

Lawyers, Symbols, and Money: Outside Investment in Law Firms

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Two recent developments have startled some people who follow the legal profession. The first was in May 2007, when the Australian law firm of Slater & Gordon engaged in an initial public offering (“IPO”) and became listed on the Australian stock exchange.¹ The second occurred at the end of October 2007, when the United Kingdom (“UK”) passed legislation allowing non-lawyer investors to acquire interests in law firms in England and Wales.²

A law firm with non-lawyer owners provides a sharp contrast with what I call the classic partnership model of the firm. The difference between the two is basic; they represent differences in kind, not simply of degree. From the perspective of the classical partnership, outside³ investment is fundamentally incompatible with the traditional character of the legal profession.

I don’t think this is the most useful comparison, however, in evaluating the prospect of outside investment in law firms. As I describe below, firms over the past twenty-five years increasingly have departed from the classic partnership model in substance, even as they largely have remained partnerships in form. We can loosely characterize this as a movement toward more of a corporate organizational model.

In considering the benefits and costs of outside investment in law firms, we need to compare a law firm with outside investors with the firm of today, which is a mixture of partnership and corporation. How different would a firm with outside investment be from the modern hybrid firm? Is outside investment simply the next logical step in the

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1. Alexia Garamfalvi, *In a First, Law Firm Goes Public*, LEGAL TIMES, May 22, 2007, available at <http://www.law.com/jsp/article.jsp?id=1179751700602>.

2. Legal Services Act, c. 29 (2007), available at http://www.opsi.gov.uk/acts/acts2007/pdf/ukpga_20070029_en.pdf.

3. By “outside” investment, I mean equity investment by non-lawyer investors.

evolution of the law firm? Or would it be a watershed moment that fundamentally changes the legal profession? Should the United States follow the lead of Australia, England, and Wales, or should it draw the proverbial line in the sand and insist that only lawyers may own law firms?

It is possible that few, if any, major law firms may take advantage of authority to raise capital from outside investors. Firms that do so may be those that represent mainly individuals, as is the case with Slater & Gordon. Even so, permitting outside investment could change the terms of the debate on regulation of the legal profession. Specifically, it could prompt a more vigorous discussion of whether self-regulation should give way to a regulated industry model. The result could be a more sophisticated discussion about the complex interplay between financial and professional demands, and greater focus on the practice entity rather than the individual lawyer.

Such a discussion is long overdue. There has been ample criticism for some time that relying heavily on self-regulation provides too much opportunity for self-interested behavior and too little consideration of important social values served by the practice of law.⁴ Restricting both law firm ownership and professional regulation to lawyers rests on and perpetuates the assumption that only lawyers are fit to determine the obligations to which they will be subject. Self-ownership of the firm thus mirrors self-regulation of the profession. It ostensibly provides a small-scale model of how lawyers as a group can be trusted to govern themselves.

This approach is inapt in a world in which lawyers increasingly are viewed as but one group of professional service providers among many. As Laurel Terry has documented, a substantial amount of state, federal, and transnational regulation reflects the adoption of an emerging paradigm in which “the legal profession is not viewed as a separate, unique profession entitled to its own individual regulations, but is included in a broader group of ‘service providers,’ all of whom can be regulated together.”⁵ This paradigm demands that if lawyers desire distinctive treatment, they need to be prepared to explain specifically why this is necessary in order to protect client or social interests.⁶

4. See DEBORAH L. RHODE, *IN THE INTERESTS OF JUSTICE: REFORMING THE LEGAL PROFESSION* 143-83 (2000).

5. LAUREL S. TERRY, *THE FUTURE REGULATION OF THE LEGAL PROFESSION: THE IMPACT OF TREATING THE LEGAL PROFESSION AS “SERVICE PROVIDERS”* 1 (2008), available at <http://www.abanet.org/cpr/terry.pdf>.

6. *Id.* at 21.

To appreciate how permitting non-lawyer ownership could spark a debate about professional regulation, it's helpful to examine the characteristics of the classic partnership, the supposed rationales for its existence, and the ways in which it purports to strike a balance between financial goals and professional values. Next, we need to consider the forces that have prompted firms to move away from this model, and the specific ways in which they've done so. Finally, we need to explore how these changes have affected law firms' ability to balance financial goals and professional values, and the extent to which a self-regulatory model adequately addresses this state of affairs.

In what follows, I offer a few preliminary thoughts on these issues. My focus will be on major law firms that provide services to corporate clients, not on smaller law practices that provide services to individuals. I think that the argument for the availability of outside investment capital in the latter setting may be especially strong, because of its potential to further the provision of more cost-effective and widely accessible legal services for individuals.⁷ I focus on large law firms because the issue of non-lawyer ownership is more complex in that sector, and because that issue serves as an important vehicle for addressing the broader question of how the legal profession should be regulated.

I. RECENT DEVELOPMENTS

A. *Australia*

I'll start with Australia, and describe what has happened there. I'm going to focus on the New South Wales legislation and regulations, which most other Australian states have followed.⁸ The Legal Profession Act ("LPA") enables providers of legal services to register as Incorporated Legal Practices ("ILPs") with the Australian Securities and Investments Commission.⁹ The ILP is then governed by its articles, the LPA and regulations adopted under it, and the nationwide Corporations Act.¹⁰ The latter gives the ILP access to the full range of fundraising options that are available to other business corporations.

7. See generally UK DEP'T FOR CONSTITUTIONAL AFF. THE FUTURE OF LEGAL SERVICES: PUTTING CONSUMERS FIRST (2005), available at http://www.dca.gov.uk/legalsys/folwp_sm1.pdf.

8. 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 STATE INT'L L. REV. 671 (2004).

9. *Id.* at 674.

10. *Id.*

Law firm partners become “solicitor directors” of the ILP, and remain subject to professional obligations.¹¹ To the extent that the LPA or regulations conflict with the Corporations Act, the LPA is to prevail.¹² Thus, for instance, an ILP must comply with financial reporting requirements in the Corporations Act.¹³ At the same time, its lawyers have duties of confidentiality that limit what they can disclose.¹⁴ The result is that there is an exception to ILPs’ securities disclosure obligations for any information that a lawyer is required to keep confidential.

An ILP must have at least one solicitor director responsible for management of the legal services provided by the firm.¹⁵ It is professional misconduct for any solicitor director not to ensure that “appropriate management systems” are in place to enable provision of legal services: (1) in accordance with the professional obligations of practitioners and (2) so that the obligations of Australian lawyers who are officers or employees of the practice are not affected by the behavior of non-lawyer officers or employees.¹⁶ The solicitor director must take steps to ensure that breaches of professional obligations do not occur and that remedial action is taken if they do.¹⁷

The solicitor director is liable for disciplinary action for an ILP’s inadequate management system, disciplinary breaches by any lawyer employed by the ILP, the conduct of non-lawyer directors of the ILP that adversely affects the provision of legal services, and the unsuitability of any non-lawyer director of the ILP to be a director of a corporation that provides legal services.¹⁸

In each state, the entity responsible for regulating the legal profession takes main responsibility for auditing ILPs’ compliance with

11. *Id.*

12. *Id.*

13. Mark & Cowdroy, *supra* note 8, at 679-80.

14. *See, e.g.*, THE LAW SOCIETY OF NEW SOUTH WALES, PROF’L CONDUCT AND PRACTICE RULES R. 3.1, *available at* <http://www.lawsociety.com.au/page.asp?PartID=574> (stating “[a] practitioner must never disclose to any person, who is not a partner director or employee of the practitioner’s firm any information, which is confidential to a client and acquired by the practitioner or by the practitioner’s firm during the client’s engagement. . . .”); *see also* Legal Profession Act § 703, 2004, No. 113 (Austl.-N.S.W.), *available at* http://www.austlii.edu.au/au/legis/nsw/consol_act/lpa2004179/s703.html (stating “[t]he Law Society Council may make rules for or with respect to engaging in legal practice as a solicitor”).

15. Mark & Cowdroy, *supra* note 8, at 681.

16. *Id.* at 686-87.

17. *See id.* at 689-92.

