Sandy Weill Stages an Epic Conversion – Better to Restore Glass-Steagall Than a Weak Volcker Rule*, FIN. TIMES, July 27, 2012, at 8 ("Now all of a sudden Sandy Weill, . . . a driving force behind the abolition of the Glass-Steagall act, is calling for a return to status quo ante."). *But see* Art Johnson, *Proposals to Break Up Big Banks Threaten All Banks*, AM. BANKER (Aug. 1, 2012, 11:15 AM), http://www.

It is important to note that the securities industry is no longer self-regulated, except with regard to the regulatory oversight of brokerage firms by FINRA.[280] This regulation primarily relates to responsibilities of broker-dealers to their customers. The NYSE is no longer a significant regulator, since it transferred most of its regulatory responsibilities to FINRA, and the largest securities firms became bank holding companies during the 2008 financial crisis and are now regulated primarily by the Federal Reserve Board.

5. THE FUTURE OF LAW FIRMS

The author has grave concerns about the present structure of the securities industry and the capital markets,[281] and is not advocating that law firms traverse a similar path. Endless expansion in response to decreased profitability of core businesses is not necessarily a public benefit. Nevertheless, if Big Law begins to feel competitive pressures to reduce rates and costs and at the same time to expand, and it needs capital in order to do so, it is likely that the ethics rules preventing nonlawyer ownership of firms will erode. It is also possible that smaller firms or innovative organizations trying to serve low-income clients could upend Rule 5.4.[282] Until now, law firms have financed growth and operations through capital investments by their partners and loans from banks and other sources. But these sources of funding require

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americanbanker.com/bankthink/proposals-to-break-up-big-banks-threaten-all-banks-1051477-1.html ("[A]n attempt to break up the large banks would hurt each and every one of us."); Steven Rattner, *Regulate, Don't Split Up, Huge Banks*, N.Y. TIMES (July 31, 2012), http://www.nytimes.com/2012/08/01/opinion/sanford-weills-glass-steagall-distraction.html?_r=0 ("Good management will always be more effective in avoiding bad outcomes than legislation . . . .").

[280] Roberta Karmel, *Should Securities Industry Self-Regulatory Organizations Be Considered Government Agencies?*, 14 Stan. J. L. Bus. & Fin. 151 (2008).

[281] *See generally* Roberta S. Karmel, *Is the Public Utility Holding Company Act a Model for Breaking Up the Banks That Are Too-Big-To-Fail?*, 62 HASTINGS L.J. 821 (2011).

[282] *See* Janson v. LegalZoom.com, Inc., 802 F. Supp. 2d 1053 (W.D. Mo. 2011) (adjudicating a class action lawsuit for unauthorized practice of law against LegalZoom, a small business that produced legal documents for customers who filled out the forms themselves via an online portal). Although LegalZoom was held to be engaged in the unauthorized practice of law by providing legal documents over the Internet for do-it-yourself clients, and then editing them, providing the legal documents was held not to be practicing law. *Id.*

large outlays. Greenberg Traurig recently made a capital call on its partners for $24 million.[283] Dewey & LeBoeuf was bankrupted by its large bank loans, and it was not the first law firm to find itself in such a difficult situation.[284] Firms that distribute 100% of their profits rather than holding back partnership capital for investment can face the same pressures that caused Dewey to collapse.[285]

Like the securities firms of the 1960s and 1970s, law firms have discovered that some of the legal work previously done by associates can either be consigned to computers or outsourced to less expensive lawyers. Though it is unlikely that computers will be able to argue cases before a jury, they are doing much of the discovery work previously done by humans. If technology becomes more important in the provision of legal services, and requires large capital outlays by firms, or if law firms become capital hungry for other reasons, law firms may well follow the path of investment banking firms and give up the advantages of the partnership form. Furthermore, is a law firm of 1,000 partners really an old fashioned general partnership or it simply a big business in partnership form?[286] Because of the LLP form of professional organization, not all partners are even liable any longer for the debts or malpractice of their putative partners. Neither are they paid in lock step arrangements. These firms are corporations in all but name, with centralized management and hierarchical arrangements. Some law firms would undoubtedly benefit from professional business management by nonlawyers.

My thesis is that sooner or later law firms will be allowed to raise equity capital, and the bar should prepare for this eventuality instead of denying it is a possibility. This could happen as the result of one state deciding that it will facilitate such a process,

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[283] Debra Cassens Weiss, *Greenberg Traurig Asks Partners to Pony Up More Cash in $24M Capital Call*, ABA J. (Aug. 8, 2012, 6:19 AM), http://www.abajournal.com/news/article/greenberg_traurig_asks_partners_to_pony_up_more_cash_in_24m_capital_call.

[284] Rich Smith, *How Dewey & LeBoeuf Became the Biggest Law Firm Bankruptcy Ever*, DAILY FIN. (June 15, 2012, 10:37 AM), http://www.dailyfinance.com/2012/06/15/a-bankruptcy-you-might-applaud-bye-bye-dewey-and-leboeuf/.

[285] Paul Lippe, *Is Your Firm Playing 'Dewey Roulette'?*, ABA J. (Aug. 15, 2012, 1:52 PM), http://www.abajournal.com/legalrebels/article/dewey_roulette/.

[286] *Cf.* Hishon v. King & Spalding, 467 U.S. 69, 73, 78–79 (1984) (reversing both district court and appellate court judgments to conclude that Title VII applies to the selection of candidates to a law firm partnership).

through legislation or action of the judiciary, or the Supreme Court or a state high court holding that current rules of legal ethics are uncompetitive or unconstitutional. Alternatively, the Department of Justice or the Federal Trade Commission could instigate action to revoke anti-competitive ABA rules.[287] Should this happen, self-regulation will be affected, as it was in the securities industry when investment firms and exchanges went public[288] and in England when ethical rules were changed to permit equity investments in law firms. Lawyers are already not entirely self-regulated, as some government oversight by the SEC was imposed by Sarbanes-Oxley.[289] Further, certain earmarks of lawyer professionalism, particularly independence and the duty of confidentiality, would need to be safeguarded or they could be lost. Considering how to preserve these values in the face of dynamic and changing business models for law firms is a large task that was initially embarked upon, but not completed, by the ABA Ethics Commission. Sooner or later, however, the legal profession will need to confront how to preserve its core values in the face of global competition and economic and technological challenges that may well lead to the need to raise capital from nonlawyers.

[287] In 1987, the FTC argued that rules limiting lawyers and nonlawyers to join the same firm were incompatible with antitrust policy and sent letters urging courts and bar committees to change their rules. *See* Andrews, *supra* note 58, at 620 ("[T]he FTC has taken the position that the lawyer ethics rules prohibiting lawyers from forming legal services firms with nonlawyers should be abolished.").

[288] *See* Karmel, *supra* note 275, at 159–60, 196–97 (detailing that in response to certain financial climate changes, the SEC has increased greater power over SROs).

[289] 17 C.F.R. §§ 201.100–205.7 (1995).