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## Rethinking the Law Firm Organizational Form and Capitalization Structure

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# Rethinking the Law Firm Organizational Form and Capitalization Structure

Edward S. Adams\*

## I. INTRODUCTION

The recent bankruptcy of large law firms has energized the debate over the viability of the traditional partnership model. Dewey & LeBoeuf filed for bankruptcy in May 2012, becoming the largest law firm bankruptcy in U.S. history.<sup>1</sup> At its peak, Dewey employed 1,400 lawyers in several offices across the globe, causing some to ask whether Dewey's collapse was an isolated product of poor management or a symptom of greater systemic problems.<sup>2</sup> But Dewey's bankruptcy was not the first to result in the dissolution of a large firm. The financial downturn of 2008 deeply affected the legal profession, and several firms went under.<sup>3</sup>

Many have already questioned the traditional business structure of the law firm in light of these bankruptcies and the manner in which they occurred.<sup>4</sup> Partner defections and limited capital place criticism squarely on the partnership model as a major factor in these bankruptcies.<sup>5</sup> Movements in Australia and the United Kingdom to liberalize law firm business structures and allow for both outside equity and multidisciplinary practices (MDPs) further fuel the criticism here in the United States.<sup>6</sup> The American Bar Association (ABA) Model Rules of Professional Conduct (Model Rules) have long prohibited public ownership and MDPs in law firms over concerns that such arrangements would encourage violations of the professional rules.<sup>7</sup>

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1. Peter Lattman, *Dewey & LeBoeuf Files for Bankruptcy*, N.Y. TIMES DEALBOOK (May 28, 2012, 10:21 PM), <http://dealbook.nytimes.com/2012/05/28/dewey-leboeuf-files-for-bankruptcy/>.

2. *Id.*

3. Examples include two San Francisco firms, Thelen and Heller Ehrman, and Howrey out of Washington. *Id.*

4. Michael Bobelian, *Dewey's Downfall Exposes the Demise of Partnerships*, FORBES (June 7, 2012, 10:49 AM), <http://www.forbes.com/sites/michaelbobelian/2012/06/07/deweys-downfall-exposes-the-demise-of-partnerships/>; *Report: New York State Bar Association: Report of the Task Force on Nonlawyer Ownership*, 76 ALB. L. REV. 865, 947 (2012-2013).

5. See Lattman, *supra* note 1.

6. See *infra* Part IV.A.

7. See MODEL RULES OF PROF'L CONDUCT R. 5.4 (2012); Paul D. Paton, *Multidisciplinary Practice Redux: Globalization, Core Values, and Reviving the MDP*

The goal of this Article is to examine the partnership model and advocate for a change in the Model Rules that would allow for public ownership of law firms, and to make disclosure of firm financials a mandatory requirement for all firms with over 100 lawyers. Part II explores the history and evolution of limited liability and law firm structures in the United States. Part III discusses incorporated law firms and MDPs and how they might benefit U.S. law firms. Part IV looks at the developments in the United Kingdom and Australia and the forces of globalization that have an effect on U.S. policy choices, concluding that global competition for legal services may force our hand. Part V advocates for similar changes in the U.S. public ownership because allowing public ownership in law firms will benefit both law firms and their clients and make firms more competitive globally. This Part concludes by advocating for mandatory disclosure requirements to benefit firms, prospective attorneys, and their clients.

## II. THE EVOLUTION OF LIMITED LIABILITY AND LAW FIRM STRUCTURES

The formation and governance of business entities is regulated by state law.<sup>8</sup> Each state has a history of corporate and partnership regulation, and in recent decades new hybrid forms of business entities have evolved to fill the needs that corporate and partnership laws alone do not adequately address.<sup>9</sup> Law firms have been adopting the new business models made available by state statutes.<sup>10</sup> Most notably, law firms have begun taking

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*Debate in America*, 78 *FORDHAM L. REV.* 2193, 2193-94 (2010); John Eligon, *Selling Pieces of Law Firms to Investors*, *N.Y. TIMES*, Oct. 29, 2011, at B1, available at <http://www.nytimes.com/2011/10/29/business/selling-pieces-of-law-firms-to-investors.html?pagewanted=all>; Sara Randazzo, *ABA Panel Says No to Outside Law Firm Ownership*, *AM. LAW. DAILY* (Dec. 5, 2011, 7:05 PM), available at LexisNexis.

8. See J.W. Verret, *Terrorism Finance, Business Associations, and the "Incorporation Transparency Act,"* 70 *LA. L. REV.* 857, 857 (2010) ("The process by which these entities are created has traditionally been governed under state law.").

9. See Robert A. Kessler, *With Limited Liability For All: Why Not a Partnership Corporation?*, 36 *FORDHAM L. REV.* 235, 252 (1967); Christel Walther, *LLC and Lawyers: A Good Combination?*, 50 *LOY. L. REV.* 359, 406 (2004); see also J. William Callison & Allan W. Vestal, "They've Created a Lamb With Mandibles of Death": *Secrecy, Disclosure, and Fiduciary Duties in Limited Liability Firms*, 76 *IND. L.J.* 271, 271-74 (2001) (discussing popular acceptance of reform efforts for business organizations); Thomas E. Rutledge, *The Alphabet Soup of Unincorporated Business Law: What is Happening with LLCs, LPs, LLPs, GPs, LLLPs, & BTs and Dealing with RUPA, RERULPA, (RE)ULLCA, UNETA, MITA, & META*, *VML0202 ALI-ABA 1* (Feb. 2006) (exploring the various disparate forms of modern business organization within the legal context).

10. See Callison & Vestal, *supra* note 9, at 273-74.

advantage of limited liability.<sup>11</sup> While the evolution to limited liability within law firms has been a huge transformation, states have not yet enabled law firms to utilize other business forms that would allow them to have both limited liability and the ability to manage capital accounts and cash flow in a way that would leave firms less vulnerable to the exit of a partner or broader outside economic influences.

*A. The Evolution of State Partnership Laws and Their Effect on Law Firm Structures*

General Partnership (GP) law was originally codified in 1914<sup>12</sup> and became the standard business form used by law firms.<sup>13</sup> The most attractive characteristic of the GP is the pass-through taxation of firm income, in which partnership profits are not subject to an entity-level tax but rather are taxed as personal income only when the partners receive a profit distribution.<sup>14</sup> More and more firms, however, have foregone the traditional GP form to instead partake in attractive limited liability entities such as limited liability companies (LLC) and limited liability partnerships (LLP).<sup>15</sup> Whereas in a GP each partner is exposed to “unlimited[] personal[] liab[ility] for both the misconduct of his or her partners, as well as any debts of the partnership to the extent that either exceed the assets of the partnership,”<sup>16</sup> in the LLC or LLP entities the respective member or partner (collectively “member”) can at a minimum limit their personal liability to their own torts and thus remove any personal liability for the torts of other members.<sup>17</sup>

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11. See Carol R. Goforth, *Limiting the Liability of General Partners in LLPs: An Analysis of Statutory Alternatives*, 75 OR. L. REV. 1139, 1140-43 (1996) [hereinafter Goforth, *Limiting the Liability*] (stating that the introduction of limited liability to professional service providers, such as law firms, relieves partners from the burden of unlimited personal liability under the general partnership model). Partners previously had been personally liable “for any loss or injury arising out of ‘any wrongful act or omission of any partner acting in the ordinary course of partnership business or with the authority of the co-partners.’” *Id.* at 1222 n.1 (quoting Unif. P’ship Act § 13 (1994), 6 U.L.A. 444 (1995)).

12. See *id.* at 1158.

13. See Martin C. McWilliams, Jr., *Limited Liability Law Practice*, 49 S.C. L. REV. 359, 361 (1998).

14. See 26 U.S.C. § 701 (2011).

15. See Joseph S. Naylor, *Is the Limited Liability Partnership Now the Entity of Choice for Delaware Law Firms?*, 24 DEL. J. CORP. L. 145, 148-56 (1999) (arguing that the Professional Corporation model is an outdated method of providing limited liability and associating the 1981 legislation on tax that provided partnerships with the same tax incentives as those available to corporations).

16. *Id.* at 147-48.

17. See *id.* at 152-53.

The LLC entity was first introduced in Wyoming in 1977.<sup>18</sup> Florida was the only other state to enact an LLC statute until the Internal Revenue Service (IRS) explicitly acknowledged that LLCs would be recognized as partnerships.<sup>19</sup> After the IRS made this acknowledgement, many states quickly jumped on the limited liability bandwagon hoping to lure new business into the state to take advantage of corporate tax revenues, as well as investment capital.<sup>20</sup> By 1995, all but three states had enacted LLC statutes.<sup>21</sup> One of the primary disadvantages of LLCs is that the formation of an LLC, depending on the state, essentially requires the creation of a new business entity.<sup>22</sup> LLCs are at a disadvantage because this business form has not been fully tested in courts, meaning that potential complications that could arise under securities and tax laws have not been fully explored.<sup>23</sup>

Although they are more recent additions in the land of hybrid business forms, LLPs have quickly grown in popularity, becoming more attractive to law firms than the LLC form.<sup>24</sup> LLPs first emerged as a new business form in Texas in 1991 and initially limited a partner's vicarious liability only to malpractice claims resulting from actions (or omissions) of other partners.<sup>25</sup> The

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18. See Susan Saab Fortney, *Seeking Shelter in the Minefield of Unintended Consequences – the Traps of Limited Liability Law Firms*, 54 WASH. & LEE L. REV. 717, 722 (1997) [hereinafter Fortney, *Seeking Shelter*] (noting that the new legislation was proposed and enacted for the purpose of allowing business entities to offer limited liability to all equity participants while avoiding double taxation).

19. See Carol R. Goforth, *The Rise of the Limited Liability Company: Evidence of a Race Between the States, but Heading Where?* 45 SYRACUSE L. REV. 1193, 1222 n.134 (1995) [hereinafter Goforth, *The Rise of the Limited Liability Company*] (stating that Rev. Rul. 88-76 was announced following years of confusion about how LLCs would be treated by the IRS).

20. See Fortney, *Seeking Shelter*, *supra* note 18, at 722-24 (explaining that attorneys and accountants viewed the LLC form as the “best of both worlds” and assisted business groups in lobbying to their respective state legislatures, having the result that many states implicitly welcomed professionals to practice as LLCs by statutory grant that LLCs may be created for “any lawful purpose”).

21. See Goforth, *The Rise of the Limited Liability Company*, *supra* note 19, at 1250 (“As of the start of 1995, only Hawaii, Vermont and Massachusetts lacked LLC legislation, and bills regarding the new form of entity were pending in all three states.”).

22. See Naylor, *supra* note 15, at 151.

23. See Goforth, *Limiting the Liability*, *supra* note 11, at 1152 (stating the lack of clarity as to which corporate and partnership doctrines will apply to LLCs and how the law will treat LLCs in general).

24. A 1995 survey of Texas law firms shows that the LLP form had been adopted by a majority of large firms. See Susan Saab Fortney, *Are Law Firm Partners Islands unto Themselves? An Empirical Study of Law Firm Peer Review and Culture*, 10 GEO. J. LEGAL ETHICS 271, 280 (1997).

25. TEX. BUS. ORGS. CODE ANN. § 152.801 (West 2011) (originally TEX. REV. CIV. STAT. ANN. art. 6132b, § 15 (West Supp. 1992)); see Fortney, *Seeking Shelter*, *supra* note 18, at 724 (noting that while Texas led the way for LLP formation, it was

LLP structure appeals to professional partnerships, such as law firms, for a variety of reasons: (1) the firms can continue to function as they did before with the added benefit of limited liability as to both tort and contract claims; (2) unlike LLCs, the LLP form does not require partnerships to create an entirely new type of business entity; and (3) the LLP form allows for the continued tradition of professionals holding themselves out as “partners” (rather than as “members”).<sup>26</sup> Within a year of the emergence of the LLP structure, the IRS issued an important ruling confirming that LLPs would continue to be taxed as partnerships, allowing the continued use of pass-through taxation.<sup>27</sup> Within six years, LLP legislation exploded across the United States and many states expanded limited liability to “full shield” protection, providing for limited personal liability for both tort and contract claims.<sup>28</sup> This type of full shield protection is necessary in large firms where not every partner can ensure the accountability of everyone else.<sup>29</sup> This race among states to attract more revenue was to the benefit of business and professional firms, not necessarily the clients whose ability to pursue individual partners or lawyers for malpractice or malfeasance was thereby diminished.<sup>30</sup>

LLP formation is simple. Most states have a filing requirement to put the public and the state on notice that the firm desires to conduct business

not without criticisms of the new form, with labels such as “help-a-lawyer-bill” and concerns about the lack of a limited liability signal to third parties).

After partnership expert Professor Alan R. Bromberg criticized the bill, legislators asked him to propose amendments. Professor Bromberg’s revisions addressed objections to the bill by:

- (1) Extending the liability limitation to all partnerships,
- (2) Denying protection to partners for misconduct of those working under their supervision or direction,
- (3) Requiring annual registration with the state and inclusion of “L.L.P.” or “registered limited liability partnership,” in the firm name, and
- (4) Requiring liability insurance in an arbitrary and admittedly often inadequate amount of \$100,000.

See *id.* at 725 (footnotes omitted).

26. Fortney, *Seeking Shelter*, *supra* note 18, at 725-26; see Naylor, *supra* note 15, at 155.

27. I.R.S. Priv. Ltr. Rul. 92-29-016 (July 17, 1992) (“[The] L.L.P. will be classified as a partnership for federal tax purposes.”).

28. See, e.g., BUS. ORGS. § 152.801(a) (“[A] partner is not personally liable to any person, including a partner, directly or indirectly, by contribution, indemnity, or otherwise, for any obligation of the partnership incurred while the partnership is a limited liability partnership.”). Subsection (a) does not, however, affect “the liability of a partner, if any, imposed by law or contract independently of the partner’s status as a partner.” *Id.* § 152.801(d)(2).

29. See Goforth, *Limiting the Liability*, *supra* note 11, at 1159; see also Milton C. Regan, Jr., *Lawyers, Symbols, and Money: Outside Investment in Law Firms*, 27 PENN ST. INT’L L. REV. 407, 423 (2008).

30. See Goforth, *The Rise of the Limited Liability Company*, *supra* note 19, at 1288.

under the shield of limited liability.<sup>31</sup> The extent of protection from liabilities varies greatly between jurisdictions.<sup>32</sup> In general, an LLP partner has partially limited liability for the negligence, wrongful acts, and other misconduct of other partners.<sup>33</sup> In an increasing number of jurisdictions, partners have no personal liability for any partnership debt (unless sophisticated creditors contract around it, of course).<sup>34</sup>

Since LLPs are an extension of GPs, they are still based upon the classic structure wherein the partners are co-owners of the firm, sharing in the firm's profits, losses and risks.<sup>35</sup> Additionally, LLP partners may participate in management while maintaining their limited-liability shield.<sup>36</sup> LLPs are also financed through capital contributions from the partners, just like in the traditional GP.<sup>37</sup> These contributions are put into capital accounts and historically have made up a large percentage of a firm's assets.<sup>38</sup> Despite the fact that individual partners' liability is limited, the LLP is still fully liable for any claims against the entity; as a result, all the partnership assets – such

31. See Goforth, *Limiting the Liability*, *supra* note 11, at 1145.

32. *Id.* at 1147.