18. *Id.* at 686-87.

requirements of the LPA and Regulations.¹⁹ The College of Law has taken the lead in developing Law Best Practices based on LAW 9000 Quality Management. In collaboration with SAI Global, it then certifies firms who meet these standards, with such certification satisfying firms' obligations under the LPA and Regulations.²⁰

The first Australian law firm to take advantage of the ability to solicit non-lawyer investors was Slater & Gordon.²¹ This firm litigates on behalf of consumers, workers, and plaintiffs in class action personal injury lawsuits.²² The firm was founded in 1935, and has litigated several major cases against corporate defendants.²³ At the time of its public offering, Slater & Gordon had 140 lawyers in several offices throughout Australia.²⁴ It projected \$58 million in revenue and \$9 million in profits for the fiscal year in which the offering occurred.²⁵

Prior to the stock offering, a handful of key lawyers (the "vendor" shareholders) owned shares in the firm.²⁶ The shares were based on personal capital contributions that these lawyers had made to fund litigation by the firm. Such funding was necessary because Slater & Gordon and other personal injury and plaintiffs' class action firms represent many clients under a conditional fee arrangement.²⁷ As is the case under a contingent fee agreement in the United States, lawyers who operate under a conditional fee arrangement in Australia generally do not collect fees in cases in which their clients are not successful. If a case is

19. For instance, in New South Wales, the Office of the Legal Services Commissioner is responsible for auditing ILPs for compliance. *See* Legal Profession Act 2004 § 670, No. 113 (Austl.-N.S.W.), *available at* http://www.austlii.edu.au/au/legis/nsw/consol_act/lpa2004179/s670.html. In Queensland, auditing is conducted by the Legal Services Commission. *See* Legal Profession Act 2007, § 130 (Austl.-Queensland), *available at* <http://www.legislation.qld.gov.au/LEGISLTN/ACTS/2007/07AC024.pdf>. In Western Australia, audits are conducted by the Legal Practice Board. *See* Legal Practice Act 2003, § 68 (Austl.-W. Austl.), *available at* http://www.austlii.edu.au/au/legis/wa/consol_act/lpa2003120/s68.html.

20. *See* The Law Society of New South Wales, Law 9000/QL Best Practice, <http://www.lawsociety.com.au/page.asp?PartID=5936#anchor47124> (last visited Sep. 20, 2008); SAI, Legal Best Practice, <http://www.sai-global.com/assuranceservices/certification/Law9000/> (last visited October 20, 2008); The College of Law, Centre for Best Practice, <http://www.collaw.edu.au/cbp/index.asp> (last visited October 20, 2008); Kellie Harpley, *Quality Assured? The New Law 9000 Quality Assurance Program*, LAWYERS WKLY. ONLINE, Jan. 21, 2005, http://www.lawyersweekly.com.au/articles/Quality-assured-The-new-Law-9000-quality-assurance-system_z66318.htm.

21. *See generally* SLATER & GORDON LTD., PROSPECTUS (2007), *available at* <http://www.slatergordon.com.au/docs/prospectus/Prospectus.pdf>.

22. *Id.* at 20.

23. *Id.*

24. *Id.* at 26.

25. *Id.* at 11.

26. SLATER & GORDON LTD., *supra* note 21, at 15.

27. *Id.* at 23, 30, 86.

successful, the lawyer is entitled to its ordinary fees plus a percentage of those fees—as opposed to a percentage of the recovery as would be the case if it were a contingent fee in the United States. A firm such as Slater & Gordon thus can incur substantial costs on matters, which it will recover only at the end of the case, often only if the litigation is successful.

The vendor shareholders owned 77.5 million shares, and an Employee Stock Ownership Program (“ESOP”) owned 12.5 million shares at the time of the offering. In the stock offering, Slater & Gordon sold 17.3 million of the vendor shares and issued 17.7 million new shares, all of which were acquired by professional and institutional investors.²⁸ The shares opened at \$AU1 per share, closed at \$AU1.40, and generated \$AU49 million in proceeds. At the close of the offering, vendor shareholders held 63% of the voting rights in the firm, while outside investors held 37% (the ESOP has no voting rights).²⁹

In an effort to ensure that key lawyers in the firm would remain in place instead of simply cashing out, the prospectus provides that vendor shareholders may sell no more than 20% of their shares each year for a five-year period.³⁰ Furthermore, such lawyers must maintain minimum share ownership while they are at the firm that is equal to the lower of five times annual salary or 20% of shareholdings at time of the IPO.³¹

The prospectus for the offering sets forth the firm’s hierarchy of duties:

Lawyers have a primary duty to the courts and a secondary duty to their clients. These duties are paramount given the nature of the Company’s business as an Incorporated Legal Practice. There could be circumstances in which the lawyers of Slater & Gordon are required to act in accordance with these duties and contrary to other corporate responsibilities and against the interests of Shareholders or the short-term profitability of the Company.³²

Slater & Gordon has used the proceeds of the offering to acquire several other small and mid-size firms in Australia, thus consolidating to some degree the market for consumer, employee, and personal injury plaintiffs’ side litigation.³³

28. *Id.* at 14.

29. *Id.* at 86.

30. *See id.* at 38.

31. SLATER & GORDON, *supra* note 21, at 87.

32. *Id.* at 84.

33. *See Legal Advice: Should you buy shares in a law firm?*, THE ECONOMIST, Aug. 21, 2008, available at http://www.economist.com/business/displaystory.cfm?story_id=11967043.

B. United Kingdom

The UK Legal Services Act of 2007 contained several provisions overhauling the legal services system in England and Wales. Relevant to my discussion is the section that authorizes “Alternative Business Structures.”³⁴

These structures had their origins in a report in December 2004 by Sir David Clementi.³⁵ Clementi was charged with studying “what regulatory framework would best promote competition, innovation, and the public and consumer interest in an efficient, effective and independent legal sector.”³⁶ Historically, there has been a variety of restrictions in the UK on affiliations among different types of lawyers and on the types of organizations in which lawyers can practice.

Among Clementi’s recommendations was that the law permit outside investment in law practices.³⁷ This was seen in particular as a way to consolidate and make more efficient the provision of legal services to individuals who traditionally have been served by small “high street” law offices.³⁸ Clementi suggested that “new investors might bring not just new investment but also fresh ideas about how legal services might be provided in consumer friendly ways.”³⁹

The UK government adopted most of Clementi’s recommendations in legislation introduced in Parliament, which was signed as the Legal Services Act.⁴⁰ Among the provisions is the authorization of what is known as “Licensed Bodies.”⁴¹ These are law practices in which a non-lawyer is a manager or has an ownership or voting interest in the entity.⁴² These entities also may provide non-legal services.⁴³

Licensed Bodies will be regulated by a licensing authority.⁴⁴ This will be either the newly-created Legal Services Board or a regulator designated by the Board, such as the Solicitors Regulation Authority formed by the Law Society in the wake of the legislation. A licensed body must have a Head of Legal Practice who is a lawyer, who is responsible for ensuring that the firm and its lawyers comply with duties

34. Legal Services Act, *supra* note 2, pt.5.

35. SIR DAVID CLEMENTI, REVIEW OF THE REGULATORY FRAMEWORK FOR LEGAL SERVICES IN ENGLAND AND WALES: FINAL REPORT (2004), *available at* <http://www.legal-services-review.org.uk/content/report/report-chap.pdf>.

36. *Id.* at 1.

37. *See id.* at 115; SLATER & GORDON, *supra* note 21.

38. CLEMENTI, *supra* note 35, at 3.

39. *Id.* at 115.

40. Legal Services Act, *supra* note 2.

41. CLEMENTI, *supra* note 35, at 42-43.

42. *Id.*

43. *Id.* at 42.

44. *Id.* at 43.

imposed by the licensing authority and the Legal Services Act.⁴⁵ The licensed body also must have arrangements in place to ensure that lawyers act in accordance with “professional principles” set forth in the act.⁴⁶ These include the duties to: (1) act with independence and integrity (2) maintain proper standards of work (3) act in the best interest of the client (4) comply with the duty to the court to act with independence in the interests of justice; and (5) maintain client confidences.⁴⁷

The licensing authority must approve each non-lawyer’s holding of a “restricted interest” in a licensed body, even if the shares are publicly traded.⁴⁸ A “restricted interest” effectively is ownership of at least 10% shares in a firm or the ability to exercise significant influence over management by virtue of a share interest.⁴⁹ A non-lawyer who is a manager or who has an ownership interest must not cause or substantially contribute to a breach by a licensed body or its lawyers of duties imposed by licensing authority.⁵⁰

The criteria for approval of non-lawyer ownership interest are that the interest does not compromise regulatory objectives, which include: (1) protecting and promoting the public interest (2) supporting the constitutional principle of the rule of law (3) improving access to justice (4) protecting interests of consumers (5) promoting competition in the provision of legal services (6) encouraging an independent, strong, diverse, and effective legal profession (7) increasing public understanding of citizens’ legal rights and duties and (8) promoting and maintaining adherence to the “professional principles” described above.⁵¹ In addition, the ownership interest must not compromise the licensed body’s ability to fulfill duties imposed by the licensing authority, and must be a “fit and proper” person to hold an interest in the firm.⁵²

In response to a licensed body’s application for non-lawyer investment, the regulatory agency may: (1) object to non-lawyer ownership interest, subject to appeal (2) impose conditions of approval

45. *Id.* at 53.

46. Legal Services Act, *supra* note 2, c. 29, sched. 13, pt. 1, § 6 (referring to the “regulatory objectives” set out in section 1 of the Legal Services Act, which includes the professional principles).

47. *Id.* c. 29, pt. 1.

48. *Id.* c. 29 sched. 13, pt. 1, § 1.

49. *Id.* c. 29, sched. 13, pt. 1, §§ 2-3.

50. *Id.* c. 29, pt. 5, § 90.