33. *Id.* at 1148. Some states impose liability on partners if the wrongdoer was under the partner's direct supervision and control. James D. Cox & Thomas L. Hazen, 1 TREATISE ON THE LAW OF CORPORATIONS § 1:7 (3d ed. 2010).

34. Cox & Hazen, *supra* note 33, at § 1:7 (“The most recent version of the Revised Uniform Partnership Act . . . provide[s] for the same type of limited liability that exists with corporations—the partners are not liable for either the tort or contract obligations of the partnership or of the other partners. Since a full liability shield can be achieved through a limited liability company, it makes little if any sense to deny this option to limited liability partnerships. It follows that an increasing number of states have adopted the full liability shield for limited liability partnerships.”).

35. See Unif. P’ship Act § 6(1) (1914), 6 U.L.A. 256 (1995); Unif. P’ship Act § 101(6) (1997), 6 U.L.A. 27 (Supp. 1998).

36. Kristin Balding Gutting, *Keeping Pace with the Times: Exploring the Meaning of Limited Partner for Purposes of the Internal Revenue Code*, 60 U. KAN. L. REV. 89, 116 (2011).

37. See Kelly L. Jones, *Law Firms as Limited Liability Partnerships: Determining the Scope of the Liability Shield: A Shield of Steel or Silk?*, 7 DUQ. BUS. L.J. 21, 29 (2005) (noting that although generally capital contribution is in the form of direct financial infusion from the partners, more often firms are leveraging debt obtained from banks); 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, 518 (2009) (“Law firms became increasingly dependent on bank financing for working capital.”); *c.f.* Tina Williams, *Partnerships: Prudent Lenders*, LEGAL WEEK (Aug. 4, 2009, 9:28 AM), <http://www.legalweek.com/legal-week/analysis/1496256/partnerships-prudent-lenders> (noting that firms’ reliance on bank financing contributed to lax management of finances, including debt collection from clients).

38. See Jones, *supra* note 37, at 29.

as the funds within the capital account – remain at risk in connection with any such liability.<sup>39</sup>

### *B. Law Firm Capital Accounts and the Struggle for Viability Through a Partnership*

Law firm capital accounts hold the firm's working capital.<sup>40</sup> An increasing number of firms have attempted to maximize earnings per partner (the frequently-used metric for law firm profitability) by limiting the number of equity partners in the firm.<sup>41</sup> This has created a two-tiered system of "partner" titles in the firm: the first-tier "rainmakers," who are the highly-coveted equity partners who bring in and maintain clients,<sup>42</sup> and the second-tier non-equity partners. If, or when, the rainmakers leave, they can take their clients with them, and – even more perilous to the company – withdraw their capital contributions.<sup>43</sup> Such an exodus of capital and the partner's associated cash flow, as well as the related problem of the firm sometimes replacing that missing capital by excessive leveraging, has resulted in an astounding number of law firms collapsing.<sup>44</sup>

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39. Edward S. Adams & John H. Matheson, *Law Firms on the Big Board?: A Proposal for Nonlawyer Investment in Law Firms*, 86 CALIF. L. REV. 1, 28 (1998).

40. *See, e.g.*, Unif. P'ship Act §18 (1914), Unif. P'ship Act § 401(a) (1997) (remaining the same in the Revised Uniform Partnership Act).

41. *See Cox, supra* note 37, at 519 ("Many firms have established a second class of nonequity partners who are paid a salary instead of sharing in the firm's profits in order to increase the appearance of high profitability.").

42. *See id.* It is imperative to keep these partners happy and to distribute a satisfactory amount of profits, sometimes leaving little left in reserve for the firm. *Id.* The ever-imminent threat is ABA Model Rule 5.6 (prohibiting enforcement of noncompete agreements of lawyers), making it so these partners can leave whenever they want, and bring their clientele with them. *See* MODEL RULES OF PROF'L CONDUCT R. 5.6(a) (2012).

43. The most common triggering events of law firm collapse include: (1) rapid overexpansion; (2) unexpected loss of significant partners to other firms; (3) breakdown in merger process of financially-distressed firm; or (4) impending expiration or renewal of law firm office lease. Hildebrandt International, *The Anatomy of Law Firm Failures*, J. LAW SOC. SCOT. (Dec. 15, 2008), <http://www.journalonline.co.uk/Magazine/53-12/1005996.aspx#.Ubf8XJxrp2F>.

44. *See Cox, supra* note 37, at 522 (discussing the Hildebrandt International study on the causes behind the recent law firm collapses, noting that financial health was a primary factor); *see also* Melissa Hogan, *Skinny Dipping: The Anatomy of Law Firm Demise*, ED WESEMANN (Jan. 28, 2010), <http://edwesemann.com/articles/general/2010/01/28/skinny-dipping-the-anatomy-of-law-firm-demise/> (putting significant emphasis on partner defections, the effect that has on finances of the firm, and the lack of a contingency plan to circumvent major structural issues in the event of such defection).



*C. LLP Statutes Have Provided Law Firms with the Most Beneficial Structure Yet, but Are Not Without Limitations and Problems*

Three main issues limit the attractiveness of LLPs: (1) the uncertainty of vicarious liability,<sup>45</sup> (2) the lack of incentive for firms to invest in their associates for fear that they will gain knowledge and then leave for a “better” job,<sup>46</sup> and (3) the ethics mandate preventing non-lawyer ownership.<sup>47</sup>

Over the last forty years, firms have created a myriad of hybrid structures in an effort to balance the encouragement of innovation and entrepreneurship with the realities of business owners’ liabilities to co-owners, employees, and third parties. Law firms have changed with time, adapting to the most efficient business form currently available: the LLP. Yet this form, like the forms that came before it, is not necessarily the right choice for every firm. The LLP structure is still difficult for firms to utilize because of significant differences in laws between states,<sup>48</sup> wariness of court treatment of LLPs in litigation,<sup>49</sup> and the ever-present mandate against non-lawyer investment.<sup>50</sup>

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45. See Robert W. Hillman, *The Impact of Partnership Law on the Legal Profession*, 67 *FORDHAM L. REV.* 393, 407-08 (1998) (“[A] form of limited vicarious liability survives even in LLPs because assets of the partnership are available to satisfy claims against individual partners. When these assets are reached, the non-lie partners effectively have nonrecourse liability for even ‘fully shielded’ obligations.”).

46. See *id.* at 409 (“Interestingly, the sudden emergence of limited liability for lawyers has occurred during a time when other, unrelated forces also are working to reduce incentives for firms to monitor and train. The ‘revolving door’ feature of many law firms, client loyalties running to the lawyer rather than the firm, clear incentives to hoard rather than to share clients, allocations of income based on individual rather than group productivity, the proliferation of satellite offices, and relentless pressures to reduce the costs of providing legal services are among the factors undermining firm investment in establishing and maintaining monitoring and mentoring mechanisms. As these trends merge with the narrowing of civil liability vicariously imposed, it is possible that firms will commit fewer resources to monitoring and mentoring activities.”).

47. MODEL RULES OF PROF’L CONDUCT R. 5.4 (2012).

48. “First Generation” statutes protect partners from malpractice claims resulting from a partner’s negligence or malfeasance while leaving LLP partners jointly (or jointly and severally) liable for other partnership liabilities, debts and obligations. J. WILLIAM CALLISON AND MAUREEN A. SULLIVAN, *PARTNERSHIP LAW & PRACTICE* § 32:3 (2011). “Second Generation” statutes generally state that partners bear no personal liability for any partnership obligations or liabilities arising from the malpractice of a co-partner or other person not under the partner’s supervision or control. *Id.* “Third Generation” statutes try to alleviate problems of the former version by providing that partners with “full protection” from vicarious liability. *Id.*

49. See *supra* note 23 and accompanying text.

50. See *supra* note 47 and accompanying text.

### III. ENTERING THE ERA OF LAW FIRM, INC. AND MULTIDISCIPLINARY PRACTICES

Currently, Model Rule 5.4 explicitly prohibits MDP arrangements, fee sharing agreements among non-lawyers, law firm leadership by non-lawyers, and law firm incorporation.<sup>51</sup> This Rule seeks to protect the lawyer's "professional independent judgment,"<sup>52</sup> but it does so by putting a broad prohibition on the structure of law firms, rather than on the behavior or conduct of lawyers.<sup>53</sup> Despite this Rule, law firm structures have been creeping towards incorporation; firms are increasingly functioning as businesses and no longer fall under the "one size fits all" category that existed in the early 1900s.<sup>54</sup> A myriad of scholars and commentators argue that Rule 5.4 is outdated.<sup>55</sup> Many states have contemplated changes, and some have even implemented such changes, allowing law firms to take advantage of alternative business structures – with limitations.<sup>56</sup> Providing firms with the option to incorporate or engage in MDPs as alternatives to the various partnership forms could enable

51. MODEL RULES OF PROF'L CONDUCT R. 5.4 (2012); see Brian MacEwen et al., *Law Firm, Ethics, and Equity Capital*, 21 GEO. J. LEGAL ETHICS 61, 62-63 (2008).

52. MODEL RULES OF PROF'L CONDUCT R. 5.4 cmt.1 (2012).

53. MacEwen et al., *supra* note 51, at 63.

54. See Chandler N. Hodge, *Law Firms in the U.S.: To Go Public or Not to Go Public?*, 34 U. DAYTON L. REV. 79, 79 (2008). Compare *id.* at 86-87 (labeling the ABA's resistance as a "ABA's medieval guild mentality" which has created an inefficient cartel in the practice of law and engaged in regulatory capture of the legal industry which represents 2% of U.S. GDP), and MacEwen et al., *supra* note 51, at 62 ("Firms have grown substantially, with many containing more than one thousand lawyers."), with Adams & Matheson, *supra* note 39, at 23 (noting that critics believe that changing the law firm model will denigrate the legal profession, as the firm will focus on ways to enhance shareholder value at the expense of the client's best interest).

55. See Adams & Matheson, *supra* note 39, at 1 (stating that this prohibition on investment in law firms has created an inefficient legal services market because firms are unable to expand, compete, and spend funds on equipment and personnel).

56. See Justin D. Petzold, *Firm Offers: Are Publicly Traded Law Firms Abroad Indicative of the Future of the United States Legal Sector?*, 2009 WIS. L. REV. 67, 91-92 (2009) (noting that North Dakota allowed investment in law firms briefly, but the law was quickly struck down by the state supreme court); Daniel Fisher, *North Carolina Bill Would Let Non-Lawyers Invest in Law Firms*, FORBES (Mar. 11, 2011, 8:22 AM), <http://www.forbes.com/sites/danielfisher/2011/03/11/north-carolina-bill-would-let-non-lawyers-invest-in-law-firms/> (announcing that North Carolina has a bill right now that would allow non-lawyer investment, up to 49% non-lawyer ownership); Lise Bang-Jensen, *New York State Bar Association Studies Law Firm Ownership by Nonlawyers*, N.Y. ST. B. ASS'N (Feb. 2, 2012), <http://www.nysba.org/CustomTemplates/Content.aspx?id=26964> (stating that a New York State Bar Association task force will study whether nonlawyers should be allowed to own equity in law firms).

outside investors to infuse much needed capital into firms without jeopardizing ethical conduct.

### *A. Implications of Incorporation and Compliance with Ethical Requirements*

The Model Rules provide an explicit prohibition on law firm incorporation.<sup>57</sup> Model Rule 5.4(d) states that “a lawyer shall not practice with or in the form of a professional corporation . . . if: (1) a nonlawyer owns any interest therein . . . (2) a nonlawyer is a corporate director or officer . . . or (3) a nonlawyer has the right to direct or control the professional judgment of a lawyer.”<sup>58</sup> However, the adoption of this Rule in whole or in part is dependent upon the choice of each state’s bar association.<sup>59</sup>

The ABA strives to force a dichotomy between law firms and businesses. It is unclear whether this dichotomy exists outside of the Model Rules. Many legal academics question the continued existence of this split given its distortion of reality and diminishing application to the functioning of many law firms.<sup>60</sup> As law firms adopt characteristics more akin to those of corporate structures than those of traditional law firm partnerships,<sup>61</sup> a rule on lawyer behavior rather than law firm structure might more effectively target the intended protections of Rule 5.4.<sup>62</sup>

#### 1. How Law Firms Would Function Within a Corporate Structure

The managerial structure of corporations and LLPs differ markedly, creating tension with the ABA and the potential for abuse of independent professional judgment. Using Delaware General Corporate Law (DGCL) statutes as a guide,<sup>63</sup> there is sufficient flexibility in the default rules to allow a law

57. See Adams & Matheson, *supra* note 39, at 4.

58. MODEL RULES OF PROF’L CONDUCT R. 5.4 (2012).

59. See generally *Standing Committee on Ethics and Professional, A.B.A. CTR. FOR PROF. RESP.*, [http://www.americanbar.org/groups/professional\\_responsibility/committees\\_commissions/ethicsandprofessionalresponsibility.html](http://www.americanbar.org/groups/professional_responsibility/committees_commissions/ethicsandprofessionalresponsibility.html) (last visited Mar. 25, 2012) (explaining that the model rules are offered as a guide to states in creating ethical standards). Model rules are, by their name, voluntary – they are a model set forth by the private national association, which encourages each state’s public bar association to adopt similar rules. See Al Sturgeon, *The Truth Shall Set You Free: A Distinctively Christian Approach to Deception in the Negotiation Process*, 11 PEPP. DISP. RESOL. L.J. 395, 395 (2011).

60. See MacEwen et al., *supra* note 51, at 77, 86 (with one author proclaiming that not only is the dichotomy wrong, but it is perpetuating the wrong model for law firms).

61. See *id.* at 62 (“law firms more closely resemble their corporate clients”).

62. See *id.* at 63.

63. DEL. CODE ANN. tit. 8, § 101 *et seq.* (West, Westlaw through 79 Laws 2013).

firm to add provisions within the certificate of incorporation (certificate) and bylaws that achieve the same purpose as Rule 5.4 in preserving independent professional judgment.<sup>64</sup>

A board of directors centrally manages corporations.<sup>65</sup> Critics of law firm incorporation argue that, if firms were to adopt a similar management structure, this would provide non-lawyers with control over the direction of the firm.<sup>66</sup> However, DGCL § 141(a) gives the board of directors the exclusive authority to control the management of the corporation, and the law firm's certificate could expressly limit shareholder power.<sup>67</sup> In addition, a law firm's bylaws could allow shareholders to make recommendations to the board. Because state corporate law provides for the board of directors to make decisions on behalf of the corporation,<sup>68</sup> shareholders would have no direct influence over the professional judgment of any individual lawyer-employee.

Further, director and officer positions could be expressly limited in the certificate to be available only to lawyers within the firm.<sup>69</sup> While shareholders would be entitled to approve the board selection, the law firm would be able to maintain control over corporate decisions. The board of directors would function similar to the managing partners within the partnership structure. Essentially, shareholders would have very few rights of legal ownership as are present in traditional shareholding, and investing in law firms would be a practice in *caveat emptor*. Upon considering the structure of a law firm in corporate form, profit maximization will likely be realized by putting clients'

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64. The certificate of incorporation only requires the following: the name and address of the corporation, the nature of and purpose of the business, information on stock authorization, and the name and address of incorporators. *Id.* § 102. The bylaws may contain any provision so long as it is consistent with the certificate. *See id.* § 109. This means that the bylaws can structure a law firm to put client confidentiality in front of the duty of loyalty with regards to absolute disclosure, making it fall within the business judgment rule.

65. *See id.* § 141(a) (stating that business affairs of the corporation will be managed by the board).

66. *See* MacEwen et al., *supra* note 51, at 87.

67. *See* DEL. CODE ANN. tit. 8, § 102(b)(1) (allowing the articles to include a provision defining, limiting and regulating the powers of the corporation, the directors, and the stockholders), Hodge, *supra* note 54, at 84 (noting that Slater & Gordon in Australia successfully achieved this through including a provision in the prospectus that specified that the firms priority of duty was to the courts, clients, and then to the shareholders).

68. *See* DEL. CODE ANN. tit. 8, § 141(a).

69. *See id.* § 102(b)(1) (allowing the certificate of incorporation to include any provision for the management of the business and/or the conduct of the affairs of the corporation, and any provision creating, defining, limiting, and regulating the powers of the corporation, the directors, and the stockholders).

needs ahead of those of shareholders, as clients are the firm's profit centers.<sup>70</sup> If the success of firms abroad is indicative of shareholder willingness to invest,<sup>71</sup> there are likely shareholders willing to invest in U.S. law firms.

Firms could take any form within the spectrum of closely-held corporations to large publicly-traded firms.<sup>72</sup> If firms chose to be publicly traded, they could still maintain control over the board by only issuing a minority of shares to outside investors.<sup>73</sup> This available spectrum would enable law firms to adopt the business model that best suited its legal needs, allowing it to explore more cost-effective methods of providing legal services.<sup>74</sup> Incorporation is a very broad concept preoccupied with achieving efficiency,<sup>75</sup> but the corporate form could be tailored to suit the specific needs of a law firm and its ethical requirements. In addition, proponents of incorporation argue that the Model Rules – governing the actual conduct of lawyers – serve to adequately protect clients in the corporate model.<sup>76</sup>

## 2. Incorporation Would Provide Law Firms with a New Method of Generating Income

Firms have started to push back against the broad prohibition in Rule 5.4. *Jacoby & Meyers Law Offices, LLP* challenged the constitutionality of Rule 5.4 of New York's Rules of Professional Conduct, which is virtually identical to Model Rule 5.4, stating that the Rule is essentially unfounded and serves only to prevent the firm from accessing capital to continue to help

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70. See Jason Krause, *Selling Law on an Open Market*, A.B.A. J. (July 1, 2007, 5:52 PM CST), [http://www.abajournal.com/magazine/article/selling\\_law\\_on\\_an\\_open\\_market/](http://www.abajournal.com/magazine/article/selling_law_on_an_open_market/) (noting that it is counter to the firms' interest to put anyone ahead of the client as clients are the lifeblood of the firm).

71. See Petzold, *supra* note 56, at 68 (pointing to Slater and Gordon's profits exceeding expectations in its first year as a publicly traded firm).

72. See DEL. CODE ANN. tit. 8 § 342(a) (defining closely-held corporations as not exceeding thirty shareholders). The default rule on closely-held corporations is that the firm is not closely held unless explicitly stated in the certificate with a heading. See *id.* § 343.

73. See Hodge, *supra* note 54, at 94.

74. See Nathan Koppel, *Jacoby & Meyers' Newest Fight: Helping Nonlawyers Own Law Firms*, WALL ST. J. (May 19, 2011), <http://online.wsj.com/article/SB10001424052748703421204576331531008464712.html> (noting the complaint filed on May 18, 2011 states that "the small [legal] practice does not have access to the capital markets that the Wall Street [law] firms have.").

75. See Gillian Hadfield & Eric Talley, *On Public Versus Private Provision of Corporate Law*, 22 J.L. ECON. & ORG. 414, 415 (2006), available at <http://scholarship.law.berkeley.edu/facpubs/496/>.

76. See Hodge, *supra* note 54, at 80 (stating that proponents believe ABA rules on issues of conflict of interest, fraud, and malpractice adequately govern the conduct of lawyers).

those most in need of legal services.<sup>77</sup> They further stated that the firm's dedication to the highest level of independent professional judgment is not predicated on the firm's source of capital, making Rule 5.4 an unnecessary barrier to the law firm's growth and innovation.<sup>78</sup>

Many proponents of law firm incorporation have pointed to Model Rule 5.4 as stymieing innovation that could lead to more efficient structures.<sup>79</sup> Incorporation allows for outside investment to reach law firms, and this investment is clearly desired as many firms lack flexibility in funds that would otherwise allow them to innovate and invest capital in new recruits.<sup>80</sup> Proponents of incorporation argue that passive investment in law firms could actually encourage lawyer-employees to act in the best interest of the firm,<sup>81</sup> in response to critics who argue that incorporation will just financially benefit the lawyers.<sup>82</sup> It remains unclear why opponents argue that passive investment would change the level of financial risk assumed by law firms.<sup>83</sup> Share prices may increase and decrease depending on the perceived value of the firm, but the exit of a rainmaker will not leave the firm in a desperate state of financial shock, as it does in the current partnership structure. A law firm's assets are the mobile individuals it employs.<sup>84</sup> In theory, firm value would not depend only on the value of an individual rainmaker but also on the efficient structure of the firm.<sup>85</sup> The efficiency of a law firm could improve with increased investment in technology, knowledge management systems, and new lawyer training.<sup>86</sup> Although the corporate form also brings with it the double-taxation system, the up-front investment received from shareholders would arguably balance this out, enabling firms to take on risky cases or contingency-fee cases with high pay-off potential (that they otherwise could not afford).<sup>87</sup>

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77. See Amended Complaint for Declaratory and Injunctive Relief at ¶ 5, *Jacoby & Myers, LLP v. Presiding Justices of the 1st, 2d, 3d, & 4th Dep'ts, App. Div. of the Supreme Court of N.Y.*, No. CV-11-3387 (LAK) (S.D.N.Y. Nov. 23, 2011), 2011 WL 7102185; Koppel, *supra* note 74.

78. See Amended Complaint for Declaratory and Injunctive Relief, *supra* note 77, at ¶ 30.

79. See Hodge, *supra* note 54, at 92-93.

80. See *id.* at 92.

81. See MacEwen et al., *supra* note 51, at 88.

82. See STEPHEN A. LIND ET AL., *FUNDAMENTALS OF CORPORATE TAXATION* 133 (Robert C. Clark et al. eds., 7th ed. 2008).

83. See *id.* at 70 (raising the question in general).

84. See David M. Stern, *Law Firm Bankruptcies*, LITIGATION, J. ABA SEC. LITIG., Spring 2011, at 9.

85. See *id.*

86. See MacEwen et al., *supra* note 51, at 84.

87. See Hodge, *supra* note 54, at 92.

### 3. The Corporate Form Enhances Transparency Through Disclosure

Just as firms will have a wide spectrum of available options when choosing a new business form, there is also a spectrum of disclosure requirements. Partnerships are not required to disclose information about the firm, but closely-held corporations and public corporations, as issuers of securities, are subject to the Securities and Exchange Commission's (SEC) scrutiny.<sup>88</sup> Therefore, the corporate form enables greater transparency through mandatory disclosure.

Clients, lawyer-employees, and society can all greatly benefit from disclosure. Some commentators currently argue that partnerships need to adopt the corporate disclosure requirements regarding the corporate governance of law firms.<sup>89</sup> Employees would benefit from greater transparency within a law firm, regardless of the firm's form, as it would allow them to have a better understanding of the firm's policies prior to joining.<sup>90</sup> Finally, society can better hold law firms and legal professionals accountable if the business decisions of a law firm are transparent, reviewable, and susceptible to public scrutiny.<sup>91</sup> Thus, disclosure would enable clients to select law firms based on reported earnings, charitable giving, and other factors beyond simply reputation that may influence a client's decision to use a firm.

The share price of a firm would also provide associates with insight into whether or not to stay with the firm.<sup>92</sup> The LLP structure only allows lawyers to own a part of the firm when they "make partner," whereas upon incorporation a firm could quickly and easily align the interests of lawyer-employees by issuing them shares of the corporation.<sup>93</sup> Transparency within a law firm connects the lawyers, especially the new associates; even when the infor-

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88. There is no provision in RUPA that requires any form of disclosure to partners, customers, or other people involved in the organization. *See generally* Revised Uniform Partnership Act (1997).

89. *See* Rachel B. Grand, Note, "It's Only Disclosure": A Modest Proposal for Partnership Reform, 8 N.Y.U. J. LEGIS. & PUB POL'Y 389, 390 (2005).

90. *See id.* at 412. Grand argues for transparency to force firms to disclose hiring criteria for new hires, *id.*, but her idea could also serve new employees and employees currently within the firm.

91. *See id.* at 391.

92. *See* MacEwen et al., *supra* note 51, at 73-74; *see also* Grand, *supra* note 89, at 407 (stating that the SEC Rule 33-8340's "new disclosure requirements are intended to make more transparent to security holders the operation of the boards of directors of the companies in which they invest.").

93. *See* MacEwen et al., *supra* note 51, at 88 (aligning interest through the use of shares). This could also incentivize the associates to stay at the firm, increasing loyalty and fiduciary duties.

mation they receive is not necessarily positive, “transparency helps employees connect to the why.”<sup>94</sup>

Attaching a share price to corporate law firms and increasing financial transparency for those outside the firm will also change the manner in which firms are valued.<sup>95</sup> Public investors that would create the market for a law firm’s shares require detailed records of a company’s costs and debt levels that are currently unavailable for U.S. firms.<sup>96</sup> And as the United States confronts large-firm bankruptcies for the first time, real issues arise as to how to properly value firms, with damaging consequences for former partners.<sup>97</sup> Increasing transparency through disclosure will sharpen valuation methods. Both insiders and outsiders will have a greater sense of what a firm is worth, potentially reflected in a share price.

The benefit of transparency must be balanced with the confidentiality required in the attorney-client relationship.<sup>98</sup> There is a risk that clients may not feel as secure sharing sensitive information with a corporate lawyer-employee.<sup>99</sup> This concern may be exacerbated in the public corporate form. Not only will law firms be governed by state corporate law and state rules on professional conduct, but they will also be subject to SEC requirements.<sup>100</sup> The SEC requires disclosures in a Form S-3 registration statement,<sup>101</sup> which could infringe on attorney-client privilege and confidentiality.<sup>102</sup> The Securities Act of 1933<sup>103</sup> requires that companies preparing to offer securities to the

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94. See Quint Studer, *The Case for Transparency: 10 Reasons Your Firm Should Keep No Secrets from Associates*, 10-4 LAW OFF. MGMT. & ADMIN. REP. 1 (2010) (stating that high performers want disclosure and certainty, not to be left in the dark).

95. Chris Johnson, *Value Proposition; Nonlawyer Ownership of Firms in the U.K. is Changing How Law Firms are Appraised*, AM. LAW., May 1, 2012, at 23. (discussing emerging methods of law firm appraisal in the U.K.).

96. See *id.*

97. See Stern, *supra* note 84, at 8-9 (discussing the unique complexities that arise in law firm bankruptcies compared to industrial businesses). In particular, the bankruptcy cases of Brobeck and Heller raised questions as to the liabilities of former partners. *Id.* at 10. The bankruptcy trustees in Brobeck argued that for the last two years of the firm’s operation, it was insolvent and undercapitalized, and additionally argued that much of the amounts paid to partners were actually dividends, leaving the former partners potentially liable. *Id.* at 11. The Heller bankruptcy was also confronted with the issue of whether and how to include revenue from former clients of defunct law firms in the valuation of a law firm. *Id.* at 14.

98. MODEL RULES OF PROF’L CONDUCT R. 1.6 (2012).

99. See MacEwen et al., *supra* note 51, at 71.

100. See Hodge, *supra* note 54, at 94-95.

101. SEC, *Form S-3 Registration Statement*, available at <http://www.sec.gov/about/forms/forms-3.pdf> (last visited July 16, 2013).

102. See MODEL RULES OF PROF’L CONDUCT R. 1.6 (2012); Hodge, *supra* note 54, at 93.

103. 15 U.S.C. § 77a *et seq.* (2011).



public include all material information about the company in a prospectus.<sup>104</sup> Failure to include material information in the prospectus constitutes a violation of law under several provisions of U.S. law, including Rule 10b-5 promulgated under the Securities Exchange Act of 1934 (Exchange Act).<sup>105</sup>

The Exchange Act, however, contains multiple exemptions to the registration and disclosure requirements for the issuance of securities.<sup>106</sup> The private placement exemption would, for example, eliminate any fear that a closely-held corporate law firm might disclose confidential client information.

### *B. The Use of MDPs and the Resulting Efficiencies from Collaboration*

Like corporate law, the rules governing lawyers are set at the state level and differ among states. The ABA provides guidance to state bar associations by providing recommendations on how best to govern the legal profession and foster professional responsibility.<sup>107</sup> While states are free to implement their own legal ethics and professional standards,<sup>108</sup> many adopt all or a majority of the Model Rules, altering rules as they believe necessary to better serve society and the legal community.<sup>109</sup> A few states have started to experiment with deviations from Model Rule 5.4, pressuring the ABA to examine the possibility of revising the Rule's prohibition on alternative law firm structures.<sup>110</sup>

This review of Model Rule 5.4 started in 2000, but the ABA has yet to unanimously endorse and implement any changes.<sup>111</sup> The ABA has explicitly

104. *See id.* § 77j.

105. *Id.* § 78a *et seq.*; 17 C.F.R. § 240.10b-5 (2013); Hodge, *supra* note 54, at 94–95 (outlining this concern).