51. Legal Services Act, *supra* note 2, c. 29, pt. 1.

52. *Id.*, c. 29, sched. 13, pt. 1, § 6.

(3) order divestiture of an interest or (4) revoke or suspend a firm's license to practice.⁵³

The authority to adopt alternative business structures is likely to go into effect in 2011, once the new Legal Services Board is finally established.⁵⁴ In the meantime, the Act authorizes Legal Disciplinary Practices, which only provide legal services. These firms can have up to 25% non-lawyer managers who invest in the firm.⁵⁵ The Solicitors Regulation Authority can approve formation of these entities, and is working on regulations to guide this process.⁵⁶ The hope is that they will be able to operate by as soon as March 2009.

II. UNITED STATES ETHICS RULES

Every jurisdiction in the United States has the equivalent of American Bar Association (“ABA”) Model Rule 5.4. Rule 5.4(a) says that a lawyer or law firm shall not share legal fees with a non-lawyer.⁵⁷ Rule 5.4(d) says that a lawyer shall not practice with or in the form of a professional corporation or association authorized to practice law for a profit if a non-lawyer owns any interest in it.⁵⁸ The comments to Rule 5.4 make clear that these restrictions are intended to “protect the lawyer’s professional independence of judgment.”⁵⁹ The concern is that investors may pressure lawyers to subordinate the interests of the client or the legal system in order to maximize financial returns to the firm.

The history of these restrictions dates back to the 1908 ABA Canons of Professional Ethics.⁶⁰ Canon 33 prohibited partnerships between lawyers and non-lawyers, while Canon 34 prohibited dividing legal fees with non-lawyers. In 1961, ABA Ethics Opinion 303 interpreted Canon 33’s prohibition of a partnership between lawyers and non-lawyers to apply to any kind of organizational affiliation between lawyers and non-lawyers.⁶¹ When the Model Code of Professional

53. *Id.*, c. 29, sched. 13, pt. 2, §§ 16-19.

54. Frances Gibb, *Who will police the lawyers now? Only a non-lawyer need apply . . .*, THE TIMES ONLINE, Nov. 8, 2007, available at <http://business.timesonline.co.uk/tol/business/law/columnists/article2831496.ece>.

55. See Solicitors Regulation Authority, Changes enabled by the Act—an overview, § 1.10, <http://www.sra.org.uk/sra/consultations/340.article> (last visited Oct. 21, 2008).

56. See Solicitors Regulation Authority, Glossary of terms, <http://www.sra.org.uk/sra/consultations/339.article> (last visited Oct. 21, 2008) (defining term “Legal Disciplinary Practice”).

57. MODEL RULES OF PROF’L CONDUCT R. 5.4 (2007).

58. *Id.*

59. *Id.*

60. See generally ABA CANONS OF PROF’L ETHICS, Preface (1983), available at http://www.abanet.org/cpr/mrpc/Canons_Ethics.pdf.

61. MAINE PROF’L ETHICS COMM’N, Opinion No. 31 (Sept. 22, 1982), available at <http://www.mebareverseers.org/Ethics%20Opinions/Opinion%2031.htm> (discussing

Responsibility was adopted in 1969, it continued the prohibition on forming partnerships⁶² and sharing fees with non-lawyers.⁶³

In 1981, the Kutak Commission, charged with making recommendations for the shift from the Model Code to the Model Rules, proposed relaxing the prohibition of non-lawyer ownership. It recommended that Rule 5.4 permit a lawyer to be employed by an organization in which a financial interest is held or managerial authority is exercised by a non-lawyer, as long as there is no interference with the lawyer's independent professional judgment or with the client-lawyer relationship.⁶⁴ In support of this recommendation, the Comment to the proposal said: "it is impractical to define organizational forms that uniquely can guarantee compliance with the Rules of Professional Conduct."⁶⁵

The Kutak Commission's proposal was rejected by the ABA membership.⁶⁶ The key moment in the discussion apparently occurred when the reporter for the Kutak Commission, Geoffrey Hazard, was asked whether the proposed rule would permit Sears to open a law office.⁶⁷ He answered that it would, and that doomed the recommendation.⁶⁸

The ABA's rejection of the Kutak Commission's proposal, as well as continuing opposition to outside investment in law firms, implicitly reflects commitment to what I call the classical partnership model of the firm. It is therefore worth looking more closely at that model, the assumptions on which it is based, and the conditions under which it can flourish.

ABA Ethics Opinion 303's holding that "if the salary of a non-lawyer employee were to be based on a percentage of the firm's net profits, a division of legal fees would be involved and Canon 34 would prohibit it").

62. MODEL CODE OF PROF'L RESPONSIBILITY DR 3-103 (1969).

63. *Id.* DR 3-102 (1969).

64. MODEL RULES OF PROF'L CONDUCT R. 5.4 (Proposed Final Draft 1981) [hereinafter MODEL RULE 5.4 PROPOSAL]; JOHN S. DZIENKOWSKI & RONALD D. ROTUNDA, LEGAL ETHICS—THE LAWYER'S DESKBOOK ON PROFESSIONAL RESPONSIBILITY § 5.4-3 (2008).

65. MODEL RULE 5.4 PROPOSAL, *supra* note 64, at 83.

66. Edward S. Adams & John H. Matheson, *Law Firms on the Big Board? A Proposal for Nonlawyer Investment in Law Firms*, 86 CAL. L. REV. 1, 8-9 (1998).

67. DZIENKOWSKI & ROTUNDA, *supra* note 64, at § 5.4-3 (citing Rita H. Jenson, *Ethics Row Looms on [Law Firm] Affiliates*, NAT'L L.J., Feb. 20, 1989, at 1, 28).

68. *Id.*

III. THE CLASSIC PARTNERSHIP MODEL

A. *Basic Elements*

In the classic partnership model of the law firm, the law firm is a voluntary association of lawyers—and only lawyers—who agree to share the risks and rewards of a common venture. Partners are owners of the firm, as opposed to its employees. They contribute capital to the firm as needed. Furthermore, they don't receive a specified salary, but share in the profits once the firm has satisfied its financial obligations. Under the classic partnership model, the distribution of those profits is largely by seniority—the lockstep system.⁶⁹ At the same time, partners are jointly and severally liable as individuals for the obligations of the firm. A creditor of the firm can seek recovery from a partner's personal assets if the firm's assets are insufficient to satisfy the creditor's claim.

The relationship among partners is governed by partnership law.⁷⁰ For the most part, that body of law permits partners to determine their rights and obligations toward the firm and toward each other by agreement. Statutes set some boundaries on the terms of this agreement, and partners are subject to the traditional common law principle that partners have fiduciary duties of care and loyalty to the partnership and to fellow partners.

Terminating a partner, for instance, is a complicated process under the classic model.⁷¹ It must be authorized by the partnership agreement.⁷² Even if authorized, it must be in good faith and not “predatory.”⁷³ If a partnership is at will rather than for a fixed term (which almost all law firms are) when a partner is terminated or withdraws, the firm must end its operations, wind-up its affairs, and form a new partnership without the terminated partner.⁷⁴ This typically happens automatically through a provision in the partnership agreement. This does not affect the firm's operations; it simply creates an accounting distinction for purposes of allocating income among the partners. A firm

69. See generally Paul C. Saunders, *When Compensation Creates Culture*, 19 GEO. J. LEGAL ETHICS 295 (2006) (reviewing MILTON C. REGAN, *EAT WHAT YOU KILL: THE FALL OF A WALL STREET LAWYER* (2004)).

70. See generally Robert W. Hillman, *The Impact of Partnership Law on the Legal Profession*, 67 FORDHAM L. REV. 393 (1998).

71. See generally Paula J. Dalley, *The Law of Partner Expulsions: Fiduciary Duty and Good Faith*, 21 CARDOZO L. REV. 181 (1999).

72. *Id.* at 181.

73. See, e.g., Allan W. Vestal, *Law Partner Expulsions*, 55 WASH. & LEE L. REV. 1083, 1092-93 (1998).

74. See, e.g., Robert W. Hillman, *Loyalty in the Firm: A Statement of General Principles on the Duties of Partners*, 55 WASH. & LEE L. REV. 997, 1032-34 (1998).

may dissolve and reform many times as partners withdraw or are terminated. Notwithstanding its trivial substantive impact, this formality persists as a residue of the classic partnership model.

The classic partnership model thus conceptualizes the law firm as a voluntary association of partners who share equally in the outcomes of a common venture, who participate as equals in self-governance through consensus, and who owe distinctive responsibilities to one another. The classic partnership is perhaps the paradigmatic example of organizational self-governance, which, as I describe below, provides a rationale for professional self-governance as well.

B. Functions of the Classic Partnership Model

We can think of the classic partnership model as addressing three concerns related to lawyer professionalism. The first is what David Wilkins has called the “agency” problem: the risk that lawyers will harm clients’ interests.⁷⁵ As agents, lawyers must remain faithful to their clients, and refrain from pursuing their own interests at their clients’ expense.⁷⁶

The second is the ability of individual lawyers to have a significant measure of control over their work, with opportunities for each lawyer to exercise his or her professional discretion. I have described this desire for “craft autonomy” elsewhere.⁷⁷ In the organizational setting, we can think of this as another type of agency problem: ensuring that those who run the firm do so in the interest of its lawyers rather than their own. Thus, professionalism raises concerns about both a client agency problem and a lawyer autonomy problem.