106. *See, e.g.*, 15 U.S.C. § 77d(2) (exempting private placements of securities); 17 C.F.R. § 230.501 *et seq.* (providing the “Regulation D” exemptions for small offerings to accredited investors). Exemptions from periodic reporting requirements also exist. *See* 15 U.S.C. § 78l; 17 C.F.R. § 240.12g-1 (providing minimum thresholds for periodic reporting under Exchange Act). Note that these exemptions are most useful for closely-held corporations, since verifying the number of shareholders for a publicly traded company is difficult.

107. *See* MODEL RULES OF PROF'L CONDUCT Preface (2012).

108. *Chronological List of States Adopting Model Rules*, A.B.A. CTR. PROF. RESP., [http://www.americanbar.org/groups/professional\\_responsibility/publications/model\\_rules\\_of\\_professional\\_conduct/chrono\\_list\\_state\\_adopting\\_model\\_rules.html](http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/chrono_list_state_adopting_model_rules.html) (last visited July 16, 2013) (providing a table of when states have adopted the ABA Model Rules while noting when states deviate through amendments that differ from the suggested Model Rules).

109. *Id.*

110. *See infra* Part III.B.2.

111. *See* Comm'n on Multidisciplinary Practice, *Background Paper on Multidisciplinary Practice: Issues and Development*, A.B.A. CTR. PROF. RESP. (Jan. 1999),

stated that it does not believe there is “sufficient basis” to allow law firms to form corporations.<sup>112</sup> In its contemplation of potential alternative business structures, the ABA appears to only have considered allowing non-lawyer partnerships with law firms, also known as MDPs.<sup>113</sup> Consequently, most states are self-initiating studies and proposals for relaxing their professional ethics rules<sup>114</sup> to allow MDPs, which results in divergence from the typical uniformity among states that generally lends credence to the Model Rules.<sup>115</sup>

### 1. MDPs in Practice and Model Rule 5.4

Today, the practice of law is more integrated with non-legal professions than ever before.<sup>116</sup> Legal advice overlaps with a variety of other professional services including tax consulting, real estate, environmental law and the expertise of scientists, employment law and human resource departments, and

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[http://www.americanbar.org/groups/professional\\_responsibility/commission\\_multidisciplinary\\_practice/multicomreport0199.html](http://www.americanbar.org/groups/professional_responsibility/commission_multidisciplinary_practice/multicomreport0199.html).

112. News Release, ABA Comm’n on Ethics 20/20 (Apr. 16, 2012), [http://www.americanbar.org/content/dam/aba/administrative/ethics\\_2020/20120416\\_news\\_release\\_re\\_nonlawyer\\_ownership\\_law\\_firms.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20120416_news_release_re_nonlawyer_ownership_law_firms.authcheckdam.pdf) (“Based on the Commission’s extensive outreach, research, consultation, and the response of the profession, there does not appear to be a sufficient basis for recommending a change to ABA policy on nonlawyer ownership of law firms.”).

113. See Issues Paper from ABA Commission on Ethics 20/20 on Alternative Business Structures to ABA Entities, Courts, Bar Associations, Law Schools, and Individuals 17 (Apr. 5 2011), available at [http://www.americanbar.org/content/dam/aba/administrative/ethics\\_2020/abs\\_issues\\_paper.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/abs_issues_paper.authcheckdam.pdf) (“While there are various approaches possible, the Working Group is seeking feedback *only with respect to the first three options* enumerated below.”) (emphasis in original).

114. See *Status of Multidisciplinary Practice Studies by State (and Some Local Bars)*, A.B.A. CTR. PROF. RESP., [http://www.americanbar.org/groups/professional\\_responsibility/commission\\_multidisciplinary\\_practice/mdp\\_state\\_action.html](http://www.americanbar.org/groups/professional_responsibility/commission_multidisciplinary_practice/mdp_state_action.html) (last visited July 16, 2013) [hereinafter *Status of Multidisciplinary Practice Studies by State*] (detailing the investigation by various states of the pros and cons of MDP relationships).

115. See *id.* See generally Laurel S. Terry, *The Work of the ABA Commission on Multidisciplinary Practice*, in STEVEN J. MCGARRY & LAUREL S. TERRY, MULTIDISCIPLINARY PRACTICES AND PARTNERSHIPS: LAWYERS, CONSULTANTS, AND CLIENTS 2.20 (2002), available at <http://www.personal.psu.edu/faculty/l/s/lst3/McGarry%20Mutlidisciplinary%20Ch2.PDF> (examining state explorations MDP in response to the ABA’s decision).

116. See, e.g., *Status of Multidisciplinary Practice Studies by State*, *supra* note 114 (detailing the positions of various states that are permitting MDP arrangements). For example, the State Bar of Arizona Task Force on the Future of the Legal Profession supported MDPs and suggests the ABA amend MRPC 5.4 and other rules, a California ethics board proposed revisions to the ABA, and Colorado adopted a resolution to allow MDPs. *Id.*

accounting and economic advice for business transactions like mergers and acquisitions.<sup>117</sup> The ABA defines an MDP as:

[A] partnership, professional corporation, or other association or entity that includes lawyers and nonlawyers and has as one, but not all, of its purposes the delivery of legal services to a client(s) [sic] other than the MDP itself or that holds itself out to the public as providing nonlegal, as well as legal, services. It includes an arrangement by which a law firm joins with one or more other professional firms to provide services . . . and there is a direct or indirect sharing of profits as part of the arrangement.<sup>118</sup>

Model Rule 5.4, entitled “Professional Independence of a Lawyer,” explicitly rejects MDPs by mandating that “[a] lawyer or law firm shall not share legal fees with a nonlawyer.”<sup>119</sup> Rule 5.4(b) further states, “A lawyer shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law.”<sup>120</sup> This provision, among others, needs to be revised in order to meet the needs of modern business and legal practice.<sup>121</sup>

Many professionals remain adamant about curtailing the development of MDPs in order to protect the professional independence of the lawyer, reduce conflicts of interests, and maintain client confidentiality and the attorney-client privilege.<sup>122</sup> Many practitioners believe that permitting MDPs will

117. See generally Bryant G. Garth & Carole Silver, *The MDP Challenge in the Context of Globalization*, 52 CASE W. RES. L. REV. 903 (2002) (exploring the growth of MDPs in a global context).

118. ABA Comm’n on Multidisciplinary Practice, *Report to the ABA House of Delegates*, A.B.A. CTR. PROF. RESP. (June 8, 1999), [http://www.americanbar.org/groups/professional\\_responsibility/commission\\_multidisciplinary\\_practice/mdprecommendation.html](http://www.americanbar.org/groups/professional_responsibility/commission_multidisciplinary_practice/mdprecommendation.html).

119. MODEL RULES OF PROF’L CONDUCT R. 5.4(a) (2012). This rule is subject to a few limited exceptions including: (1) paying a lawyer’s estate after a lawyer’s death, (2) when a lawyer purchases the legal practice of a deceased attorney, (3) when a lawyer or law firm compensates employee(s), and (4) when a lawyer shares court-awarded legal fees with a nonprofit organization which interacted with the lawyer. *Id.*

120. MODEL RULES OF PROF’L CONDUCT R. 5.4(b) (2012).

121. John S. Dzienkowski & Robert J. Peroni, *A Market Approach to Regulating the Delivery of Legal Services in the Twenty-First Century*, 69 FORDHAM L. REV. 83, 89 (2000).

122. See generally Kathryn Lolita Yarbrough, Comment, *Multidisciplinary Practices: Are They Already Among Us?*, 53 ALA. L. REV. 639, 653-58 (2002) (exploring opposition to MDPs in the legal profession); John Paul Lucci, Note, *New York Revises Ethics Rules to Permit Limited MDPs: A Critical Analysis of the New York Approach, the Future of the MDP Debate After Enron, and Recommendations for Other Jurisdictions*, 8 FORDHAM J. CORP. & FIN. L. 151, 175-77 (2003) (noting common arguments from MDP opponents). For example, accountants have disclosure obligations in stark contrast to lawyers who are mandated to preserve client confidences. *Id.* at 168.

compromise the legal profession's reputation, fearing that lawyers will succumb to business pressures – perhaps even unconsciously – by settling lawsuits merely to please shareholders.<sup>123</sup> Opponents feel MDPs will not be able to fully protect client interests as the paramount objective and fear that MDPs will threaten the financial structure of law firms.<sup>124</sup>

Despite critics, advocates believe MDPs are inevitable and necessary to provide clients with the most efficient and affordable legal and non-legal services.<sup>125</sup> MDP advocates criticize the motives of those desiring to prevent the MDP movement from reaching fruition by labeling their resistance as an attempt to preserve lawyers' status quo.<sup>126</sup> Critics of Model Rule 5.6, which prevents non-compete agreements among lawyers, similarly argue that the Model Rules are more concerned with protecting the status of law firms than serving public policy.<sup>127</sup> For example, a California court has observed that blanket prohibitions, such as forbidding lawyer non-compete agreements, are *not* necessarily intended to serve client needs.<sup>128</sup> Law firms can simultane-

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123. See Tyler Cobb, Note, *Have Your Cake and Eat It Too! Appropriately Harnessing the Advantages of Nonlawyer Ownership*, 54 ARIZ. L. REV. 765, 771-74 (2012) (describing and critiquing this argument); James R. DeBuse, Note, *Opening at \$25 1/2 Is Big Firm U.S.A.: Why America May Eventually Have a Publicly Traded Law Firm, and Why Law Firms Can Succeed Without Going Public*, 34 J. CORP. L. 317, 336 (2008) (arguing that ownership and interference with professional judgment are one in the same for law firms).

124. Robert A. Stein, *Multidisciplinary Practices: Prohibit or Regulate?*, 84 MINN. L. REV. 1529, 1532 (2000) (explaining that many opponents think of MDPs as a mechanism for the Big Five accounting firms to enter the market of practicing law, and where nonlawyer supervisors of lawyers would disregard standards of professional conduct).

125. MDPs can provide clients with "one-stop shopping" for all of their professional needs. See Stefan F. Tucker, *Written Remarks of Stefan F. Tucker Submitted to the Commission on Multidisciplinary Practice*, A.B.A. CTR. PROF. RESP. (Feb. 4, 1999), [http://www.americanbar.org/groups/professional\\_responsibility/commission\\_multidisciplinary\\_practice/tucker1.html](http://www.americanbar.org/groups/professional_responsibility/commission_multidisciplinary_practice/tucker1.html). Simultaneously, MDPs will enhance affordability by reducing redundant costs since services can be provided under one business entity, and the enhanced competition of professional services will create greater access to legal services. See Renee Newman Knake, *Democratizing the Delivery of Legal Services*, 73 OHIO ST. L.J. 1, 42-45 (2012).

126. See, e.g., Letter from Robert Gordon, Professor, Yale Law School, to Sherwin P. Simmons, Chair, ABA Commission on Multidisciplinary Practice (May 21, 1999), available at [http://www.americanbar.org/groups/professional\\_responsibility/commission\\_multidisciplinary\\_practice/gordon.html](http://www.americanbar.org/groups/professional_responsibility/commission_multidisciplinary_practice/gordon.html) ("[T]he organized bar's resistance to new modes of practice, though often clothed in the high-minded rhetoric of protecting the ethical standards and independent judgment of the legal profession, has been to a considerable extent motivated by far less elevated desires to protect the incomes of lawyers from economic competition or their status from erosion.").

127. See MODEL RULES OF PROF'L CONDUCT R. 5.6 (2012).

128. See *Howard v. Babcock*, 863 P.2d 150, 160 (Cal. 1993) ("We seek to achieve a balance between the interest of clients in having the attorney of choice, and the

ously operate as businesses and maintain high ethical standards; preserving professional ethics and allowing the *business* of law to serve clients' needs are not juxtaposed positions. The arguments of the advocates of MDPs, as well as California's authorization of lawyer non-compete agreements, demonstrate how the ABA can loosen restrictions while still maintaining control of legal ethics through more tailored regulations.

The indistinct line between legal and non-legal services suggests that professionals already often overlap their services when advising clients.<sup>129</sup> The traditional role of the lawyer merely as zealous advocate is no longer the norm; today, lawyers need to be able to assist clients with a number of legal issues that overlap with issues not traditionally dealt with by a lawyer. In other words, the needs of clients are not neatly compartmentalized.<sup>130</sup> Additionally, rapid technological advancements and financial globalization suggest that lawyers need to unite with non-legal professionals and that law firms need to access capital markets in order to be effective in meeting their clients' needs.<sup>131</sup> Proponents of the ABA endorsing new models for law firms acknowledge the sensible concern with ethical implications raised by the MDP structure, but believe that professional conduct regulations can allay fears and uncertainties.<sup>132</sup>

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interest of law firms in a stable business environment. We have recognized that restraint of competition among partners is permissible only to the extent it protects the reasonable interests of the business seeking the restraint.”).

129. See generally Yarbrough, *supra* note 122, at 658-64 (describing the movement of the “Big Five” accounting firms into traditionally legal fields). The legal services clients need are not isolated from the other professional services that they are seeking. Cf. Stein, *supra* note 124, at 1534 (2000) (“Firms currently exist that specialize in mergers and acquisitions, advising corporations on a variety of issues including legal issues, in a merger and acquisition context. These firms include investment bankers, economists, and lawyers. In addition, financial planners, who may not be lawyers, give advice, on the application of tax laws to their clients. Human resource companies give advice to their clients about employment practices and the firing of employees. Litigation support firms include technology experts to advise law firms how to manage litigation more effectively by using new technologies.”).

130. See Marsha M. Mansfield & Louise G. Trubek, *New Roles to Solve Old Problems: Lawyering for Ordinary People in Today's Context*, 56 N.Y.L. SCH. L. REV. 367, 372 (2012) (arguing that lawyers should seek “insights gleaned from other professions such as mental health, health care, and business, employ advanced technologies, and consider the variety of interests that affect the well-being of the clients beyond simply the bare legal issues.”).

131. Stein, *supra* note 124, at 1531.

132. See, e.g., Edward A. Adams, *New Rule Authorizes Discipline of Firms; Responsibility for Supervision Imposed*, 215 N.Y.L.J. 7 (June 4, 1996) (noting that in 1996 New York became the first state in the U.S. to permit disciplining the law firm in addition to individual lawyers); see also John H. Matheson & Peter D. Favorite, *Multidisciplinary Practice and the Future of the Legal Profession: Considering a Role for Independent Directors*, 32 LOY. U. CHI. L.J. 577, 611 (2001) (proposing that independent legal directors can monitor MDPs and ensure ethical compliance); cf.

## 2. The Historical Development and the Modern Application of MDPs

Upon the inception of the Canons of Professional Ethics in 1908, the ABA was silent as to the treatment of MDPs.<sup>133</sup> The ABA did not expressly forbid non-lawyer partnership arrangements in the practice of law until 1928, fearing that MDPs could lead to the demise of professional independence and zealous advocacy of client interests.<sup>134</sup> This Rule effectively prohibited any law firms from adopting a business form or joint venture with a non-lawyer.<sup>135</sup>

The ABA has failed to demonstrate that this Rule lessens the risk of infringement on independent professional judgment, yet insists that it is the *only* necessary and sufficient solution to maintain the independent professional judgment of attorneys.<sup>136</sup> However, not all jurisdictions agree. The District of Columbia permits partnerships and fee sharing among lawyers and non-lawyers as long as the entity provides *solely* legal services.<sup>137</sup> Consequently, in D.C. an accountant can assist lawyers in providing clients with tax advice, psychologists and social workers can assist with child custody hearings, and lobbyists can work with lawyers to accommodate client needs.<sup>138</sup> The rule does not limit potential new business forms to partnerships as it allows firms to engage with non-lawyers in “partnerships or other forms of organization.”<sup>139</sup> This leaves open the possibility that an MDP could also be a corporation, as the rule does not prohibit non-lawyer ownership or fee sharing. However, it does require that all non-lawyer managers be subject to the D.C. Rules of Professional Conduct and provides that lawyers supervising

MODEL RULES OF PROF'L CONDUCT R. 5.1 cmt.2 (2012) (requiring lawyers with “managerial authority” to provide policies for reasonable assurance that all lawyers in the firm will conform to the MRPC).

133. See CANONS OF PROF'S ETHICS (1908).

134. See JOHN T. NOONAN & RICHARD W. PAINTER, PROFESSIONAL RESPONSIBILITIES OF THE LAWYER 383, 376, 385 (Foundation Press, 1997).

135. Katherine L. Harrison, *Multidisciplinary Practices: Changing the Global View of the Legal Profession*, 21 U. PA. J. INT'L ECON. L. 879, 883-84 (2000).

136. *Id.* at 891-93.

137. See D.C. RULES OF PROF'L CONDUCT R. 5.4 (2007). All members of the MDP agree to ethics rules and lawyers agree to take responsibility for non-lawyers. *Id.*

138. See Stein, *supra* note 124, at 1538; see also Mansfield & Trubek, *supra* note 130, at 368 (explaining that clients are informed and consent to the integration of legal and non-legal services); cf. Garth & Silver, *supra* note 117, at 913 (“McKee Nelson in Washington, D.C., a firm that was organized in 1999 by two tax specialists, describing itself as ‘An Independent Law Firm Allied With Ernst & Young.’ As of January 2002, McKee Nelson had positioned itself to offer legal advice on ‘tax litigation, transactional structuring, and capital markets needs of companies doing business in the global economy.’”).

139. D.C. RULES OF PROF'L CONDUCT R. 5.4(a)(4), 5.4(b), (2007).

non-lawyers are liable for that person's failure to obey those rules.<sup>140</sup> It appears that this rule would adequately assure compliance with the other rules and would not otherwise jeopardize a lawyer's independent professional judgment.

Similarly, in April 2000, after six months of investigating the advantages and disadvantages of altering the state's ethics rules, a New York State Bar Association Special Committee recommended permitting MDPs.<sup>141</sup> In 2001, the New York Lawyer's Code of Professional Responsibility Disciplinary Rule 1-107 authorized the integration of lawyer and non-lawyer services by allowing lawyers and law firms to pursue contractual relationships with non-legal professionals or non-legal firms, subject to certain conditions.<sup>142</sup> Non-legal professionals had to meet certain requirements, such as: (1) have a minimum of a bachelor's degree and be on a list retained by the New York Appellate Division, (2) be occupied in a position licensed by the State of New York or a federal agency, and (3) adhere to professional conduct that is comparable to lawyers' ethical requirements.<sup>143</sup> In addition, the non-legal professionals could not control the lawyer or law firm or share profits earned by the lawyer or law firm.<sup>144</sup> However, DR 1-107 still expressly prohibits MDPs as non-lawyers do not share "the core values of the legal profession."<sup>145</sup>

Other professional groups are interested in joining law firms, whether through MDPs or contractual procedures, as is allowed in New York.<sup>146</sup> In the 1990s, accounting firms advocated for MDPs, but the calamities of Enron and WorldCom halted MDP development in the United States.<sup>147</sup> Looking

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140. *Id.*

141. N.Y. STATE BAR ASS'N SPECIAL COMM. ON THE LAW GOVERNING FIRM STRUCTURE & OPERATION, PRESERVING THE CORE VALUES OF THE AMERICAN LEGAL PROFESSION: THE PLACE OF MULTIDISCIPLINARY PRACTICE IN THE LAW GOVERNING LAWYERS 1 (Apr. 2000), available at <http://www.law.cornell.edu/ethics/mdp1.htm>.

142. See Roy Simon, *The DR 1-107 Definition of a Non-Legal "Professional,"* N.Y. PROF'L RESPONSIBILITY REP. 1 (Feb. 2002).

143. *Id.* at 2.

144. Lucci, *supra* note 122, at 185.

145. N.Y. COMP. CODES. R. & REGS. tit. 22, § 1200, R. 5.8 (West, Westlaw through 35 N.Y. Reg. (July 17, 2013)) (also known as DR 1-107).

146. See Lucci, *supra* note 122, at 162-63.

147. See NOONAN & PAINTER, *supra* note 134, at 376, 383, 385. Accounting firm Arthur Anderson played the dual role of accountant and consultant, which arguably created improper motives and a conflict of interest. Burnele V. Powell, *The Lesson of Enron for the Future of MDPs: Out of the Shadows and into the Sunlight*, 80 WASH. U. L.Q. 1291, 1296 (2002). Many scholars emphasize the reduced ethical obligations of nonlawyers, fearing that MDP arrangements could hinder the legal reputation and independence. See Commission on Multidisciplinary Practice, Transcript, Report to the House of Delegates (Aug. 1999), available at [http://www.americanbar.org/groups/professional\\_responsibility/commission\\_multidisciplinary\\_practice/mdphouse.html](http://www.americanbar.org/groups/professional_responsibility/commission_multidisciplinary_practice/mdphouse.html). But see Powell, *supra*, at 1296 (arguing that the Enron debacle demon-

beyond the scope of the ABA, many foreign countries permit lawyer and non-lawyer professional arrangements.<sup>148</sup> In fact, the United States' "Big Five" accounting firms have engaged in legal markets abroad.<sup>149</sup> Accounting firms want to collaborate with law firms to enhance the services that they can offer, and many clients want an integrated professional service to meet their business needs. However, the Model Rules have halted this development.

### 3. The ABA's Current Position on MDPs

Though many jurisdictions have unilaterally initiated rules that would allow firms to adopt alternative business structures, the ABA has continued to stand by its prohibition even as its own investigations and committees have questioned the continued ban.<sup>150</sup> In 1998, a commission was appointed to review the possibility of allowing MDPs.<sup>151</sup> Ultimately, the commission reported that the ABA should both allow lawyers to share fees with non-lawyers and authorize professional partnerships consisting of lawyer and non-lawyer professionals.<sup>152</sup> Nonetheless, the ABA House of Delegates was not convinced that the new forms would protect a lawyer's independent professional judgment.<sup>153</sup>

Consequently, the evidence in favor of MDPs and the push-back the ABA is receiving from firms should require the ABA to continue to either justify its position or to "examine" the implications of MDPs on ethical compliance. The ABA will continue to examine whether the ethics rules should be modified to permit MDPs. This examination will emphasize three principles: "protecting the public; preserving core professional values; and maintaining a strong, independent, and self-regulated profession."<sup>154</sup> In August

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states the need for MDPs because legal oversight helps inform clients of liability risks and ethical obligations).

148. See *infra* Part IV.

149. Adam A. Schulenburger, Note, *Would You Like Fries with That? The Future of Multidisciplinary Practice*, 87 IOWA L. REV. 327, 333 (2001); see also Garth & Silver, *supra* note 117, at 908.

150. Terry, *supra* note 115, at 2.13-2.19; see also Stein, *supra* note 124, at 1539-45 (providing a detailed history of the ABA Commission and House of Delegates decision-making process, in which all participants had unanimously recommended permitting MDP arrangements subject to limitations).

151. See Stein, *supra* note 124, at 1539.

152. See Terry, *supra* note 115, at 2.14.

153. *Id.* at 2.6-2.10.

154. Discussion Paper from ABA Commission on Ethics 20/20 on Alternative Law Practice Structures, (Dec. 2, 2011), available at [http://www.americanbar.org/content/dam/aba/administrative/ethics\\_2020/20111202-ethics2020-discussion\\_draft-alps.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111202-ethics2020-discussion_draft-alps.authcheckdam.pdf). The report further summarized:

The Commission has ruled out certain forms of nonlawyer ownership that currently exist in other countries. In particular, the Commission rejected: (a) publicly traded law firms, (b) passive, outside nonlawyer investment or own-



2012, the ABA Commission on Ethics 20/20, after conducting three years of research, decided it would revisit the issue of MDPs, including perhaps developing suggestions for modifying the current Model Rules.<sup>155</sup>

#### IV. GLOBALIZATION OF THE LEGAL PROFESSION

The practice of law has not been sheltered from the forces of globalization. Regulators and practicing lawyers have both been forced to reconsider the assumptions underpinning the practice of law that have been traditionally defined by its domestic reach.<sup>156</sup> As the U.S. debate over law firm structure continues, other countries like the United Kingdom and Australia have enacted changes to increase the flexibility of the law firm structure and invite outside equity into law firms.<sup>157</sup> This Part seeks to review those changes and the motivations that spurred them, and concludes by discussing how international reform and the pressures of globalization may affect the debate over law firm structure here in the United States.

##### *A. Reform in Australia and the United Kingdom*

For many U.S. law firms, the practice of law is no longer contained within the country's borders.<sup>158</sup> Many U.S. firms have offices abroad,<sup>159</sup> and foreign firms have offices in the United States.<sup>160</sup> Australia and the Unit-

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ership in law firms, and (c) multidisciplinary practices (i.e., law firms that offer both legal and non-legal services separately in a single entity).

*Id.* at 1.

155. Memorandum from Jamie S. Gorelick & Michael Traynor, Co-Chairs of the ABA Commission on Ethics 20/20 regarding the Final Revised Drafts of First Set of Commission Proposals, (Feb. 21, 2012), available at [http://www.americanbar.org/content/dam/aba/administrative/ethics\\_2020/20120221\\_ethics\\_20\\_20\\_circulation\\_cover\\_memo\\_revised\\_august\\_2012\\_proposals\\_for\\_comment.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20120221_ethics_20_20_circulation_cover_memo_revised_august_2012_proposals_for_comment.authcheckdam.pdf) (proposing, *inter alia*, "a new sentence to Comment [16] to Rule 1.6 that explicitly states that the disclosure of information, by itself, does not constitute a violation of the proposed Rule 1.6(c) if a lawyer took reasonable precautions to guard against it.").

156. See *infra* Part IV.B.

157. See *infra* Part IV.A.

158. See generally Krause, *supra* note 70.

159. Anthony Davis, *A New Approach to Law Firm Regulation*, AM. LAW. DAILY (July 22, 2010), available at LexisNexis. American firms historically dominated the international legal market. *Id.*

160. See Steven Mark, *Harmonization or Homogenization?: The Globalization of Law and Legal Ethics – An Australian Viewpoint*, 34 VAND. J. TRANSNAT'L L. 1173, 1182-83 (2001) (noting that as companies develop increasingly global interests, businesses have begun seeking law firms that understand the laws in multiple countries and can provide services for cross-border transactions); Carole Silver, *Regulatory Mismatch in the International Market for Legal Services*, 23 NW. J. INT'L L. & BUS.

ed Kingdom in particular have modernized law firm structures within their jurisdictions to enable the firms to be more competitive internationally.<sup>161</sup> The motivations for reform in these two countries share similarities as well as differences. Understanding the factors that led Australia and the United Kingdom to change the form of the law firm structure offers a glimpse into what pressures may lead the United States to consider and implement similar changes.

Australia's Legal Profession Act 2004 enabled law firms to adopt the corporate form.<sup>162</sup> The change was not sudden.<sup>163</sup> The state of New South Wales introduced limited MDPs to Australia through the Legal Profession Act 1987.<sup>164</sup> Despite the availability of the MDP, restrictions designed to preserve potential ethical conflicts limited their use.<sup>165</sup> Nevertheless, the use of MDPs motivated Australian regulators to begin thinking about the practice of law as a business that should be governed by competitive practices.<sup>166</sup> During the late 1990s, regulators determined that the restrictions on MDPs were anti-competitive; as a result, the restrictions were removed.<sup>167</sup> In 2001, New South Wales became the first jurisdiction in the world to legalize the corporate structure for law firms.<sup>168</sup>

A unique set of motivations led to the widespread adoption of the 2004 Act.<sup>169</sup> First, lawyers were facing increasing competition from non-lawyers over basic legal services.<sup>170</sup> Several Australian jurisdictions allowed MDPs to exist, and the effect was the erosion of traditional legal services being performed solely by lawyers.<sup>171</sup> Second, Australian law firm partnerships did

487, 527-28 (2003) (noting the practice of foreign law firms opening offices in the U.S began in the early 1970's).

161. Davis, *supra* note 159.

162. Petzold, *supra* note 56, at 68-69.

163. *Id.* at 73-74.

164. Steven Mark & Georgina Cowdroy, *Incorporated Legal Practices – A New Era in the Provision of Legal Services in the State of New South Wales*, 22 PENN. ST. INT'L L. REV. 671, 673 (2004).

165. *Id.* at 673 (describing two restrictions on MDPs: (1) lawyers were required to maintain majority voting rights over the participating non-lawyers, and (2) lawyers were required to retain at least 51% of the net income).

166. See Mark, *supra* note 160, at 1194-95.

167. See Mark & Cowdroy, *supra* note 164, at 673.

168. See *id.* at 674 (chronically New South Wales's passage of the Legal Profession Act 2000 and the Legal Profession Regulation 2001); Mark, *supra* note 160, at 1195 (“[T]o date, New South Wales has been the only jurisdiction in . . . the world to allow legal entities – including MDPs – to incorporate as businesses.”).

169. Petzold, *supra* note 56, at 73-74.

170. *Id.* at 75.