A final concern related to lawyer professionalism is what Wilkins calls the “externality” problem.⁷⁸ The concern here is the possibility that “lawyers and clients together [will] impose unjustified harms on third parties or on the legal framework.”⁷⁹ In the most general terms, this concern focuses on the need for lawyers to be sensitive to their role as stewards of the legal system.

75. David B. Wilkins, *Who Should Regulate Lawyers?*, 105 HARV. L. REV. 799, 819-20 (1992).

76. Milton C. Regan, Jr., *Law Firms, Competition Penalties, and the Values of Professionalism*, 13 GEO J. LEGAL ETHICS 1, 37 (1999).

77. *See infra*.

78. Wilkins, *supra* note 75, at 820.

79. *Id.*

The classic partnership model theoretically addressed each of these concerns.⁸⁰ With respect to the client agency problem, the model provided some assurance that the client would receive high-quality legal services. First, the prospect of personal liability gave each partner an incentive to monitor the work of other lawyers in the firm.⁸¹ Second, lockstep compensation provided an incentive for partners to share knowledge and information with other lawyers in the firm, thereby enhancing the quality of the services that the firm provided.⁸²

Furthermore, a lockstep system ideally served to align the individual lawyer's interest with that of the firm. Individual decision-making was less likely to be dominated by individual cost-benefit analysis because individual marginal productivity was not the basis for financial remuneration. The individual might still be tempted to subordinate the client's interest to the economic interest of the firm as a whole, but the individual payoff from doing was indirect and might be too small to justify taking the risk. In addition, the "up or out" system ostensibly provided clients with assurance that the firm was comprised of only the very best lawyers. All these features operated to provide signals that compensated for the fact that the quality of professional services is difficult to evaluate.

Finally, professional socialization emphasized the lawyer's fiduciary duty to the client. The fact that the firm was run only by lawyers gave clients some assurance that decisions would be made by persons who had internalized the ethos of devotion to the client, and who would informally regulate behavior related to important issues such as confidentiality and unconflicted representation.⁸³

The classic partnership model addressed concerns about individual lawyer autonomy and independence by giving partners a voice in the operation of the firm. All managers of the firm were lawyers, which eliminated the kind of "external" agency problem that exists between shareholders and corporate executives.

To be sure, an internal agency problem remained, in that partners in the firm had to monitor the partners to whom they delegated authority.

80. See Royston Greenwood & Laura Empson, *The Professional Partnership: Relic or Exemplary Form of Governance?*, 24 ORG. STUD. 909 (2003), available at <http://oss.sagepub.com/cgi/content/abstract/24/6/909>.

81. See Laura Empson, *Surviving and Thriving in a Changing World: The Special Nature of Partnership*, in MANAGING THE MODERN LAW FIRM: NEW CHALLENGES NEW PERSPECTIVES 10, 15 (2007); see generally Susan Saab Fortney, *Am I My Partner's Keeper? Peer Review in Law Firms*, 66 U. COLO. L. REV. 329 (1995).

82. See, e.g., Vestal, *supra* note 73, at 297.

83. See generally Lawrence J. Fox, *Redefining Lawyers' Work: Multidisciplinary Practice Old Wine in Old Bottles: Preserving Professional Independence*, 72 TEMPLE L. REV. 971 (1999).

These agency costs were minimized, however, because partners were relatively sophisticated and knowledgeable monitors, and they had opportunities to influence the partner-managers because of working in close proximity to them. The firm therefore was able to use informal collegial monitoring as a substitute for more costly systems of formal control that characterize other major economic organizations.⁸⁴

With respect to regulating externalities, the classic partnership relied in part on the norm that a lawyer is an officer of the court and, more generally, that he or she bears some responsibility for maintaining the integrity of the legal system. The scope of this norm has always been a source of some contention within the profession, and the neutral partisan model seems to have gained increasing influence in recent years. Nonetheless, the fact that the firm was run and controlled by lawyers was seen as the best way to realize the best hope that this norm would have some influence. Individual lawyers ideally were socialized to accept it, and a lawyer-run organization provided the opportunity for collective reinforcement of it.

Lockstep compensation also purported to address the externality problem. It was designed to minimize temptation for individual lawyers to maximize their income by ignoring third party effects in pursuing clients' aims. As with the potential client agency problem, a lawyer might be tempted to ignore externalities in order to enhance the firm's income, but the payoff from that would be smaller and less direct than if he or she were compensated on the basis of individual productivity.

The partnership in its classic form thus appeared to provide some assurance that the ideals of the profession would not be eroded by the rise of law firms whose size dwarfed what had come before. The ability of the firm to serve as a self-governing organization of lawyers signaled that society could continue to trust lawyers as a whole to regulate themselves with the interests of clients and the public in mind.

The classic partnership model was particularly well-suited to the oligopolistic market for legal services that largely prevailed until the early 1980s.⁸⁵ Oligopolistic firms have considerable ability to set prices, face only mild pressures for improving efficiency, and have the latitude to structure their operations with some non-financial considerations in mind. They can eschew the unseemly overt competition and explicit acknowledgement of financial goals that characterize firms more directly subject to market forces. The fact that firms in this era seemed to offer a

84. Empson, *supra* note 81, at 14-15.

85. See, e.g., Peter A. Joy, *What We Talk About When We Talk About Professionalism: A Review of Lawyers' Ideals/Lawyers' Practices: Transformations in the American Legal Profession*, 7 GEO. J. LEGAL ETHICS 987, 1002-08 (1984).

credible claim that they were guided by considerations beyond pure self-interest made professional self-regulation appear to be a tenable strategy for governing the conduct of lawyers. To reiterate an earlier point, the capacity for organizational self-regulation provided assurance of the viability of professional self-regulation.

C. *Cracks in the Model*

As is well-known, the market for legal services has become significantly more competitive over the past three decades in ways that do not require extensive reiteration here. Although most law firms formally remain partnerships, they have departed from the classic partnership model in several ways. In some cases, these departures have occurred because this model could not respond to the practical needs of firms in a competitive market. In other cases, the changes necessary to respond to market pressures have reconfigured firms in ways that the classic partnership model cannot accommodate.⁸⁶ In either case, the combined result is that: (1) the classic partnership model no longer describes significant features of law firms and (2) for those classic features that remain, that model has a much less credible claim that it adequately addresses the concerns of professionalism.

One source of pressure on the classic model is that firms have grown much larger over the last generation, with multiple offices domestically and overseas. This of course makes informal collegial control more difficult. It requires greater reliance on more specialized management structures, which increases internal agency costs. In addition, it makes full involvement in decision-making a much less realistic ambition. This loss in voice can reduce commitment to the firm and incentives to share knowledge. The average modern law firm also now contains a greater diversity of practice areas than in the past, which may make consensus harder to achieve and expectations less predictable.

Firms now face significant pressures from clients to provide legal services more efficiently.⁸⁷ As firms compete on this basis, they are beginning to disaggregate legal work into more discrete tasks and to

86. For a succinct description of the forces that are placing pressure on the partnership form in professional services firms generally, see Empson, *supra* note 81, at 16-18.

87. See, e.g., Rees Morrison, *Ten Ways to Analyze Outside Counsel Spending*, N.Y.L.J., May 23, 2007, available at <http://www.law.com/jsp/PubArticle.jsp?id=900005481569#>; Eriq Gardner, *Pfizer Litigators Endure Beast of a Beauty Contest*, CORP. COUNS., Oct. 13, 2005, available at <http://www.nelsonmullins.com/news/nelson-mullins-articles-speeches-detail.cfm?id=50>; Posting of John Earnhart, *Cisco General Counsel on State of Technology in the Law* to http://blogs.cisco.com/news/comments/cisco_general_counsel_on_state_of_technology_in_the_law/ (Jan. 25, 2007, 14:13 EST).

assign each task to the lowest-cost provider both inside and outside the firm, whether these are lawyers or non-lawyers. Competitive pressures have shortened what we might call the “legal services lifecycle.” In the course of this lifecycle, a legal service or practice area first emerges as distinct and innovative, which means that it can be priced at a premium. Over time, competitive pressures push toward disaggregation of the work into more routine components requiring less skill.⁸⁸ Eventually, with enough experience and competition, the service or practice area becomes a commodity, with low profit margins and fierce competition based mainly on price. The window during which a first mover in a service area can gain above market profits therefore is steadily shrinking.

This places a greater premium on formal operational and monitoring systems. The greater the disaggregation of a service into discrete tasks, the more amenable that service is to the application of standard formal procedures and reliance on technology. By contrast, the informal collegial control that characterizes the classic partnership model is less efficient and produces less predictable outcomes for many tasks. While judgment and discretion remain important in determining how to assemble and interpret the various components of an engagement, the percentage of the project that requires these attributes may be relatively small. Large chunks of work can even be delegated to persons outside the firm, such as contract lawyers in the United States or abroad.