171. See Mark, *supra* note 160, at 1198-99. The struggle to define the scope of the “practice of law” led many non-lawyers to get involved in fields traditionally practiced by only lawyers. *Id.* at 1198. Uncompetitive law firm structure may partially explain how lawyers became effectively barred from practicing traditional lawyer

not enjoy the benefits of limited liability to the same extent as U.S. firms do today.<sup>172</sup> Third, because each of Australia's states legislates its own rules and regulations regarding the practice of law,<sup>173</sup> a lack of uniformity limited the true availability of the corporate form. In 2004, to further the goals of uniformity and competitiveness both domestically and internationally, the Law Council of Australia adopted the National Legal Professional Model Provisions.<sup>174</sup> This set the stage for the Legal Profession Act 2004.<sup>175</sup> With the passage of the Act, incorporated law firms no longer had to concern themselves with regulatory conflicts in states that would not allow a publicly owned law firm to enter the market. Up until the passage of the Act, every corporate firm remained privately held. Widespread adoption of the Act allowed Slater & Gordon, the poster child of publicly-owned law firms, to seek public capitalization, and it is now traded on the Australian Stock Exchange.<sup>176</sup>

The United Kingdom also undertook dramatic reform of its legal system when it enacted the Legal Services Act 2007.<sup>177</sup> Sir David Clementi prepared a report in 2004 on behalf of the United Kingdom government which concluded that the regulations were "outdated, inflexible, over-complex, and insufficiently accountable or transparent."<sup>178</sup> Similar to Australia, the need for increased competition, efficiency, and consumer satisfaction in legal services were the main justifications for reform.<sup>179</sup> The resulting Act created – among other reforms – "alternative business structures," allowing non-lawyer

functions; this reason at the very least was at the heart of Australia's reform. Petzold, *supra* note 56, at 76.

172. See Petzold, *supra* note 56, at 77. The consequences of such extensive liability were that law firms had to be constantly on alert for malpractice suits, and were forced to develop prophylactic measures in anticipation. *Id.* Such measures included "running bare," by holding small amounts of insurance and limiting the assets in the firm to minimize damages. *Id.*

173. See Mark, *supra* note 160, at 1176.

174. See Petzold, *supra* note 56, at 74. For comparison, the Law Council of Australia functions much like the ABA, as a national advocacy group for lawyers, and the National Legal Professional Model Provisions are equally similar to the Model Rules advocated by the ABA. While not authoritative, they serve to unify the professional rules among jurisdictions. *Our Role*, LAW COUNCIL OF AUSTRALIA, <http://www.lawcouncil.asn.au/lawcouncil/index.php/about-the-law-council-of-australia/our-role> (last visited Aug. 19, 2013).

175. See Petzold, *supra* note 56, at 74.

176. Richard Lloyd, *British Firms are Watching Australia's Law Firm IPOs with Interest*, AM. LAW. DAILY (June 6, 2007), available at LexisNexis.

177. See Petzold, *supra* note 56, at 82.

178. DAVID CLEMENTI, REVIEW OF THE REGULATORY FRAMEWORK FOR LEGAL SERVICES IN ENGLAND AND WALES, FINAL REPORT 1 (2004) (emphasis omitted).

179. Petzold, *supra* note 56, at 82. Consumer complaints were common, consistent, and well-documented. *Id.* at 86. The thought was that the problem was not with individual lawyers and firms, but that the entire system was faulty. *Id.* at 82.

investment in firms, subject to a fit to own test for shareholders seeking to own more than ten percent.<sup>180</sup>

Chief among the reasons for reform in both Australia and the United Kingdom was the call for competitiveness and efficiency in the practice of law.<sup>181</sup> Australia's focus on competitiveness was based partly on both international and domestic pressures.<sup>182</sup> Trade in transnational legal services was declining in the early 2000s,<sup>183</sup> and lawmakers saw liberalization as a necessary step for Australia to compete on a global level.<sup>184</sup> The push for liberalization through the elimination of anti-competitive rules also dominated discussions about the fragmented state of professional rules.<sup>185</sup>

In the United Kingdom, however, the push for increasing competition shared only a few similarities with the Australian experience. On one hand, like Australia, the increasing participation in the market for basic legal services by non-lawyers was pervasive enough to convince regulators and practitioners that change was needed.<sup>186</sup> However, this problem could have been fixed simply by tightening the definition of what constitutes the practice of law and reserving more basic services for lawyers.<sup>187</sup> The true source of zeal for competition policy in the United Kingdom began when the Labour Party came back into power in 1997 and began strongly pushing a free-market agenda.<sup>188</sup> Consumer dissatisfaction with legal services prompted lawmakers to reevaluate the system.<sup>189</sup> The Legal Services Act was the culmination of

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180. See Cox, *supra* note 37, at 536-37 (Whether an outside investors is fit to own may be "conditioned on approval of the investor's "probity and financial position," as determined by the licensing authority.").

181. Petzold, *supra* note 56, at 82.

182. *Id.* at 75.

183. See Mark, *supra* note 160, at 1186-87 ("By 1997-98, exports had risen to \$207 million and imports were eighty- three million dollars, with a surplus of \$124 million. The latest figures, however, reveal that exports have stagnated – to around two hundred million dollars in the past two years – while legal service imports have fallen by a dramatic forty percent in 1999-2000.").

184. *Id.* at 1187-89 (discussing reforms aimed at reducing restrictions on foreign lawyers).

185. *Id.* at 1189 (noting that efforts to harmonize fragmented professional rules among states by the Law Council of Australia, other bar associations, and regulators focused on the promotion of competition policy).

186. See Petzold, *supra* note 56, at 83.

187. See Christopher J. Whelan, *The Paradox of Professionalism: Global Law Practice Means Business*, 27 PENN ST. INT'L L. REV. 465, 471 (2008) ("Traditionally, in the U.K., there have been very few restrictions on offering legal advice and assistance. Most legal services can be offered by anyone for free or for a fee. Some important legal services are "reserved" . . . [h]owever, the list is relatively short.").

188. See Petzold, *supra* note 56, at 81-82.

189. *Id.* at 86.

the belief that liberalizing business structures would increase responsiveness to consumers.<sup>190</sup>

The pressures that prompted change in Australia and the United Kingdom do not exist to the same extent in the United States. Differences both in policy preferences and the systems of regulation explain why a similar push to remove restrictions on law firm structure has not taken off in the United States. The U.S. legal profession is self-regulated by the courts,<sup>191</sup> not by legislation.<sup>192</sup> Although some have criticized the model as a failure,<sup>193</sup> the ABA remains committed to the justifications for self-regulation.<sup>194</sup> With both Australia and the United Kingdom, the move to allow publicly-owned firms came by way of legislation. The Legal Services Act also created the Legal Services Board to oversee all legal regulation<sup>195</sup> due to the consumer complaints that the system was not providing adequate access to justice.<sup>196</sup> Additional political sources of reform in the United Kingdom and Australia stem from antitrust regulators and consumer advocacy groups, interests which have little impact on the regulation of U.S. lawyers.<sup>197</sup>

The competitive pressures in the United Kingdom and Australia are also manifestly lacking in the United States. The historical pressure on lawyers to compete with non-lawyers for legal services in these countries is a relative non-issue in the United States.<sup>198</sup> The ABA has aggressively attempted to

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190. *Id.* at 86-87.

191. *See, e.g.,* Whelan, *supra* note 187, at 467.

192. This is not entirely true. *See* Ted Schneyer, *Thoughts on the Compatibility of Recent U.K. and Australian Reforms with U.S. Traditions in Regulating Law Practice*, 2009 J. PROF. LAW. 13, 16 (2009) (citing section 307 of the Sarbanes-Oxley Act and SEC regulations as examples of “piecemeal” regulations that do not interfere or replace basic features of the self-regulatory system).

193. Fred C. Zacharias, *The Future Structure and Regulation of Law Practice: Confronting Lies, Fictions, and False Paradigms in Legal Ethics Regulation*, 44 ARIZ. L. REV. 829, 831 (2002) (arguing that regulators rely on “idealizations about lawyers or the practice of law” when drafting or amending rules).

194. *See* Gillian K. Hadfield, *Legal Barriers to Innovation: The Growing Economic Cost of Professional Control Over Corporate Legal Markets*, 60 STAN. L. REV. 1689, 1697-98 (2008).

195. *See* Whelan, *supra* note 187, at 475-76 (“One of the most striking features of the reforms is the extent to which regulators are now independent of the legal profession.”).

196. *See id.* (noting that the board consists of lay people, and that one of its primary objectives is to ensure consumer confidence in the legal profession). All complaints about the legal profession are also now handled by an independent regulatory body. *Id.* at 477.

197. *See* Schneyer, *supra* note 192, at 25 (noting further that “the ‘state action’ doctrine in federal antitrust law immunizes state court rules governing law practice and firm structure from antitrust scrutiny . . .”).

198. *See* Petzold, *supra* note 56, at 96-97. Because maintaining a strict definition of what constitutes legal work is inherently difficult due to the natural overlap of

define the practice of law and persuade states to maintain and enforce laws that prevent non-lawyers from practicing traditionally-legal functions.<sup>199</sup> The scheme of self-regulation, combined with the attitude that legal functions should be confined to legal practice, stems from the belief that the practice of law is a “profession” rather than merely a business.<sup>200</sup> This assumption, while being questioned by many legal scholars in the United States, at least partially insulates the industry from criticisms that the rules impede pure competition. This is somewhat tautological, as it is the competitive pressures in the United Kingdom and Australia that have eroded the conception of law as something other than a business. Until the United States begins to feel that its law firms are threatened by inflexible business structures, the calls for reform will be minimal. However, global pressures may create those threats and lead the United States down the path of outside equity in law firms.

### *B. Pressures of Globalization on U.S. Policy*

Differences between the American system of law and the United Kingdom and Australian systems help explain why the United States is watching the effects of firm-structure reform unfold overseas instead of seriously engaging in reform discussions itself. However, the forces of globalization in conjunction with these reforms abroad may still impact the future of U.S. regulatory policy. Globalization is a tricky concept to define, and it carries with it several different but important meanings.<sup>201</sup> Globalization is characterized by the removal of barriers between countries and the increasing flow of goods, people, and ideas around the world.<sup>202</sup> Economics, governance, and culture are all forces of globalization that affect the practice of law.<sup>203</sup>

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some legal and non-legal services, the problem exists on some level in the U.S., but the fear of criminal sanctions minimizes the problem. See Charles W. Wolfram, *Multidisciplinary Partnerships in the Law Practice of European and American Lawyers*, in *LAWYER'S PRACTICE AND IDEALS: A COMPARATIVE VIEW* 329-31 (John J. Barcelo & Roger Cramton, eds., 1999).

199. See, e.g., Comm'n on Multidisciplinary Practice, *MDP Recommendation*, A.B.A. CTR. PROF. RESP. (July 13, 2000), [http://www.americanbar.org/groups/professional\\_responsibility/commission\\_multidisciplinary\\_practice/mdprecom10f.html](http://www.americanbar.org/groups/professional_responsibility/commission_multidisciplinary_practice/mdprecom10f.html) (noting the “lawyer’s duty to help maintain a single profession of law”).

200. See generally, MODEL RULES OF PROF’L CONDUCT PREAMBLE AND SCOPE COMMENT 10, available at [http://www.americanbar.org/groups/professional\\_responsibility/publications/model\\_rules\\_of\\_professional\\_conduct/model\\_rules\\_of\\_professional\\_conduct\\_preamble\\_scope.html](http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/model_rules_of_professional_conduct_preamble_scope.html) (noting that the practice of law is a self-governing profession).

201. See Jonathan Goldsmith, *The Core Values of the Legal Profession for Lawyers Today and Tomorrow*, 28 NW. J. INT’L L. & BUS. 441, 443-44 (2008).

202. See *id.*

203. See *id.*

The practice of law has become increasingly global, growing exponentially since the mid-1980s.<sup>204</sup> This trend is exemplified by increases both in the trade of legal services and in the number of law firms that have established offices worldwide.<sup>205</sup> As corporations have gone transnational, the need for transactional services covering multiple national jurisdictions has increased.<sup>206</sup> And as transactions become increasingly complex, spanning multiple countries in law and location, law firms that want to compete must develop an international presence.<sup>207</sup>

Free market economic rationalism accompanies these trends as the dominant economic theory of globalization.<sup>208</sup> Firms in London now compete directly with firms in New York, a reality that has consequences for the consideration of law firm structure.<sup>209</sup> The practice of law is increasingly seen as the practice of business on the global level.<sup>210</sup> Clients demand cost-effectiveness, and the sheer number of firms competing for their business means that they will get it. In a world where competitiveness demands efficiency, the policy choices of the United Kingdom and Australia undoubtedly affect U.S. law firms.

In terms of pure economic competition, there are two main ways that the U.S. insistence on the partnership model might disadvantage U.S. firms. First, the ethical justifications for banning outside capital demand a certain level of “quality” of representation by U.S. firms that the new liberalized programs do not. In particular, prohibiting U.S. firms from offering non-legal services might make them less attractive to clients searching for a one-stop shop. If there are ethical trade-offs with the liberalized structure, then the policymakers of the United Kingdom and Australia are comfortable with them. In a market economy, the consumer dictates business. If corporate clients are willing to accept the risk of a violation of the professional rules for a cheaper price tag offered by firms in Australia and the United Kingdom, then U.S. firms may be shut out of the market for those “lower quality” services.<sup>211</sup> For example, the increasing practice of outsourcing legal work pre-

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204. James R. Faulconbridge et al., *Global Law Firms: Globalization and Organizational Spaces of Cross-Border Legal Work*, 28 NW. J. INT'L L. & BUS. 455, 456 (2008).

205. *Id.*

206. *Id.* at 457-58.

207. *See* Mark, *supra* note 160, at 1182-83.

208. *See id.* 1174-75.

209. *See* Faulconbridge et al., *supra* note 204, at 457-58.

210. *See id.* at 465 (noting that law firms that practice globally tend to have competitive advantages, such as “technology, management and marketing” over local firms).

211. *See* Mark Tuft, *Supervising Offshore Outsourcing of Legal Services in a Global Environment: Re-examining Current Ethical Standards*, 43 AKRON L. REV. 825, 844 (2010) (examining the ethical difficulties presented by outsourcing legal work to contract lawyers or lawyers outside of the United States).

sents ethical dilemmas, and the Model Rules require the outsourcing lawyer to manage and supervise the outsourced work in order to avoid an ethics violation.<sup>212</sup> The attendant ethical duties for the supervision of outsourced lawyers require the supervisor to ensure that the outsourced lawyer is in compliance with all of the ethical rules.<sup>213</sup> The supervision of non-lawyers requires that they are not engaging in the unauthorized practice of law.<sup>214</sup> Competitive complications may arise in the form of higher transaction costs or because competing codes of professional conduct have more relaxed rules regarding, for example, the unauthorized practice of law.