Competitive pressures also can generate increasing need for law firm capital. One source of this need is to pay for the information technology that enables firms to rationalize and provide services more efficiently. Another is the desire to open more offices overseas, whose delayed profitability current partners may not be willing to subsidize through capital contributions or lower claims on profits. Still another impetus for more capital is to be able to fund the acquisition of lawyers, practice groups, or entire firms as part of an expansion strategy. A partnership’s capital base is limited to the wealth of its partners, and its assets are mobile. A firm thus may feel the need to look to other sources of capital to fund its operations.

As is well known, law firm compensation systems have moved toward more performance-based models that feature less income-sharing and risk diversification.⁸⁹ This elevates the potential significance of individual cost-benefit calculations in influencing behavior.

88. See DAVID MAISTER, *MANAGING THE PROFESSIONAL SERVICE FIRM* 21-30 (1993).

89. See generally Ronald Gilson & Robert Mnookin, *Sharing Among the Human Capitalists: An Economic Inquiry Into the Corporate Law Firm and How Partners Split Profits*, 37 *STAN. L. REV.* 313 (1985).

Today's law firm also typically includes multiple categories of lawyers, rather than simply partners who own the firm and employees who don't. The number and proportion of non-equity, or income, partners, as well as other categories of permanent salaried lawyers, has grown significantly in recent years.⁹⁰ In addition, even equity partners are subject to potential loss of equity status or expulsion, and may be treated in some cases as employees, rather than owners, for employment discrimination purposes.⁹¹ Firms now include a much larger percentage of lawyers who are employees who have no opportunity to become owners. This shrinking prospect of equity partnership can limit commitment to the firm and reduce motivation to do good work, while the decline of an up or out policy may weaken the firm's ability to signal the quality of its lawyers.

Finally, virtually every firm has moved to eliminate partner joint and several liability by adopting a limited liability organizational form. This is a response to the increasing scale of the modern law firm, acknowledgment of diminishing ability to rely on informal collegial controls on behavior, and, with a highly active lateral market, probably less commitment to the firm as an institution for sharing risks and rewards.

The realities of law firm practice today therefore do not comport with the assumptions that underlie the classic partnership model. That model's reliance on collegial controls is ill-suited to address a more acute internal agency problem. Its reliance on consensus decision-making is too cumbersome for a fast-paced competitive market. Its assumption of unlimited personal liability is at odds with a reduced sense of individual commitment to the firm, and seems unfair in light of the inability of partners to monitor all their colleagues' work. Its reliance on informal supervision and maximum individual autonomy is in conflict with the effort to standardize legal tasks, to provide cost-efficient service, and to minimize risks of liability.

Thus, even if today's law firms remain partnerships in form, they have departed significantly from the classic partnership model. Firms are moving closer to a corporate model: distinct separation of ownership and control, multiple categories of workers and lines of authority, greater standardization of tasks, productivity-based compensation, limited individual liability, and reliance on temporary workers that mimics corporate "just in time" production processes.

90. See generally William Henderson, *Single-Tier versus Two-Tier Partnership Tracks at Am Law 200 Law Firms: Evidence and Theory*, 84 N.C. L. REV. 1691 (2006).

91. See, e.g., *EEOC v. Sidley Austin*, 315 F.3d 696 (7th Cir. 2002).

One major component of the classic partnership model remains, however, because it is required by law: ownership of law firms only by lawyers.⁹² Does this make sense? Is non-lawyer ownership the line in the sand that we must not cross, or the next natural evolutionary step? One way to approach this issue is to ask what the implications of non-lawyer ownership might be for law firms' ability to address traditional concerns about client agency costs, individual lawyer autonomy, and externalities to which the classic partnership model purported to be a response.

IV. CONCERNS ABOUT OUTSIDE INVESTMENT

A. *Client Agency Concerns*

One argument against allowing a law firm to sell shares to the non-lawyers is that lawyers will be caught in a conflict between their fiduciary duties to shareholders and their fiduciary duties to clients. In particular, we might fear that lawyers who do not act to maximize share price because of client interests might be sued by shareholders for breach of their duty of loyalty. This may be a particular concern if the law firm is publicly traded. It is an impossible position to put lawyers in, the argument goes, so we just should avoid it by not allowing law firms to sell shares.

This *is* an impossible position for a lawyer to be in. If this were our only choice, selling shares would be a bad idea. There's nothing, however, that says that shareholders are entitled to the same degree of devotion as clients. Shareholders have rights that are defined to a large degree by the securities that the company issues. A common shareholder, for instance, ordinarily isn't entitled to dividends unless the directors choose to pay them. Some shares have voting rights; others don't; some do with respect to certain issues.

A law firm's prospectus, therefore, could have a provision similar to the one that Slater & Gordon prepared.⁹³ As I've described above, the description of risks in the firm's prospectus states that the firm's duties are, in order of priority: to the court, to clients, and to shareholders. Fulfilling the first two duties may require subordinating the interest of shareholders in certain situations. Furthermore, as in Australian legislation authorizing Incorporated Legal Practices,⁹⁴ a rule or statute

92. MODEL RULES OF PROF'L CONDUCT (2007).

93. See SLATER & GORDON LTD., *supra* note 21.

94. See, e.g., Legal Profession Act 2004, *supra* note 19.

permitting law firms to have outside investors could state explicitly that ethics rules have priority in any instance in which they conflict with obligations under corporate law.

In this way, ethics rules in a sense would be incorporated into the duties of law firm directors and officers. This would preserve lawyers' traditional fiduciary obligations, and prevent them from having to choose between those and duties to shareholders. Shareholders would be on notice of these provisions, and the features of these securities presumably would be taken into account in the price of the firm's shares in the market.

But, someone might say, what if shareholders are unhappy with how the directors are discharging their responsibilities—and mount an election challenge to them? Won't directors always be vulnerable to this? Won't the fear of it create the risk that lawyers will slight their professional obligations?

The first, practical, answer to this is that the risk of being unseated by a shareholder revolt is pretty remote in most publicly traded enterprises. The SEC, for instance, has recently reaffirmed its rule that shareholders can't force the company to put shareholder candidates for the board on the company's proxy ballot.⁹⁵ The risk of effective shareholder electoral challenges in most companies thus is more theoretical than real.

The second answer is that the law firm could issue only minority shares to outside investors, vesting control in lawyers within the firm. Non-lawyer shareholders wouldn't be in a position to intimidate directors into violating their professional obligations. Google, for instance, has issued dual class shares that give the founders voting rights disproportionate to their shares in the firm compared to public shareholders.⁹⁶ Indeed, the firm could issue only non-voting shares, as was effectively the case in the Blackstone IPO.⁹⁷ The Blackstone offering provides just one example of how a partnership can raise money in the capital markets while ensuring that insiders retain control over the entity.

But, someone might argue, in publicly traded firms shareholders *don't need to vote* in order to exert influence—they *just need to sell their*

95. Proposed Rule: Shareholder Proposals Relating to the Election of Directors, SEC Release No. 34-56161, 17 CFR, pt. 240 (July 27, 2008).

96. Elinor Mills, *Google Sticks with Dual Class Structure*, CNET NEWS, May 11, 2006, available at http://news.cnet.com/Google-sticks-with-dual-class-structure/2100-1030_3-6071494.html.

97. See Susan Beck, *The Transformers: Investors May be Able to Buy Their Stock, But Fortress and Blackstone Don't Act Like Other Public Companies*, AM. LAW. Nov. 1, 2007, at 94.

shares. If a law firm is listed on the stock exchange, it will want to keep its share price up. In order to do that, it will need to keep shareholders happy. Thus, shareholders can exert pressure on lawyers to satisfy shareholders at the expense of clients—even if shareholders have a minority interest or no voting rights at all. In terms of ethics rules, the argument is that the lawyer will have a conflict of interest. Specifically, the representation of a client may be “materially limited” by “a personal interest of the lawyer” under Rule 1.7(a)(2).⁹⁸

There is always some risk that a lawyer will try to maximize his or her own financial interest at the expense of the client. This is true of any setting or organization in which a lawyer practices, from solo practitioner to global law firm. Furthermore, law firms already put a great deal of emphasis on Profits per Partner (“PPP”). The AmLaw 100 is the equivalent of the Dow Jones average for law firms. Would clients be more at risk if share price replaces PPP as the scorecard?

The answer to that question depends on whether the change in the audience from PPP to share price is likely to put clients at greater risk. Who’s the audience for PPP? Who makes decisions based on this metric? Mainly, the audience consists of lawyers within a firm and prospective laterals that it might attract from other firms. Clients and law graduates might have some interest in this metric, but neither has an especially important stake in pushing for a higher PPP in a particular firm.