The second potential disadvantage to U.S. firms is a capital disadvantage. Large infusions of capital investments may give firms in the United Kingdom and Australia a head start on global expansion and encourage innovation. Some argue that law firms are not traditionally capital-intensive, and do not need a heavy dose of equity investment in order to expand. However, that argument is only true when comparing law firms of the same structure. When law firms compete, the organizational structures compete as well. Opportunities to take on additional risk, either in specific cases or in expansion decisions, demand flexibility and adaptability.<sup>215</sup> There are several examples of these opportunities where a capital advantage could be decisive. One is the potential for large-scale corporate law firm mergers. Following liberalization, markets tend to consolidate as a result of either mergers or rapid growth.<sup>216</sup> Another opportunity may also allow those law firms to “invest” in lawyers, where London firms poach successful New York partners.<sup>217</sup> Whether these turn out to be profitable strategies remains to be seen, but it is at least clear that firms without these capital contributions will likely be unable to compete for those opportunities.

## V. ANALYSIS

In 1977, prior to the enactment of the Model Rules, the ABA formed the Commission on the Evaluation of Professional Standards (Kutak Commis-

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212. *See id.* at 826, 844.

213. *See id.* at 829-30.

214. *Id.* at 831.

215. For example, a U.S. firm, bound by Model Rule 5.4, considering expansion in Australia will be faced with the same competitive dilemma that Australian law firms faced when they competed with non-lawyers for basic legal services under the old rules.

216. *See* STEPHEN DAVIES, THE ECONOMIC IMPLICATIONS OF PARTNERSHIP RESTRICTIONS IN THE LEGAL SERVICES SECTOR AND THEIR POSSIBLE REMOVAL 13 (2005), available at <http://competitionpolicy.ac.uk/documents/107435/107584/davies.pdf>.

217. *See* Ron Zapata, *U.S. Law Firm IPOs Inevitable, Legal Scholars Say*, LAW360 (Apr. 1, 2008, 12:00 AM), <http://www.law360.com/articles/51864/u-s-law-firm-ipos-inevitable-legal-scholars-say>.



sion) to examine whether the ABA should revise or replace the then-current Model Code of Professional Responsibility.<sup>218</sup> The Kutak Commission recommended a proposed rule 5.4 that focused on lawyer conduct rather than law firm structure, resulting in a proposed rule that would have allowed non-lawyer investment in and managerial control of law firms.<sup>219</sup> The proposed rule would have also permitted law firms to incorporate and be publicly traded.<sup>220</sup> Thus, the proposed rule would likely have accomplished the goals of allowing: (1) law firms to incorporate and access capital; (2) alternatively-structured law firms to flourish, with lawyers having the ability to engage in business arrangements and fee-sharing agreements with non-lawyers; and (3) law firms to decide whether to go public. Unfortunately, opponents presented several arguments addressing why ownership or management of law firms by non-lawyers was potentially harmful.<sup>221</sup> These arguments resonated with the ABA House of Delegates, which rejected the Kutak Commission's proposed rule and instead adopted the current Rule 5.4.<sup>222</sup> Recognizing that "expanding technology, the globalization of financial markets, and increased government regulation had reshaped client demand for legal services,"<sup>223</sup> the ABA formed the Commission on Multidisciplinary Practice in 1998.<sup>224</sup> In 2000, twenty-three years after the Kutak Commission's recommendation, the Commission on Multidisciplinary Practice acknowledged that the Model Rules were inappropriate in light of global developments;<sup>225</sup> however, the recommendation was once again overshadowed by ethical concerns and the Rules remain unchanged thirteen years later.<sup>226</sup>

Maintaining the Rules in their current form has stymied U.S. law firms by preventing access to much-needed infusions of capital and restricting alternative firm structures that could result in increased efficiency and competi-

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218. See GEOFFREY C. HAZARD, JR. ET AL., *THE LAW OF LAWYERING* § 1.12 (3d ed. 2009).

219. See Edward S. Adams & John H. Matheson, *Law Firms on the Big Board?: A Proposal for Nonlawyer Investment in Law Firms*, 86 CALIF. L. REV. 1, 8 (1998). See, e.g., KAN. RULES OF PROF'L CONDUCT R. 5.4 (2007); MO. RULES OF PROF'L CONDUCT R. 4-5.4 (2007); NEB. RULES OF PROF'L CONDUCT R. 3-505.4 (2008).

220. Adams & Matheson, *supra* note 219, at 9.

221. ABA, *A LEGISLATIVE HISTORY: THE DEVELOPMENT OF THE ABA MODEL RULES OF PROFESSIONAL CONDUCT, 1982-2005*, 580-81 (2006).

222. Matthew W. Bish, *Revising Model Rule 5.4: Adopting a Regulatory Scheme that Permits Nonlawyer Ownership and Management of Law Firms*, 48 WASHBURN L.J. 669, 670 (2009).

223. *Id.* at 678.

224. Ryan S. Christensen, *Roosters in the Henhouse? How Attorney-Accountant Partnerships Would Benefit Consumers and Corporate Clients*, 37 J. CORP. L. 911, 914 (2012).

225. See *id.* at 918.

226. See *id.*

tive advantages.<sup>227</sup> The Rules need to be modified to allow U.S. law firms to effectively compete in the global legal services industry. Such modifications could be paired with mandated disclosures and clauses in articles of incorporation or bylaws to prevent the concerns raised by opponents of the Kutak Commission's recommendations.

*A. The ABA Needs to Modify the Model Rules to Address the Legal Needs of a Changing Society*

As global society changes, so do its legal needs and, subsequently, so does the means by which the legal profession addresses those needs. In 2000, the Commission on Multidisciplinary Practice acknowledged the impact of forces upon society and the legal profession, and the disconnect between the Model Rules and our changing society.<sup>228</sup> Among the needs identified were improved access to legal services and greater transparency of law firm management and operations.<sup>229</sup> Twelve years later, the ABA continues to refrain from modifying Model Rules 5.1 and 5.4 to align with the realities of the world in which they are to operate. To address the changing legal needs of society, including the aforementioned needs for access and transparency, the ABA needs to embrace that which scholars and commentators propose, Australia and the United Kingdom permit, and some state legislatures have contemplated: enabling law firms to incorporate and engage in alternative business structures, with limitations.

**1. Alternative Business Structures Are Mutually Beneficial to Law Firms and Interested Parties**

The flexibility of the alternative business structure is mutually beneficial to law firms and interested parties. The alternative business structure vehicle provides firms with greater access to the capital markets as well as flexibility of funds and management structures.<sup>230</sup> Increased access to capital allows law firms to more heavily invest in technology, knowledge management systems, and new lawyer training.<sup>231</sup> Investment in these resources enables law firms to deliver higher-quality legal services more efficiently. In addition, the

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227. See Hodge, *supra* note 54, at 92-93.

228. See Christensen, *supra* note 224, at 918.

229. *Id.* (The ABA Commission on Multidisciplinary Practice listed forces that have impacted society and the legal profession including: client interest in more efficient and less costly legal services; advances in technology and telecommunications; globalization; and lack of lawyer accountability.)

230. See Neil Rose, *Top Consumer Law Firm Targets Tie-Up with Big Brands After Receiving ABS License*, LEGALFUTURES (Nov. 1, 2012), <http://www.legalfutures.co.uk/latest-news/exclusive-top-consumer-law-firm-targets-tie-up-big-brands-receiving-abs-licence> [hereinafter Rose, *Top Consumer Law Firm*].

231. See MacEwen et al., *supra* note 51, at 84.

flexibility of the alternative business structure permits strategic partnering of attorneys with other professionals.<sup>232</sup> As a result, law firms would have the ability to target a greater number of client types.<sup>233</sup> Firms would be able to continue assisting those clients most in need, but could also cater to other client types with varied issues.<sup>234</sup>

Existing and prospective clients and the general public would also reap the benefits of law firms adopting alternative business structures. Today's clients, irrespective of their classification or socio-economic statuses, often have legal needs that are inseparable from their other professional service needs.<sup>235</sup> Investments in the working and human capital at a firm would enable the firm to address the multidisciplinary issues of their clients. In turn, clients would find the alternative business structure appealing as a convenient one-stop shop that could offer a comprehensive solution to their legal and non-legal issues.

## 2. Cost of Capital and Public Demand Compel Law Firms to Increase Transparency Regardless of Their Governance Structure

Proponents of law firms incorporating and adopting alternative business structures appreciate that limitations on governance structures need apply. For instance, increased access to capital and flexibility of funds would result in a need for greater transparency of law firms.<sup>236</sup> The rationale is two-fold. The cost of capital (particularly public capital) includes a tangible social cost, one that manifests itself through the general public's demand for transparency.<sup>237</sup> Parties with vested interests in incorporated or alternative business

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232. See Neil Rose, *Focus: Alternative Business Structures – Law and New Order*, THE LAWYER (Nov. 6, 2011), <http://www.thelawyer.com/news-and-analysis/the-lawyer-management/abs-news-and-analysis/focus-alternative-business-structures-law-and-new-order/1010138.article> [hereinafter Rose, *Alternative Business Structures*] (Alternative business structures in the United Kingdom are recognized as purposeful entities that function as tools for law firms to employ strategically in building global and diverse practice rather than simply ends in themselves); see also Rose, *Top Consumer Law Firm*, *supra* note 230.

233. See Rose, *Alternative Business Structures*, *supra* note 232.

234. See Hodge, *supra* note 54, at 92 (Law firms can afford taking on riskier client types or contingency fee cases with high pay-off potential).

235. See Cliff Ennico, *How to Hire an Attorney*, ENTREPRENEUR, <http://www.entrepreneur.com/article/58326-1> (last visited Aug. 19, 2013) (urging that every business needs a lawyer to handle the intricacies of the law and further the ultimate success of the business).

236. See generally Studer, *supra* note 94, at 1.

237. See SADOK EL GHOUL ET AL., DOES CORPORATE SOCIAL RESPONSIBILITY AFFECT THE COST OF CAPITAL? 3-4 (July 2010), available at [http://www.edwards.usask.ca/centres/csfm/\\_files/presentations/dev%20mishra.pdf](http://www.edwards.usask.ca/centres/csfm/_files/presentations/dev%20mishra.pdf) (arguing that socially responsible companies have higher valuation and lower risk, creating incentives to demonstrate a commitment to socially beneficial practices).

structure law firms, such as investors, employees, and clients (existing and prospective), should be able to obtain general information on the firm.

Here we suggest transparency of the firm financials, at a basic and unobtrusive level. Though law firms may cringe at the idea of increased transparency of their financials, they likely will be willing to pay the price in order to incorporate or adopt alternative business structures. Experience shows that publicly-traded law firms in Australia and the United Kingdom are willing to make this sacrifice.<sup>238</sup> The best means by which to achieve this financial transparency is through a disclosure requirement. Consider the financial industry and the SEC's mandatory disclosure requirements.<sup>239</sup> In order to respond to such criticisms and continue as a self-governing profession,<sup>240</sup> law firms should be subject to disclosure requirements analogous to those imposed by the SEC,<sup>241</sup> regardless of the firms' governance structures.

*B. There Should Be Mandatory Disclosure of Basic Financial Information for All Incorporated Law Firms and Other Law Firms Employing 100 or More Attorneys*

"Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."<sup>242</sup> Regardless of the applicability of securities laws to an incorporated law firm,<sup>243</sup> any state that allows law firms to assume a corporate structure should require the disclosure of basic financial documentation. States, of course, would be perfectly free to set the terms of use for incorporated law firms, just as they are free (within the confines of federal preemption) to implement their own security "blue sky" laws. Indeed, the benefits of this disclosure are significant enough that the disclosures should be required of all law firms with more than 100 lawyers, regardless of governance structure. For too long the finances of large law firms have been sheltered from public view,<sup>244</sup> avoiding the scrutiny of investors, employees, and prospective

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238. See Lloyd, *supra* note 176.

239. See, e.g., SEC, FORM X-17A-5, available at [http://www.sec.gov/rules/other/nasdaqllcf1a4\\_5/g\\_secform.pdf](http://www.sec.gov/rules/other/nasdaqllcf1a4_5/g_secform.pdf) (last visited July 21, 2013) (requiring brokers and dealers to disclose basic financial information and an audited balance sheet on a quarterly basis).

240. See generally MODEL RULES OF PROF'L CONDUCT PREAMBLE AND SCOPE COMMENT 10, *supra* note 200.

241. See generally SEC, FINANCIAL REPORTING MANUAL, available at <http://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.shtml> (last visited Aug. 19, 2013) (outlining SEC's financial disclosure requirements).

242. LOUIS BRANDEIS, OTHER PEOPLE'S MONEY 92 (1914).

243. See *supra* Part III.A.3.

244. See Grand, *supra* note 89, at 391 ("The SEC requires national exchanges such as the NYSE and NASDAQ to de-list companies that do not comply with its disclosure and audit rules; law firms face no similar consequences. And there is no

employees alike.<sup>245</sup> Large law firms should be required to disclose financial information for both the good of the general public and the good of lawyers.

A disclosure requirement would simply extend the normal requirements for a business to furnish books and records to its stakeholders, recognizing that the general public has a stake in the provision of legal services. It would also be similar to the requirement that other professionals, such as broker-dealers, furnish basic information to the public regarding the financial situation of their firms.<sup>246</sup> A shareholder already has a limited right to inspect the books and records of a corporation.<sup>247</sup> A partner has a similar right to access the books and records of the partnership, as well as information reasonably required to properly exercise the partner's functions.<sup>248</sup> These rights of access mean that a mandatory disclosure regime would only expand the ability to find financial information beyond the direct owners of the partnership or corporation. There is little reason not to provide freely to the public that which must already be furnished to the ownership of a firm. The cost of distributing this information is not a concern, simply because it could be done electronically.<sup>249</sup> Because the public has a similar interest to the partners in understanding and knowing the finances of a law firm, all firms of over 100 lawyers should be required to make minimally-intrusive financial disclosures available to the public.

### 1. Disclosure Would Benefit Attorneys and Prospective Employees

Attorneys should welcome the implementation of disclosure requirements for large law firms. The current lack of information regarding internal firm finances can lead to the sudden and spectacular collapse of large law firms with hardly any notice.<sup>250</sup> This sudden collapse is possible because of

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threat of a shareholder class action for breach of fiduciary duty to strike fear among law firm partnerships as it does among directors of public companies.”).

245. *But see* Cox, *supra* note 37, at 523 (“Hiring partners and recruiters have noticed that, in contrast to flush times when candidates are chiefly concerned about personal fit and compensation, they now ask ‘more specific questions about the financial history, equity levels, borrowing habits and financing plans of the firms they are considering.’”).

246. *See, e.g.*, SEC, FORM X-17A-5, *supra* note 239.

247. *See, e.g.*, DEL. CODE ANN. tit 8, § 220 (West, Westlaw through 79 Laws 2013); MINN. STAT. ANN. § 302A.461 (West, Westlaw through 2013 Regular Sess.).