As an audience, lawyers are motivated by money as much as anyone else. The fact that a person’s sense of well-being tends to be powerfully shaped by comparison with a perceived peer reference group means that PPP rankings have the potential to spur behavior that is significantly influenced by financial considerations. Lawyers are not, however, completely one-dimensional. They also value things like professional status, reputation, and satisfaction in their work. They won’t necessarily pursue money as the highest priority in every single situation—even though the prominence of PPP may increase the percentage of instances in which they do.

Now consider the audience for share price: investors and stock analysts who provide them information. These folks are a bit more one-dimensional. I may have a lot of different interests and values, but in my role as an investor I’m pretty single-minded. I want a higher rather than a lower return. A publicly traded firm may have to answer to an audience that is less forgiving of a failure to maximize profits than does a firm that is not publicly traded.

98. Model Rules Of Prof’l Conduct R. 1.7(a)(2) (2007).

Is the difference one of degree or kind? There may be somewhat greater temptation in a publicly traded firm, but is there enough that we should categorically rule out permitting firms to sell shares? If the difference is one of degree, how does the incremental increase in risk compare to benefits that we believe non-lawyer investment would provide? Finally, even if we believe that the gravitational pull of share price makes publicly traded law firms a bad idea across the board, that doesn't mean that private non-lawyer ownership also is misguided.

What about firms with outside ownership interests that are not publicly traded, for whom there is no share price? How likely is it that private investors will be able to exert pressure to compromise client interests for the sake of financial returns? The firm can exercise some control over this by structuring its securities so that owners are passive investors. If prospective investors are aware that ownership does not include any participation in governance, and that their interests may be superseded by the firm's duties to clients and the legal system, those who choose to invest will have no legitimate expectation of being able to influence decisions within the firm.

Even with passive investors, however, one concern may be that as a practical matter investors' provision of capital to the firm will give them some influence over it. This may be, but it is no different than is the case now with lenders who provide funds to firms. Loan agreements typically contain covenants establishing financial benchmarks for the firm that can effectively constrain firms' freedom of action. Law firms that want to avoid default may have to make choices that they would not make if they did not have to satisfy the requirements of lenders. The pressure to do so, of course, stems from the fact that law firms are obligated to pay their debts. By contrast, they would have no responsibility to guarantee any payments to shareholders.

Finally, one might argue that the market for legal services will create disincentives for firms to slight the interests of clients. A firm that subordinates client interest to its own financial gain risks long-term economic ruin. Prospective clients will avoid a firm that acquires a reputation for doing this. The argument is that a publicly traded firm will be motivated to promote, rather than slight, its clients' interest, because that's the best way to keep the share price high. This argument would seem to have particular force with respect to firms with large corporate clients that are able to look out for themselves. It may be less persuasive with respect to firms with one-shot individual clients, although even in these cases their dissatisfied clients can hurt the reputation of the firm.

B. *Lawyer Agency Concerns*

What might non-lawyer ownership mean for lawyers' ability to exercise discretion, independent judgment, and control over their work? First, we have to recognize that, even without non-lawyer investment, firms have adopted a substantial number of measures that have subjected lawyers to the type of organizational influence that is characteristic of a corporate management model.

For instance, firms have concentrated management authority in executive committees; hired non-lawyers for positions such as chief administrative officer and chief marketing officer; established general counsel positions; designated specific partners as ethics or loss prevention counsel; created committees to resolve ethical issues; established more formal lines of reporting among departments, practice groups, and management committees; adopted more formal procedures for identifying conflicts; imposed standard terms for engagement letters with clients; required specific procedures for reviewing legal opinions and other work furnished by the firm; adopted performance metrics for practice groups and individuals to guide internal investment and compensation decisions; and now more systematically evaluate their market position and business strategy. Furthermore, law firm insurers press for systems, policies, and procedures that impose more uniform standards of behavior within the firm.

All these developments have occurred in firms that formally remain partnerships. They have been prompted by market forces, not by organizational or capital structures. Would non-lawyer investment create incentives for firms to intensify these efforts even more? If so, would this culminate in serious intrusions on lawyers' exercise of professional judgment?

To begin to answer this question, we need to appreciate that there is an asymmetry in the impact of the measures that I've described. To put it bluntly, lawyers who generate significant business as a practical matter are less fettered by these measures than are other lawyers. Because firms cannot enforce covenants not to compete nor penalize lawyers who leave with clients in tow, they may have limited leverage over lawyers who produce high revenues.⁹⁹ The result is that an active lateral market for profitable partners constrains the firm's ability to impose policies across the board. There is a limit to how far firms believe they can push. This limit varies from firm to firm, but all firms must contend to some degree with the threat of rainmaker exit.

99. See generally Regan, *supra* note 76.

A firm that wants to attract and retain non-lawyer investment will need to limit the extent to which it is dependent on partners with minimal commitment to the firm. Investors want stability and predictability, which is threatened by wide swings in profitability produced by the exits and entries of partners from a firm. They will prefer firms in which clients are institutionalized and there is loyalty and cooperation, rather than those in which lawyers hoard clients, fight over client credit and refuse to mentor juniors.

In order to serve as an attractive investment, a firm will need to rely less on individual rainmakers and more on the performance of the firm as a whole. It will need to devote resources to building organizational capital rather than stockpiling a stable of profitable but mobile rainmakers. This means adopting measures that integrate members more securely within the firm, and taking steps to increase loyalty and commitment to reinforce that integration. A firm that successfully does this will build "firm-specific capital" that can deter exit by making it less attractive. This in turn will give them more leverage in instituting firm-wide policies and procedures with which high-revenue lawyers are more likely to comply.

This analysis suggests that the desire to attract non-lawyer investment may reduce the influence of highly profitable partners *vis a vis* the firm. The corresponding increase in the firm's influence of course could be used for good or ill, depending on the aims of those who hold the levers of power.

There's a good argument, however, that on balance the current influence of rainmakers amplifies the market pressures that firms feel, and that a reduction in that influence could at least make more feasible the adoption of policies informed by other values. The emphasis on PPP, for instance, is based mainly on the desire to remain competitive in the lateral market. If that market comes to cast a smaller shadow and firms are able to build more firm-specific capital, firms may be less reluctant to invest in professional training and development because it will be more likely that lawyers will stay long enough for such investments to pay off. This of course also furthers the welfare of the individual lawyers who receive such attention.

Efforts to attract non-lawyer investment thus could create incentives to build firm-specific capital that provides a firm with some buffer from forces in the lateral partner market. This could offer a space in which to promote non-financial values that enhance the experiences of lawyers within the firm.

C. Externality Concerns

What about the risk that pressure in firms to maximize the value of their shares will lead law firms to pursue client's interests regardless of lawyers' duties to the court, the legal system, and society? The argument is that the corporate scandals of the last few years have already shown us that lawyers trying to hold on to clients in a fiercely competitive market may do their clients' bidding even when it's wrong to do so. This pressure will be even more intense when the result of losing a client could be a drop in the investment value of the firm.

Again, we have to ask ourselves how much greater the pressure will be than under current circumstances, when PPP is such an important metric. Will firms' incentives be dramatically different from what they are now?

The market likely won't be as effective in making sure that lawyers fulfill their duties to the legal system as it will be in making sure that lawyers look after client interests. There's no party who represents the interest of the legal system or society as a whole that consistently can exert the influence that a major client can.

That difference is a function of the competitive market for legal services, however, rather than the organizational form of the law firm. How likely will concern for share value increase this difference? Will it be enough categorically to insist that the current prohibition remain?

Our experience with publicly owned corporations suggests that concern for share price can place significant pressure on behavior. There is a well-established body of work criticizing the incentives that are created by a relentless focus on this metric. PPP is calculated annually, but share price is reported every day. Law firms currently determine their financial condition annually, but publicly traded companies must report quarterly. Joining at least the ranks of publicly traded companies thus could incrementally lead law firms to adopt a shorter-term perspective that increases pressure to disregard externalities.

At the same time, the existence of a robust ethical infrastructure within a firm can counter some of these pressures. Such an infrastructure consists not only of firm-wide policies and procedures, but of a credible commitment by management to professional ideals and values. A major challenge to the creation and maintenance of these programs, however, is the relative ease with which profitable partners can leave the firm. Partners in management positions, law firm counsel who deal with ethics and liability, and law firm insurers consistently lament how difficult it can be for firms effectively to monitor and influence lawyers accustomed to regarding themselves as portable law practices. An active lateral

market effectively reinforces profitability as a major constraint on any effort to promote non-financial values within the firm. If firms are able to build more firm-specific capital because of the need to attract investors, they could gain more leverage over their lawyers' behavior and temper the force of this constraint.

This leverage could of course be a mixed blessing, depending on the values of those who run a given firm. Firms could use it to push even more effectively for behavior that gives priority to financial performance. Even firms that have a genuine commitment to broader professional values will continue to be subject to intense competitive forces, which could lead them to establish reward systems that slight those values. In both cases, lawyers may have an incentive to look the other way when clients impose harm on third parties or the legal system.

A focus on share value rather than Profits per Partner thus could give firms some respite from the pressures of the lateral market, but there is no guarantee that they will use it to be more attentive to larger social values. Outside investment may create the possibility of a greater sense of social responsibility, but it cannot ensure it. Just as with any business, the need for competitive survival will necessarily influence the amount of weight that a law firm can give to interests beyond its own and those of its clients.

Where does that leave us? Perhaps surprisingly, outside investment will not automatically lead firms to give short shrift to social values—and could even promote greater fidelity to them. Even if the likely practical impact of such investment is indeterminate, however, permitting it could have symbolic importance that prompts a more searching discussion of lawyer regulation.

V. TOWARD A REGULATED INDUSTRY MODEL

Perhaps the most important consequence of allowing outside investment in law firms is that it would serve as a powerful acknowledgment that law firms are business enterprises. It may seem ludicrous to suggest that we haven't reached this point yet, given the widespread attention to law firm financial metrics in the legal, business, and popular media. Law firm practice by any measure is big business. Yet to how many other industries do we permit the privilege of self-regulation?

The persistence of the self-regulatory model suggests that we still haven't come to grips with the business and organizational realities of the legal profession. We put most of our faith in the virtue of lawyers, both as individuals and as a collective, as if proper socialization and character were all that's necessary in order to balance complex business

and professional demands. Thus, for instance, in all but two states, ethics rules are directed solely at individual lawyers, despite the increasing importance of organizational structures in shaping behavior. Notwithstanding law firms' adoption of many features of the corporation, our regulatory system is still premised on the assumptions of the classic partnership model and the oligopolistic market conditions under which it emerged and thrived.

As we have seen, the classic partnership model has lost much of its salience as competition in legal services has intensified. Firms have responded to competition by abandoning major features of that model. Those elements that remain have been seriously weakened in their ability to serve the functions that the model historically was intended to serve. Put simply, law firm behavior is now powerfully shaped by market forces, leaving firms with less latitude to take account of other considerations in daily and strategic decision-making by the lawyers within them.

It's precisely this prominent influence of competitive market forces that leads society to reject self-regulation as the model for other business enterprises. No matter how well-intentioned, entities that operate in such markets must necessarily assign significant weight to financial considerations in order to survive. Therefore, it is unrealistic to assume that they can be completely trusted on their own to give sufficient attention to broader interests and to police their own behavior.¹⁰⁰

As law firms move closer to other businesses in both form and substance, this logic increasingly is applicable to them as well. Limiting ownership of law firms to non-lawyers, however, permits the pretense that self-regulation by lawyers is a viable strategy that distinguishes law firms from other economic enterprises. Eliminating this restriction thus could force us to confront more squarely the tensions—as well as possible complementarities—between market competition and professional values.

Regardless of how many firms actually seek outside investors, their authority to do so thus would make more tenable the application of a regulated industry model to the legal profession. This model need not assimilate law practice to all other businesses—lawyers do have important obligations that most market actors do not. Nor need it rely on a classic command and control philosophy of regulation. Measures adopted under the rubric of the “New Governance” paradigm are more flexible, and feature more informal interaction between regulator and

100. See generally MICHAEL J. SANDEL, *DEMOCRACY'S DISCONTENT: AMERICA IN SEARCH OF A PUBLIC PHILOSOPHY* (1996).

regulated entity, than a traditional government-centered approach. These include “negotiated rulemaking, audited self-regulation, performance-based rules, decentralized and dynamic problem solving, disclosure regimes, and coordinated information collection.”¹⁰¹

One form that regulation could take, for instance, is what Ted Schneyer has called “bar corporatism.”¹⁰² Schneyer uses this term to describe one way in which regulation of financial institution lawyers might evolve in light of crises such as the widespread savings and loan failures of the 1980s and early 1990s.¹⁰³ Bank regulatory agencies asserted authority during this period to sanction lawyers whom the agencies believed had failed to fulfill their professional responsibilities.¹⁰⁴ Schneyer suggests that such agencies are in the best position to establish practice protocols that provide sufficient notice of what behavior will be required of lawyers for regulated entities.¹⁰⁵ As occurred with many of the banking agency initiatives, however, Schneyer expects that there will be vigorous debate and discussion with the bar in the process of adopting such measures.¹⁰⁶ While the bar may lose its purported monopoly over professional governance, it still will “exert its influence in tandem with federal regulators.”¹⁰⁷

The Securities and Exchange Commission’s (“SEC”) adoption of the *Rules Governing Lawyers Appearing and Practicing Before the Commission*, under the authority of the Sarbanes-Oxley legislation, reflects a version of this process.¹⁰⁸ The SEC published proposed rules in January 2003 that imposed responsibilities on securities lawyers to report evidence of possible wrongdoing to higher authority within a company.¹⁰⁹ The rules elicited considerable commentary from the bar, especially concerning a requirement that a lawyer who reported suspected wrongdoing to a company’s board but received an inadequate response disclose her suspicions to the SEC.¹¹⁰ The SEC withdrew this provision in the final rules, and eliminated or revised other portions of

101. Orly Lobel, *The Renew Deal: The Fall of Regulation and the Rise of Governance in Contemporary Legal Thought*, 89 MINN. L. REV. 342, 345 (2004).

102. Ted Schneyer, *From Self-Regulation to Bar Corporatism: What the S&L Crisis Means for the Regulation of Lawyers*, 35 S. TEX. L. REV. 639, 658 (1994).

103. *Id.* at 640-43.

104. *Id.* at 640-43, 646 n. 31.

105. *Id.* at 643, 648-49.

106. *Id.* at 643.

107. Schneyer, *supra* note 102, at 643.

108. Sarbanes-Oxley Act of 2002, H.R. 3763, 107th Cong. § 307 (2002).

109. Proposed Rule: Implementation of Standards of Professional Conduct for Attorneys, SEC Release Nos. 33-8150; 34-46868, 17 CFR pt. 205 (Jan. 2003).

110. *Id.*

the rules in response to comments.¹¹¹ To date, the agency has not brought any action against an attorney for violation of the rules.

A hybrid model of regulatory collaboration between an independent commission and professional groups could be another useful model. The system in the UK, for instance, may evolve in this direction, with the newly-created Legal Services Board setting standards for professional bodies' exercise of the authority that the Board delegates to them. A new Office of Legal Complaints will take over complaint handling from professional groups, and these groups must separate their regulatory and professional advocacy functions.

Many elements of the bar are likely to resist the move to a regulated industry model, claiming that only self-regulation can ensure professional independence. A reflexive, categorical insistence on preserving monopoly power, however, should not substitute for a thoughtful analysis of how specific values can be promoted by particular regulatory arrangements.

To begin with, it's important to recognize that self-regulation has never been as preemptive and uncontested as the bar has wished. State legislatures periodically pass legislation that regulates the legal profession. Dissatisfaction with bar oversight also has prompted some government regulation of lawyers on the federal level. Banking lawyers are subject to rules established by banking and financial institutions regulatory agencies. The Internal Revenue Service's Circular 230 imposes obligations on lawyers involved in tax practice. The Securities and Exchange Commission has promulgated the rules on reporting to higher authority mentioned above. Those rules apply to lawyers appearing and practicing before the Commission, but in practice both law firms and corporate legal departments treat them as applicable to all lawyers. In addition, common law and statutory liability rules serve as perhaps the main practical source of "regulation" of lawyers who provide services to corporate clients.¹¹² Finally, the requirements of insurance carriers also can serve effectively to govern lawyer conduct in significant ways.¹¹³

Moreover, the claim that state supreme courts have inherent and exclusive authority to regulate the legal profession is contested, and in any event fails to justify across-the-board self-regulation. Until the late-nineteenth century, courts in most states "were content to consider

111. Sarbanes-Oxley Act of 2002, *supra* note 108.

112. MILTON C. REGAN, JR. & JEFFREY BAUMAN, *LEGAL ETHICS AND CORPORATE PRACTICE* 366-404 (2005).

113. See Anthony E. Davis, *Professional Liability Insurers as Regulators of Law Practice*, 65 *FORDHAM L. REV.* 209, 210-11 (1996).

individual cases and let the legislature set general rules.”¹¹⁴ After that point, courts began to assert authority based on separation of powers principles, but that claim has not been subject to sustained inspection or debate, nor has it been uniformly regarded as persuasive. Furthermore, even if this claim were plausible, it applies most directly only to litigation, not to the wide range of other work that lawyers perform. Nor have courts been especially diligent in exercising an oversight role. Establishing professional rules has been a low priority for courts, which for the most part have delegated the function to bar associations.