248. REVISED UNIF. P'SHIP ACT § 403 (2012).

249. *See Electronic Records Transition: What's Your Status?*, IRON MOUNTAIN, <http://www.ironmountain.com/Knowledge-Center/Reference-Library/View-by-Document-Type/General-Articles/E/Electronic-Records-Transition-Whats-Your-Status.aspx> (last visited Feb. 18, 2013) (asserting that using electronic records reduces costs, boosts efficiency, and decreases data error).

250. *See, e.g.*, Linda Sandler & Sophia Pearson, *After Dewey & LeBoeuf, It's Lawyers v. Lawyers*, BLOOMBERG BUSINESSWEEK (May 31, 2012), <http://www.businessweek.com/articles/2012-05-31/after-dewey-and-leboeuf-its-lawyers-v-dot->

the ability of a law firm to take on large amounts of debt in anticipation of expansion, while the firm's rainmakers are not obligated to stay and keep their clients with the firm.<sup>251</sup> The exit of major partners can deprive a firm of the revenues it had depended upon to pay the interest on debt, creating a sudden and catastrophic collapse.<sup>252</sup> A minimum level of disclosure would help to prevent surprise collapses by warning employees about the amount of leverage a firm has taken on. Employees would then be able to plan for the amount of risk that the firm's finances presented, and minimize their exposure to loss. Recent hires and prospective employees would not waste time considering a firm that they believed to be "too risky" for their personal tastes.

Additionally, disclosure would have numerous benefits for firms that are not at risk.<sup>253</sup> Disclosing firm finances would dispel rumors among employees that the situation is unstable, keeping partners and associates at the firm by easing fears of financial stress.<sup>254</sup> This would help to alleviate the difficulties of a transient workforce twice over. Openness about the financial situation would show employees the reason for certain financial or compensation decisions, eliminating any "us versus them" mentalities and facilitating cooperative solutions.<sup>255</sup> Disclosure regarding firm hiring and promotion practice accompanying firm financials could assist recruitment efforts by dispelling worries of sexism at the firm, or eliminate sexism – intentional or not – by shaming any firms with gender-disparate results.<sup>256</sup> All in all, the majority of a law firm's associates, potential associates, non-lawyer employees, and even many partners should enjoy the benefits of knowing the true financial situation of the firm.

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lawyers ("The firm, based in New York, fell apart in a matter of weeks this year after ousting its chairman and watching at least 250 of its 304 partners decamp to competing firms.").

251. See Robert W. Hillman, *Professional Partnerships, Competition, and the Evolution of Firm Culture: The Case of Law Firms*, 26 J. CORP. L. 1061, 1067 (2001) (describing the ability of partners to move to new firms and take their clients with them, creating financial instability at the abandoned firm).

252. Although a firm will be able to insist on payment of a share of client fees for representation, which began at the firm, the exodus of partners will nonetheless deprive the firm of cash flows of future representation of that client. See *id.* at 1069-74. This share of fees for future representation will often be far more valuable than the representation on the particular matter of representation when the partner departs. *Id.*

253. See generally Studer, *supra* note 94, at 1.

254. *Id.* ("People assume the worst when they don't hear from leaders.").

255. *Id.*

256. See Grand, *supra* note 89, at 410-11 (describing how disclosure could remedy gender discrimination in law firm hiring and promotions practices).

## 2. Disclosure Would Benefit Clients and Prospective Clients

Consider the collapse of a law firm from the client's point of view. A client has every incentive to avoid a firm teetering on the brink. The client has selected a particular law firm for its competence in the field and invests a significant amount of time and money in obtaining legal assistance. Upon collapse, the partners and associates assigned to represent this client may scatter to any number of different firms.<sup>257</sup> If the client is lucky, one of the departing partners keeps the file; otherwise, it is time to find new counsel.<sup>258</sup> The client could potentially end up paying to replicate large portions of the representation, including basic review of the file. Worse, during a bankruptcy regulators may wish to inspect a firm's documents, including files that may be confidential and privileged. Hearings would be required to explain why such documents are covered by attorney-client privilege, and this becomes more complicated when counsel is no longer in the business.<sup>259</sup> The client's entire case could end up delayed as a result of the legal team representing it being shattered.<sup>260</sup> This is a nightmare for a client to face. A client would therefore have every incentive to check firm finances and avoid firms that present a substantial risk of collapse, unless it could obtain a discount on legal fees proportionate to the risk. This risk premium would provide another incentive to law firms to avoid over leveraging.

## 3. Disclosure of Firm Finances Would Benefit Shareholders and Creditors

The general public – including creditors and any potential shareholders – could benefit from the disclosure of some amount of financial in-

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257. See, e.g., Martin Coyle & Julie DiMauro, *Dewey & LeBoeuf Collapse Highlights Importance to Clients of Safeguarding Records*, REUTERS (June 1, 2012), <http://blogs.reuters.com/financial-regulatory-forum/2012/06/01/dewey-leboeuf-collapse-highlights-importance-to-clients-of-safeguarding-records/> (“Records for clients of attorneys moving to other firms would be transferred, as in the case of any lateral transfer. The issue of records pertaining to clients not associated with any departed attorneys is more problematic, because the firm has an obligation to notify such clients and arrange for the proper disposition of the records.”).

258. *Id.*

259. See *id.* (“[A] judge might need an explanation as to why a document was covered by the privilege badge. A firm and its lawyer might need to explain this in court.”).

260. See Nate Raymond & Jessica Dye, *Fallout from Dewey Collapse Hits Clients*, CHICAGO TRIBUNE (May 28, 2012), [http://articles.chicagotribune.com/2012-05-28/news/sns-rt-us-dewey-clientsbre84r0lc-20120528\\_1\\_clients-firm-winston-strawn](http://articles.chicagotribune.com/2012-05-28/news/sns-rt-us-dewey-clientsbre84r0lc-20120528_1_clients-firm-winston-strawn) (describing a sixty-day reprieve granted to the Arab Bank Group, a defendant represented by Dewey & LeBoeuf lawyers, because its defense team was “decimated” by the bankruptcy).

formation from large law firms. Currently, public perceptions and creditors' views of firms are shaped by the limited information provided by law firms, leading to an extreme emphasis on profits-per-partner rather than firm finance as a whole.<sup>261</sup> These metrics are easily manipulated by firms that seek to bolster appearances simply by creating more "non-equity partners" and decreasing equity partners, or by cutting out low revenue or pro bono services.<sup>262</sup> Law firms focusing on these numbers have strong incentives to sacrifice long-term stability for short-term gains in purely money-driven metrics.

By contrast, a law firm providing a more detailed picture of its finances would be less likely to be able to hide untoward details from the public behind a favorable profit-per-partner number. Sunlight, as Louis Brandeis suggested, would prove a powerful disinfectant for a law firm focusing too strongly on bottom-line numbers. The general public, be they creditors, potential shareholders, stakeholders, or clients, would all be able to form a more accurate understanding of a firm's position in society if the firm were required to disclose financial information to the public.

#### 4. Disclosure Is Compatible with Ethical and Legal Confidentiality Requirements

Opponents of law firm incorporation have argued that the confidentiality requirements of the attorney-client relationship are incompatible with the mandatory disclosure required by the SEC and state securities laws.<sup>263</sup> In essence, the argument goes as follows: first, a lawyer has an obligation to maintain the confidentiality of his clients' matters.<sup>264</sup> Second, either a mandatory disclosure regime – such as that required by securities laws – or a financial disclosure system could require a firm to disclose when new clients opt to retain its services but before the clients are ready to make a public announcement.<sup>265</sup> One particularly acute example of this would be if a firm specializing in mergers and acquisitions had been hired in confidence by a large corporation to consider a possible acquisition. Such an event could be considered material information required to be disclosed in a financial report, but disclosure would run contrary to the client's justified need for discretion

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261. See Petzold, *supra* note 56, at 89; MacEwen et al., *supra* note 51, at 72-73 (indicating profits per equity partner and revenue per lawyer receive the most emphasis and affect firm behavior the most of any metric).

262. See MacEwen et al., *supra* note 51, at 76.

263. See, e.g., Hodge, *supra* note 54, at 93; Steve Mark, *Views from an Australian Regulator*, 2009 J. PROF. LAW. 45, 56-58 (2009).

264. MODEL RULES OF PROF'L CONDUCT R. 1.6 (2012).

265. For example, if a firm retains a client with a substantial up-front fee shortly before publishing its annual 10-K report or the mandatory reporting proposed herein, skeptics argue that it would be required to disclose information regarding the source of these funds in breach of client confidences.



lest stock prices of its potential targets rise prematurely. However, this concern for inconsistent obligations is overblown.

First, there may not actually be a contradiction between mandatory disclosure and client confidences. Generally speaking, the securities laws and disclosure regimes only require reports on *material* information, and the U.S. Supreme Court has defined this as information which would have a “substantial likelihood” to be “viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.”<sup>266</sup> It is reasonable to wonder when the exact identity of a party might ever be capable of significantly altering the total mix of information available to an investor. Surely the only “material” information to an investor would be the amount of money and the certainty of payment, without need for specific information that could breach client confidences. Indeed, in crafting a new mandatory disclosure regime states could carve out an exception stating that any information that personally identifies a client would not be deemed material.<sup>267</sup>

Second, we can turn to the experience of Australia and its publicly-traded law firms for guidance about how to handle potential conflicts. Slater & Gordon are subject to reporting requirements, which include a continuous disclosure requirement for information that could have a material effect on stock valuation.<sup>268</sup> The Australian authorities found a simple yet elegant solution: simply require disclosure up-front in the prospectus and state that the duties to the client would trump the duties to the shareholder in cases of conflict.<sup>269</sup> Placing shareholders on notice that the firm will not breach client confidences should it face a contradiction like this serves to even further remove the information regarding client identity from materiality because shareholders will be able to discount their purchase price to account for this risk.

Finally, the SEC already allows for requests for confidential treatment of information that would otherwise be disclosed.<sup>270</sup> These confidential treatment requests are available for reasons that parallel the exemptions under the Freedom of Information Act.<sup>271</sup> The most pertinent of these exceptions

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266. *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

267. *See Cobb, supra* note 123, at 774-75 (suggesting, for example, that either a regulatory carve-out for certain information or even confidentiality agreements for nonlawyer managers could successfully keep confidential client information private).

268. *See generally* Steve Mark, *supra* note 263, at 56-58 (describing Australian reporting requirements).

269. *See id.* at 58 (“the evident tension in duties may be resolved through careful drafting of the corporation’s prospectus, constituent documents and shareholder agreements . . .”).

270. *See* 17 C.F.R. §§ 200.80, 230.406, 240.24b-2 (2013); SEC, *Confidential Treatment Requests*, SEC.GOV (July 11, 2001), <http://www.sec.gov/interps/legal/slbcl1r.htm>.

271. 5 U.S.C. § 552(b) (2012) (exempting from public disclosure matters covered by statutes either without discretion or according to particular criteria).

are for trade secrets and confidential commercial or financial information, and for information specifically exempted from disclosure by statute.<sup>272</sup> Even if confidential client information were otherwise subject to disclosure under the securities laws or an expanded disclosure regime, a similar exemption for confidential treatment of the most sensitive information should take precedence over the needs for disclosure. All in all, there is no reason to suspect that the obligation of confidentiality is actually in tension with reasonable disclosure requirements in practice because of materiality limitations and confidentiality exceptions.

### 5. Disclosure for All Firms of More Than 100 Lawyers

For the foregoing reasons, basic disclosure is essential for all firms of more than 100 lawyers, regardless of whether these firms choose to incorporate. The disclosure for these firms does not need to be as extensive as the disclosure for compliance with securities regulations; instead, this disclosure regime could be modeled around the requirements for other professionals. One example of this less extensive disclosure regime is the requirement of broker-dealers to submit quarterly Financial and Operational Combined Uniform Single Reports, as required under Exchange Act Rule 17a-5.<sup>273</sup> This report does not rise to the level of other SEC documents, such as registration statements, but is nonetheless sufficient for a potential customer to infer the financial solvency of the broker-dealer and to guard against some risky financial decision-making by the broker. This information should be required of legal professionals for similar reasons it is required of brokers: because sunlight is the best disinfectant for unsound financial practices.

The basic mandatory reporting required of law firms of more than 100 lawyers would not present any significant confidentiality concerns. The reporting would be restricted to a basic balance sheet and income statement, omitting any client-specific details that could jeopardize confidentiality. The required information would simply relate to solvency of the firm: assets, liabilities, income, and expenses, broken down into constituent but not client-specific categories. The disclosure of this information would permit current and prospective employees and clients, as well as potential creditors, to judge the financial solvency of the firm before making any decisions regarding representation or investment. The result would likely be a more efficient market for legal representation and employment by large law firms, and a cleansing of debt-heavy balance sheets due to unfavorable market reaction to unsound financial strategies.

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272. *Id.* § 552(b)(3)-(4).

273. See generally 17 C.F.R. § 240.17a-5 (2013) (requiring the filing of audited financial statements and the information required on related SEC forms, as well as delivery to customers that request the information); SEC, FORM X-17A-5, *supra* note 239.

The legal profession has largely remained a self-regulating industry. Other self-regulating industries have recognized the importance of financial disclosure to the maintenance of professional standards.<sup>274</sup> By requiring the legal profession to engage in the same disclosure that the legal profession expects of others, we could raise the ethical standards of lawyers and ensure the financial security of large law firms in the future. This would benefit lawyers, their clients, and the law firms themselves moving forward.

## VI. CONCLUSION

Introducing the corporate form to U.S. law firms is a step overdue. The potential benefits of this structure – increased efficiency and innovation, which would increase access to higher quality legal services – far outweigh the speculative sacrifices to professional ethics. Increased transparency and mandatory financial disclosure will end the practice of obscuring law firm performance in misleading financial information. Clients deserve better, and if U.S. firms want to remain competitive in the market for global legal services they must have access to more flexible business structures. The notion of the law firm as an entity distinct from a business is dying. Other countries are recognizing that fact and are implementing changes that will disadvantage U.S. firms. The writing was on the wall for bloated firms saddled with debt when the 2008 recession hit. The time has come to change course and treat law firms as the global enterprises they have become.

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274. For example, the Financial Industry Regulatory Authority (FINRA) acts as the self-regulatory organization for securities firms and provides regulation and oversight to brokerages. Among other services, FINRA uses disclosure as a mechanism to protect investors.

FINRA believes that investor education is a critical component of investor protection. Over the last decade, we have worked hard to develop a strong investor education outreach program. We produce alerts, interactive tools and educational content to help investors make wise financial decisions. Our BrokerCheck tool, for example, provides investors with a quick way to check a broker's disciplinary and professional background. Encouraging people to take this simple step before doing business – or continuing to do business – with a broker is part of our greater commitment to protecting investors.

Richard G. Ketchum, *Chairman's Message*, FINRA, <http://www.finra.org/AboutFINRA/> (last visited July 21, 2013).