The bar also is likely to object that a regulated industry model would threaten the ability of the legal profession to serve as a buffer between government and citizens. Gillian Hadfield has noted that “[t]he origins of American professional regulation” lie in “the vision of the role of the lawyer as a fundamental guardian of the Constitution, democracy, and individual rights. . . .”¹¹⁵

As Hadfield observes, however, protecting constitutional liberties does not provide the justification for all rules that the bar has adopted.¹¹⁶ Much of the work of lawyers is devoted not to curbing the power of the state, but to promoting efficient market transactions, innovation, production, and trade.¹¹⁷ For purposes of regulatory design, these functions raise different issues, and require consideration of different sets of values.¹¹⁸ Some current rules stifle economic innovation and make legal services more expensive without vindicating any basic democratic values.¹¹⁹ Dismantling a system of categorical self-regulation would allow a more explicit discussion of which rules intend to promote which objectives, as well as an evaluation of how well they do so.

This leads to a broader point. We want the legal profession to serve a variety of values, not simply one. We do want lawyers to provide protection against state overreaching. We also, however, want them to provide affordable legal services, make dispute resolution proceed reasonably smoothly, and impart to clients a sense of respect for the law, among other things. There’s a good argument that determining how best

114. Thomas M. Alpert, *The Inherent Power of the Courts to Regulate the Practice of Law: An Historical Analysis*, 32 BUFF. L. REV. 525, 533 (1983).

115. Gillian Hadfield, *Legal Barriers to Innovation: The Growing Economic Cost of Professional Control Over Corporate Legal Markets*, 60 STAN. L. REV. 1689, 1729 (2008).

116. *See id.* at 1702-06 (discussing the history, advantages, disadvantages and current issues concerning balancing the political function of the law and the economic function of the law).

117. *Id.* at 1702.

118. *Id.*

119. *See generally id.* at 1702-06 (discussing the history, advantages, disadvantages and current issues concerning balancing the political function of the law and the economic function of the law).

to balance and promote these aims should be accomplished through a publicly accountable democratic process, rather than a system under which lawyers decide which rules should govern them without any involvement by from the rest of society.¹²⁰ That deliberation will need to take account of issues such as relative institutional capacity, what safeguards might be necessary to prevent undue state encroachment on the ability of lawyers to serve their clients, and which restrictions on commercial activity genuinely serve social values.¹²¹ The important point is that such a process would be far more productive than reflexive deference to lawyer self-regulation.

Finally, we need to consider the concern that moving from a self-regulatory to a regulated industry model would cause the capacity for ethical deliberation to wither among lawyers. One might argue that the practice of self-regulation fosters a sense of professional responsibility based on the notion of the lawyer as an autonomous moral agent, whose actions are the product of self-governance rather than responses to external compulsion. Participation in discussions within the legal community about how to reconcile competing values and which obligations to assume helps refine lawyers' ethical judgment and practical reason.¹²² The reality may not always match the aspiration, but self-regulation serves as a powerful expression of the capacities to which lawyers aspire.

By contrast, the argument goes, a regulated industry model conceptualizes the lawyer as a self-interested actor whose behavior must be constrained by society as a whole. This actor can't be trusted to seek the public good on his own, so we must influence behavior by imposing penalties for failing to do so. This diminishes the lawyer's sense that she is an autonomous moral actor, and limits occasions for the kind of reflective deliberation that can help refine ethical judgment.

One response to this argument is that the legal profession has moved from regulations framed in open-ended terms that require the exercise of discretion to black letter rules that are intended to provide explicit notice of what behavior is prohibited.¹²³ The profession itself thus appears to be skeptical of the educative potential of self-regulation.

120. See Wilkins, *supra* note 75, at 844-46 (discussing the legislative controls argument for enforcing professional norms).

121. See *id.* at 819-20.

122. On practical reason, see ANTHONY KRONMAN, *THE LOST LAWYER: FAILING IDEALS OF THE LEGAL PROFESSION* (1993).

123. See generally Tanina Rostain, *Ethics Lost: Limitations of Current Approaches to Lawyer Regulation*, 71 S. CAL. L. REV. 1273 (1998).

Second, there are perils in extending the analogy of individual self-governance to the collective level. Deliberation by an individual involves reconciling conflicting impulses, values, and interests within a single subject. Collective deliberation involves both that process and the accommodation of these concerns among multiple subjects. The latter inevitably raises issues of power, rationality,¹²⁴ and scale that weaken, even if they do not fully discredit, the analogy to individual deliberation.

Next, it is misguided to think of regulation by society as an “externally” imposed constraint. This rests on an impoverished sense of individual autonomy and an asocial conception of professional autonomy. A sense of individual identity that is the predicate for conceptualizing autonomy ineluctably rests on relationships with others and social practices such as reciprocity.¹²⁵ The notion of professional identity reflects the need for certain individuals to serve social purposes through the performance of a social role. The professional autonomy of lawyers makes sense only in a society governed by the rule of law. The existence of laws regulating the profession thus is not an external imposition of alien restrictions, but a social practice that is internal to the kind of community in which the idea of lawyer autonomy is a meaningful value.

Finally, we do need to take seriously the concern that adoption of a regulated industry model might subtly reshape lawyers’ self-conceptions. Specifically, the fear is that lawyers may abandon the ideal of themselves as professionals charged with some measure of social responsibility, and adopt in its place an identity as simply another group of self-interested actors. They may interpret their ethical behavior as compliance with regulation rather than as freely chosen action that expresses their values. The lawyer’s former understanding of his or her own motivation would be a less durable foundation for desirable conduct than would the latter.¹²⁶

First, it is an open question how much lawyers currently conceive of themselves as professionals charged with social obligations. There is substantial criticism that, notwithstanding the dominance of self-regulation, lawyers have abandoned broader commitments for the sake of

124. See generally KENNETH J. ARROW, *SOCIAL CHOICE AND INDIVIDUAL VALUES* (2d ed. 1970).

125. See generally CHARLES TAYLOR, *HEGEL AND MODERN SOCIETY* (1979); CHARLES TAYLOR, *THE ETHICS OF AUTHENTICITY* (1992).

126. See, e.g., Ann E. Tenbrunsel & David M. Messick, *Sanctioning Systems, Decision Frames, and Cooperation*, 44 *ADMIN. SCI. Q.* 684 (1999); David M. Messick, *Alternative Logics for Decision Making in Social Settings*, 39 *J. ECON. BEHAV. & ORG.* 11 (1998); Bruno S. Frey & Felix Oberholzer-Gee, *The Cost of Price Incentives: An Empirical Analysis of Motivation Crowding-Out*, 87 *AM. ECON. REV.* 746 (1997).

commercial gain.¹²⁷ I will assume for the purposes of this discussion, however, that enough lawyers have retained a sense of public responsibility to raise concern about the possibility of its loss.

One response to the fear that lawyers' self-conceptions will be changed for the worse is that the types of new governance initiatives that I have described¹²⁸ involve collaboration, self-monitoring and shared responsibility that can prompt attribution of motives to internal values rather than self-interested responses to externally-imposed constraints.

A more fundamental response is that the concern about lawyer self-understanding implicitly rests on acceptance of the traditional dichotomy between law as a profession and law as a business. According to this dichotomy, as members of a profession that engages in self-regulation lawyers are assumed to act on the basis of internalized professional values. Ethical conduct therefore is the expression of these values. As participants in business, they are assumed to act in accordance with self-interest. Ethical behavior therefore occurs only when the law makes unethical conduct too costly.

We can recognize that law is a business, however, without accepting the view that this nullifies its status as a profession. We need a more complex account of market actors, including lawyers, that incorporates the notion that they are capable of being moved by a sense of social responsibility even as they must respond to competitive forces. Exploring under what circumstances this is likely to occur will help determine the mix of regulatory approaches that is appropriate in various contexts. Movement to a regulated industry model may prompt this kind of reassessment. Such a reassessment in turn could influence lawyers' understandings of their own responsibilities and motivations. There is no guarantee that all of this will happen. It is sufficiently plausible, however, to call into question the claim that movement to a regulated industry model would inevitably result in an impoverished understanding among lawyers of their role in society.

VI. CONCLUSION

The assumption of organizational self-governance under the classic partnership model has provided support for the claim to self-governance by the legal profession as a whole. Both emphasize professional socialization and virtuous character as the key mechanisms for balancing the financial and professional demands that lawyers face. These

127. *See, e.g.*, Sol M. Linowitz, *THE BETRAYED PROFESSION: LAWYERING AT THE END OF THE TWENTIETH CENTURY* (1994).

128. *See supra* notes 102-13 and accompanying text.

mechanisms had some plausibility in an oligopolistic market for legal services, in which firms could publicly efface business considerations and emphasize their commitment to professional ideals.

Currently, market conditions are radically different. Firms no longer conform to the classic partnership model, and the strategy of self-regulation faces increasing difficulty in reconciling financial and professional concerns. The power of the model persists, however, and restrictions on law firms that do not apply to other business enterprises lend support to it. We need more carefully to consider which of these restrictions are justified and which are not. I have suggested that non-lawyer investment will not necessarily threaten traditional professional values, and that it may in fact provide incentives and opportunities to reinforce them. Most notably, permitting firms to obtain outside investment could represent an important symbolic step toward rethinking how the United States legal profession should be regulated. These thoughts admittedly are speculative, but they suggest at a minimum that we should follow developments in England, Wales, and Australia with an open mind.